



Government Procurement in Times of Fiscal Uncertainty

Kate M. Manuel

Legislative Attorney

Erika K. Lunder

Legislative Attorney

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Summary

When confronted with actual or potential funding gaps, funding shortfalls, or budget cuts, the federal government has a number of options as to prospective and existing procurement contracts. Many of these options arise from contract law and, in particular, certain standard clauses included in federal procurement contracts. Among other things, these clauses allow the government to (1) unilaterally change certain terms of the contract, such as the specifications or the method and manner of performing the work; (2) delay, suspend, or “stop work” on the contract; and (3) terminate the contract for the government’s convenience. However, courts have also found that the government has certain rights because it is the government, regardless of whether the contract provides for these rights. Such rights are commonly described as “inherent rights,” and include the right to terminate the contract for convenience and, according to one tribunal, the right to suspend work.

The government’s rights are broadest where prospective contracts are concerned. Prospective contractors generally do not have a right to a government contract, and the government, like private persons, is generally free to determine whether to enter a contract to procure goods or services. This is true even if the agency has issued a solicitation for a proposed procurement, and prospective contractors have expended time and money in responding to that solicitation. Agencies have broad discretion in canceling solicitations prior to contract award, and contractors must generally show that cancellation was in bad faith or otherwise unreasonable in order to recover the costs of preparing bids or proposals for canceled solicitations. The exercise of an option is, similarly, a unilateral right of the government.

The extent of the government’s rights where existing contracts are concerned depends upon the type of contract (e.g., indefinite-quantity), the nature of the goods or services being procured (e.g., construction), and the facts and circumstances of the case. For example, the terms of indefinite-quantity contracts would generally permit the government to cease ordering goods or services from the contractor once the guaranteed minimum has been ordered. Various changes clauses would similarly permit the government to make certain unilateral reductions, or increases, in the work to be performed under the contract, including the quantity of goods and services provided. Other clauses provide for suspension or delay of work by the government, or permit the government to order the contractor to stop work. In addition, the government may terminate all or part of a contract for its convenience, as well as cancel multi-year contracts. When the government exercises these rights, the contractor could potentially be entitled to an equitable or other adjustment, other compensation, or an extension of time in which to perform. The nature of such recourse varies significantly, however, and in some cases, the government could potentially avoid liability for actions that delayed or increased the costs of the contractor’s performance because it acted in its sovereign capacity.

Congressional and public interest in this issue has persisted over the past year due to recent events. The prospect of a funding gap and government shutdown in April 2011 was followed by debate over whether to raise the debt limit in July and August 2011. More recently, there have been budget cuts and the possibility of sequestration under the Budget Control Act (BCA) of 2011 (P.L. 112-25). In particular, the BCA calls for mandatory cuts in federal spending, effective January 2, 2013, if legislation cutting the deficit is not enacted by January 15, 2012. Such legislation was not enacted, and although Congress could act to prevent sequestration, the prospect of mandatory cuts in FY2013 through FY2021 has raised questions about how the government might go about reducing spending on procurement contracts.

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Introduction

The federal *procurement process* (i.e., the process whereby agencies obtain goods and services from the private sector) requires funding. Contractors are generally paid using appropriated funds, and agency personnel—who are generally also paid with appropriated funds—are responsible for entering and administering contracts on the agency’s behalf.¹ The use of appropriated funds to finance contract performance and/or administration means that federal contracts may be affected by actual or potential funding gaps² or shortfalls, such as could arise from a failure to raise the debt limit,³ budget cuts, or sequestration.⁴ While these occurrences are distinct in their causes and their effects upon federal procurement, as **Table 1** illustrates, all prompt similar questions about what the government must or may do when confronted by a lack of funds, and how contractors could be affected by potential government actions.

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This report provides an overview of the various options that the government has, pursuant to contract law or otherwise, when confronted with actual or potential funding gaps, funding shortfalls, or budget cuts. It begins by considering the legal principles underlying the government’s generally broad rights not to incur new obligations⁸ (e.g., by canceling solicitations

¹ Some contracts (e.g., energy savings performance contracts) may be performed without the use of appropriated funds to pay the contractor. *See, e.g.*, 42 U.S.C. § 8287(a) (authorizing agencies to enter into contracts “solely for the purpose of achieving energy savings and benefits ancillary to that purpose” that provide for the contractor to incur the costs of implementing energy saving measures). However, the persons administering such contracts on behalf of the agency could be paid with appropriated funds.

² *See generally* CRS Report RS20348, *Federal Funding Gaps: A Brief Overview*, by Jessica Tollestrup. Funding gaps are associated with government shutdowns. *See generally* CRS Report RL34680, *Shutdown of the Federal Government: Causes, Processes, and Effects*, by Clinton T. Brass.

³ *See generally* CRS Report RL31967, *The Debt Limit: History and Recent Increases*, by D. Andrew Austin and Mindy R. Levit.

⁴ *See generally* CRS Report R41965, *The Budget Control Act of 2011*, by Bill Heniff Jr., Elizabeth Rybicki, and Shannon M. Mahan.

⁵ P.L. 112-25, tit. I, 125 Stat. 241-49 (Aug. 2, 2011).

⁶ *See, e.g.*, Billy House & Michael Catalini, Sequestration Isn’t a Sure Thing, *Gov’t Exec.*, Nov. 14, 2011, available at <http://www.govexec.com/oversight/2011/11/sequestration-isnt-a-sure-thing/35407>.

⁷ *See, e.g.*, Charles S. Clark, Contractors Will Remain in Limbo During Debates Over Automatic Defense Cuts, *Gov’t Exec.*, Jan. 18, 2012, available at <http://www.govexec.com/defense/2012/01/contractors-will-remain-in-limbo-during-debates-over-automatic-defense-cuts/40856>.

⁸ An *obligation* is a definite commitment by the government to spend appropriated funds. A contract is one of the primary ways by which the government obligates funds. *See, e.g.*, John E. Jensen, *Quick Reference to Federal Appropriations Law* 188-89 (2d ed. 2006) (contracts obligating appropriated funds).

or declining to exercise options). The report then addresses the contractual and other rights that the government may exercise under existing contracts (e.g., changing certain terms of the contract or altering the performance period). Overall, these rights are comparatively well established. However, as the report concludes, the effects of the exercise of these rights upon contractors and, particularly, upon federal spending on procurement contracts is less clear and generally would depend upon the facts and circumstances of individual cases. The report does not address changes in contract policy that could also occur in response to funding shortfalls,⁹ nor does it address the effects that exercising certain of the rights noted here might have upon agency programs.¹⁰

Table I. Funding-Related Occurrences Affecting Federal Procurement Contracts

Event	Potential Effects
Funding gaps (i.e., intervals during the fiscal year when appropriations for a particular project or activity are not enacted into law)	Government cannot incur new financial obligations (e.g., enter contracts, allot additional funding to cost-reimbursement contracts); agency personnel are generally unavailable for contract administration (e.g., approving invoices, authorizing payment)
Failure to raise the debt limit (i.e., the Department of the Treasury's authority to issue new debt to manage cash flow or pay interest on the federal deficit)	Payments to contractors, including any contract financing payments, may be delayed or deferred as the Department of the Treasury prioritizes and determines which outstanding obligations are paid and in what order
Sequestration (i.e., process of automatic, largely across-the-board spending reductions under which budgetary resources are permanently canceled to effectuate certain budget policy goals)	Government may seek to reduce spending on new contracts or existing contracts; any reductions in agency personnel could mean delays in contract administration; any changes in agency operations could affect contract performance

Source: Congressional Research Service

General Principles

In thinking about the government's contractual and other legal rights in this area, it helps to keep in mind the ways in which government contracts are—and are not—like other contracts. In many ways, federal procurement contracts *are* like other contracts between private parties, notwithstanding the fact that certain terms of these contracts are required by law.¹¹ Like other

⁹ See, e.g., David Hansen, DOD Relying on Existing Programs to Meet \$60 Billion Savings Set by Panetta, 97 *Fed. Cont. Rep.* 112 (Feb. 7, 2012) (DOD planning to rely on “new business practices,” such as increased competition for contracts); David Hansen, Attorneys Predict More Risk, Less Reward for Government Contractors in 2012, 97 *Fed. Cont. Rep.* 59 (Jan. 24, 2012) (reduced use of cost-reimbursement contracts); Charles S. Clark, Budget Preview Hits Defense Contractors on Weapons and Management, *Gov't Exec.*, Jan. 26, 2012, available at <http://www.govexec.com/defense/2012/01/defense-budget-preview-hits-contractors-weapons-and-management/40978> (alterations to major weapons systems).

¹⁰ For example, certain changes to the scope of contracts for “major defense acquisition programs” could result in Nunn-McCurdy breaches. See, e.g., Elizabeth A. Ferrell, Short- and Long-Range Impact of Budget Cuts on Government Contractors, 95 *Fed. Cont. Rep.* 628 (June 14, 2011).

¹¹ See, e.g., 41 U.S.C. § 2303(b)(3) (requiring the development of a personal conflicts-of-interest clause or a set of clauses for inclusion in contracts for the performance of certain “acquisition functions”); Federal Leadership on Reducing Text Messaging While Driving, Executive Order 13513, 74 *Fed. Reg.* 51225 (Oct. 6, 2009) (“Each Federal agency, in procurement contracts, grants, and cooperative agreements, and other grants to the extent authorized by applicable statutory authority, entered into after the date of this order, shall encourage contractors, subcontractors, and recipients and subrecipients to adopt and enforce policies that ban text messaging while driving company-owned or (continued...)”).

contracting parties, the government generally has a duty to perform largely as specified in the contract, absent modification, excuse, or discharge of its obligations.¹² Also like other contracts, government contracts are construed in light of the parties' intent, and the parties' intent could potentially be found to be contrary to the literal meaning of the contract.¹³ For example, a contract that purports to be a *fixed-price contract* (i.e., a contract whereby the contractor agrees to supply certain goods or services to the government at a predetermined price) could be found to be a *cost-reimbursement contract* (i.e., a contract that provides for the government to pay the contractor, at a minimum, allowable costs incurred in performing the contract up to a total cost specified in the contract) because other terms of the contract indicate that this was the parties' intent.¹⁴ Similarly, as with other contracts, certain implied duties, such as the duty of good faith and fair dealing, will be read into federal procurement contracts even when they are not express terms of the contract.¹⁵ Such duties could potentially become important where changes to existing contractual obligations, like those discussed below, are involved because one of the implied duties that contracting parties generally have is mitigating the damages they incur due to the other party's conduct.¹⁶ In addition, like other contracting parties, the government and/or government contractors could potentially waive certain terms of the contract,¹⁷ or their failure to perform could be excused.¹⁸

Certain standard terms of federal procurement contracts, discussed below, do permit the government to take certain actions that could potentially give rise to liability for breach under the

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-rented vehicles or [government-owned vehicles], or while driving [privately-owned vehicles] when on official Government business or when performing any work for or on behalf of the Government.”).

¹² A *modification* is a written change in the terms of a contract. Generally, modifications must be *bilateral*, or agreed to by both parties. Performance may be excused in certain circumstances, such as when an event occurs after the formation of the contract that makes it impossible to perform a contractual promise. *See, e.g., Taylor v. Caldwell*, 122 Eng. Rep. 309 (K.B. 1863) (defendant excused from performance when the music hall that the defendant had promised to let the plaintiff use for concerts was destroyed in a fire). Discharge of a party's obligations is also possible either by agreement of the parties (e.g., accord and satisfaction, assignment, release) or by operation of law (e.g., bankruptcy).

¹³ The “plain language” of the agreement is the starting point for interpreting a contract. *See, e.g., McAbee Constr. Co., Inc. v. United States*, 97 F.3d 1431, 1435 (Fed. Cir. 1996). However, the court or other tribunal will not give the words of the agreement their ordinary meaning when it is clear that the “parties mutually intended and agreed to an alternative meaning.” *Harris v. Dep’t of Veterans Affairs*, 142 F.3d 1463, 1467 (Fed. Cir. 1998).

¹⁴ *LSI Serv. Corp. v. United States*, 422 F.2d 1334 (Ct. Cl. 1970). *See also Franklin Co., ASBCA 9750*, 65-1 BCA ¶ 4,767, *aff’d*, *Franklin Co. v. United States*, 381 F.2d 416 (Ct. Cl. 1967) (finding that the contracts in question were not requirements contracts, despite being designated as such, because they provided for the supply of the same kind of services in the same place, and there cannot be two simultaneous requirements contracts for the same services in the same place).

¹⁵ *See, e.g., 6800 Corp., GSBGA 5880*, 83-2 BCA ¶ 16,581 (relying, in part, on Section 205 of the *Restatement (Second) of Contracts*, which states that “[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement”).

¹⁶ *See, e.g., American Int’l Contractors, Inc./Capitol Indus. Constr. Groups, Inc., A Joint Venture, ASBCA 39544*, 95-2 BCA ¶ 27,920 (denying contractor's claims as to delay because excavation was possible in part of the work area).

¹⁷ A *waiver* is a relinquishment of a legal right. *See, e.g., American Nat’l Bank & Trust Co. v. United States*, 23 Cl. Ct. 542 (1991). The government could potentially be bound by a waiver if the contractor relies upon the waiver to its detriment. *See, e.g., Miller Elevator Co. v. United States*, 30 Fed. Cl. 662, 687 (1994) (constructive waiver of specifications by acceptance of a nonspecification performance); *Freeway Ford Truck Sales, Inc. v. Gen. Servs. Admin.*, GSBGA 10662, 93-3 BCA ¶ 26,019 (finding termination for default improper where the government had waived its right to terminate by allowing the contractor to continue with production). However, agencies may not waive statutory requirements unless specifically authorized to do so. *See, e.g., M-R-S Mfg. Co. v. United States*, 492 F.2d 835 (Ct. Cl. 1974) (contracting officer could not waive the requirements of the Truth in Negotiations Act).

¹⁸ *See supra* note 12.

common law of contracts. For example, the various changes clauses—allowing the government to unilaterally change certain terms of the contract¹⁹—run contrary to the general rule that modifications to a contract must be bilateral.²⁰ However, to the degree that these rights arise from terms of the contract,²¹ private parties could, and sometimes do, enter contracts granting themselves such rights. Perhaps the best example of this is the clause allowing the government to terminate the contract for its convenience, which the Federal Acquisition Regulation (FAR) requires to be included in all federal procurement contracts.²² Termination for convenience clauses are also used in contracts between private parties to give the parties some flexibility as to the quantity of goods or services delivered under the contract, as well as limit the scope of potential liability under the contract.²³ Such clauses are necessary, particularly in private contracts, to avoid the operation of the general rule that a buyer who informs a seller that he does not intend to purchase certain goods or services provided for in a contract has anticipatorily repudiated, or breached, the contract and is liable for damages, potentially including anticipatory profits and consequential damages.²⁴ *Anticipatory profits* are profits that the non-breaching contractor would reasonably have realized had the contract been performed.²⁵ *Consequential damages* are damages that, while not a direct result of the breach, are a consequence of it.²⁶

There are, however, several ways in which government contracts differ from other contracts precisely because the government is the sovereign. One way is that certain standard contract terms, such as the clause allowing the government to terminate the contract for its convenience, will be read into contracts from which they are lacking. The grounds upon which this is done, and potentially also the types of clauses that will be read in, have arguably shifted over time. The most recently articulated grounds for doing so are that (1) the clause represents a “deeply ingrained strand of public procurement policy,” and (2) federal regulations can “fairly be read” as permitting the clause to be read into the contract because they require agencies to incorporate the clause in their contracts.²⁷ However, courts had previously held that termination for convenience clauses, in particular, should be read into government contracts because the government should be given broad latitude to act in the “public interest.”²⁸ Another way in which government contracts

¹⁹ See *infra* notes 84-89 and accompanying text.

²⁰ See, e.g., *Ford v. Ford*, 68 P.3d 1258, 1268 (Alaska 2003).

²¹ Certain of the government’s rights discussed below do not arise solely from contract. For example, while standard contract clauses allow the government to terminate a contract for its convenience, the government has been found to have this right even if the contract does not provide for it. See *infra* notes 26-27 and accompanying text.

²² See, e.g., 48 C.F.R. § 49.502(a) (“The contracting officer shall insert the clause at 52.249-1, Termination for Convenience of the Government (Fixed-Price) (Short Form), in solicitations and contracts when a fixed-price contract is contemplated and the contract amount is not expected to exceed the simplified acquisition threshold.”).

²³ See, e.g., *At Your Convenience: Courts Are Generally Enforcing Termination for Convenience Clauses in Private Sector Contracts That Are Well Drafted and Prudently Invoked*, 21 *Los Angeles Law.* 42 (1998).

²⁴ See, e.g., *Davis Sewing Machine Co. v. United States*, 60 Ct. Cl. 201, 217 (1925), *aff’d*, 273 U.S. 324 (1927). The granting of this right by contract would, in itself, generally suffice to ensure that the party terminating the contract is not liable to the other party for anticipatory profits in the event that it does not take all the goods or services provided for in the contract. However, termination for convenience clauses included within the contract often also specify the extent of compensation owed to the non-terminating party in the event of termination. This compensation is generally limited to the costs of performance and profit on the portion of the contract that has been performed.

²⁵ See, e.g., *Elson v. Indianapolis*, 204 N.E. 857, 861 (Ind. 1965).

²⁶ See, e.g., *Acker Constr., LLC v. Tran*, 2012 Ark. App. LEXIS 318, at *15 (Mar. 14, 2012).

²⁷ *G.L. Christian & Assocs. v. United States*, 312 F.2d 418, 426 (Ct. Cl. 1963).

²⁸ *Russell Motor Car Co. v. United States*, 261 U.S. 512, 521 (1923) (“With the termination of the war the continued production of war supplies would become not only unnecessary but wasteful. Not to provide, therefore, for the cessation of this production when the need for it has passed would have been a distinct neglect of the public interest.”); (continued...)

differ from other contracts is that, in certain cases, the government could avoid liability for conduct that would otherwise give rise to liability for breach because it acted in its sovereign capacity when it took the action. For example, in one recent case, the U.S. Court of Appeals for the Federal Circuit found that the government was not liable for damages incurred by a contractor after the government blocked the contractor's access to a construction site on a military base for 41 days following the terrorist attacks of September 11, 2001.²⁹ According to the court, the government took this action in its capacity as a sovereign, and the action was not "specifically targeted at appropriating the benefits of a government contract."³⁰

Prospective Obligations

The government's rights are broadest where prospective contracts, or prospective *obligations* (i.e., definite commitments to spend appropriated funds) under existing contracts, are concerned. The Supreme Court has held that, "[l]ike private individuals and businesses, the Government enjoys the unrestricted power to produce its own supplies, to determine those with whom it will deal, and to fix the terms and conditions upon which it will make needed purchases."³¹ This generally means that the government may cancel a solicitation, decline to exercise an option under a contract, and not allot additional funding to cost-reimbursement contracts, even if the contractor has expended costs in preparing a bid or offer in response to the solicitation, or otherwise relied upon the expectation that the government would exercise the option, or allot additional funding.³² The contractor's ability to recover when the government opts not to incur new obligations is generally limited, although it is broader when the government does not allot additional funds to incrementally funded cost-reimbursement contracts than in other cases.

The Anti-Deficiency Act generally bars agencies from incurring new obligations during funding gaps by prohibiting the obligation of funds in excess or advance of appropriations.³³ Agencies would generally not be similarly barred from incurring new obligations when the debt limit is not

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United States v. Corliss Steam-Engine Co., 91 U.S. 321, 323 (1875) ("[I]t would be of serious detriment to the public service if the power of the head[s] of [federal agencies] did not extend to providing for all ... possible contingencies by modification or suspension of the contracts and settlement with the contractors.").

²⁹ Conner Bros. Contrs. Co., Inc. v. Geren, 550 F.3d 1368 (Fed. Cir. 2008).

³⁰ *Id.* at 1374.

³¹ Perkins v. Lukens Steel Co., 310 U.S. 113, 127 (1940). The only exception to this rule, as far as contractors are concerned, is that contractors have a liberty interest in being able to challenge allegations about their integrity that could deprive them of their livelihood. *See, e.g.,* Old Dominion Dairy Prods., Inc. v. Sec'y of Def., 631 F.2d 953, 963 (D.C. Cir. 1980). In addition, the legislative branch can restrict the discretion of the executive branch to contract out, or perform in-house, specific functions. *See, e.g.,* Water Resources Development Act, P.L. 101-640, § 314, 104 Stat. 4641 (Nov. 28, 1990) (codified at 33 U.S.C. § 2321) ("Activities currently performed by personnel under the direction of the Secretary in connection with the operation and maintenance of hydroelectric power generating facilities at Corps of Engineers water resources projects are to be considered as inherently governmental functions and not commercial activities."); National Defense Authorization Act for FY1994, P.L. 103-160, § 848(a)(1), 107 Stat. 1724-25 (Nov. 30, 1993) (codified at 10 U.S.C. § 2304e(a)) (prohibiting certain types of competition between Department of Defense (DOD) and small businesses). Inherently government functions may not be contracted out.

³² Some commentators have suggested that budget cuts, in particular, could result in fewer new contracts, as well as reluctance to allot additional funds to cost-reimbursement contracts. *See, e.g.,* Contractors Will Remain in Limbo, *supra* note 7.

³³ 31 U.S.C. § 1341(a)(1)(A)-(B).

increased, or spending is cut, but they may voluntarily limit such obligations in order to reduce spending.

Canceling a Solicitation

Even if the government has already issued a *solicitation* (i.e., a request for interested persons to submit bids or offers to the government³⁴), it generally has broad discretion to cancel the solicitation at any stage in the procurement process prior to award of the contract.³⁵ The Federal Acquisition Regulation (FAR) expressly authorizes cancellation of solicitations in certain circumstances, although these circumstances differ depending upon the method of source selection (i.e., sealed bidding, negotiated procurement³⁶) and the timing of cancellation, in the case of procurements conducted using sealed bidding.³⁷ Pursuant to the FAR, agencies arguably have the broadest discretion in canceling solicitations in negotiated procurements, where cancellation will generally be upheld so long as there was a “reasonable basis” for it.³⁸ However, even in the case of cancellations after bid opening in sealed-bidding procurements, where agencies have the least discretion, they arguably retain considerable discretion. While a “cogent and compelling reason” is required for cancellation after bid opening,³⁹ judicial and other tribunals have found that the determination of whether a sufficiently compelling reason for cancellation exists is “primarily within the discretion of the administrative agency and will not be disturbed absent proof that the decision was clearly arbitrary, capricious, or not supported by substantial evidence.”⁴⁰ In practice, this means that agencies will generally prevail so long as they can articulate reasonable, supportable grounds for the cancellation. Such grounds can include

³⁴ See 48 C.F.R. § 2.101 (“Solicitations under sealed bid procedures are called ‘invitations for bids.’ Solicitations under negotiated procedures are called ‘requests for proposals.’”).

³⁵ See, e.g., *CW Gov’t Travel v. United States*, 46 Fed. Cl. 554, 559 (2000) (noting that cancellation of solicitations is permitted by the Federal Acquisition Regulation (FAR)).

³⁶ In sealed bidding, the procuring activity awards the contract to the lowest-priced, qualified, responsible bidder without conducting negotiations with the bidders. This is in contrast to negotiated procurement, where the procuring activity bargains with offerors after receiving proposals, and awards the contract to the offeror whose proposal rates most highly on evaluation criteria that include, but are not limited to, cost or price.

³⁷ See, e.g., 48 C.F.R. § 14.209(a) (expressly permitting cancellation at any time before bid opening, if cancellation is “clearly in the public interest,” such as when goods or services are no longer required); 48 C.F.R. § 14.404-1(c)(1)-(10) (expressly permitting cancellation after bid opening if the specifications have been revised, the goods or services are no longer required, or “cancellation is clearly in the public’s interest” for other reasons); 48 C.F.R. § 15.206(e) (expressly permitting cancellation at any stage of the procurement process if the government changes its requirements, or terms and conditions, so substantially that the solicitation cannot be amended). As the FAR explains, cancellation of bids after opening is subject to more scrutiny than cancellation of bids prior to opening because “[p]reservation of the integrity of the competitive bid system dictates that, after bids have been opened, award must be made to that responsible bidder who submitted the lowest responsive bid.” 48 C.F.R. § 14.404-1(a).

³⁸ *KAES Enterprises, LLC—Protest and Costs*, B-402050.4, 2009 CPD ¶ 49 (“In a negotiated procurement, a contracting agency has broad discretion in deciding whether to cancel a solicitation, and need only establish a reasonable basis for doing so.”); *PAI Corp.*, B-244287.5, 91-2 CPD ¶ 508 (upholding a determination to cancel a solicitation after the submission of proposals and selection of an intended awardee); *Sys. Analytics Group*, B-236575, 89-1 CPD ¶ 57 (upholding a determination to cancel a solicitation after receipt and evaluation of initial proposals).

³⁹ See, e.g., *CFM Equip. Co.*, B-251344, 93-1 CPD ¶ 280 (“[A]s a general rule, in a negotiated procurement the contracting agency need only demonstrate a reasonable basis to cancel a solicitation after receipt of proposals, as opposed to the ‘cogent and compelling’ reason required to cancel an [invitation for bids] where sealed bids have been opened. . . . The standards differ because in procurements using sealed bids, competitive positions are exposed as a result of the public opening of bids, while in negotiated procurements there is no public opening.”) (internal citations omitted).

⁴⁰ *Ace-Federal Reporters, Inc.*, B-237414, 90-1 CPD ¶ 144.

changes in agency mission or operations,⁴¹ lack of funds,⁴² or deciding to perform the work in-house,⁴³ any or all of which could occur in response to funding shortfalls or budget cuts. In contrast, a showing of bad faith or fraud on the part of the agency (e.g., canceling a solicitation to avoid an award to a specific offeror⁴⁴) could result in a cancellation determination being found unreasonable and, thus, improper.⁴⁵

When cancellation is found to have been improper, the contractor could potentially recover its bid preparation and proposal costs (although not its protest costs).⁴⁶ However, proving that cancellation was pretextual, in particular, can be difficult because public officials are presumed to act in good faith,⁴⁷ and “[p]laintiffs must do more than assert what amounts to mere naked charges of arbitrary and capricious action.”⁴⁸ The fact that contractors may have incurred costs in responding to the solicitation does not, in itself, entitle them to any recovery in the event that the solicitation is canceled.⁴⁹

Declining to Exercise an Option⁵⁰

An *option* is a “unilateral right in a contract by which, for a specified time, the Government may elect to purchase additional supplies or services called for by the contract, or may elect to extend the term of the contract.”⁵¹ The FAR generally authorizes agencies to incorporate options in

⁴¹ See, e.g., Applied Resources, Inc., B-400144.7; B-400144.8, 2009 CPD ¶ 161 (agency needs changed due to change in mission); Schreck Indus., Inc., B-174956, 1972 U.S. Comp. Gen. LEXIS 2475 (Apr. 11, 1972) (government no longer needed goods); Microfilm Commc’ns Sys., Inc., B-180465, 74-2 CPD ¶ 140 (government adapted existing equipment to meet needs); Restoration Unlimited, Inc., B-221862, 86-1 CPD ¶ 493, *aff’d on recons.*, B-221862.2, 86-2 CPD ¶ 57 (private organization offered to donate goods to government).

⁴² See, e.g., Williams College, B-259351, 95-1 CPD ¶ 162 (“[P]rotester’s assertion that budgetary constraints were the real reason for canceling the [request for proposals] provides no basis for sustaining the protest since a contracting officer may properly cancel a solicitation where lack of funds causes the agency to reassess its minimum needs and reduce its requirements significantly.”); Kato/Intermountain Elec. (J.V.), B-245807, 92-1 CPD ¶ 129 (cancellation where price of lowest eligible bid was greater than the funds available for the contract); Satellite Servs., Inc., B-225624, 87-1 CDP ¶ 314 (uncertainties regarding funding); Consol. Maint. Co., B-209766, 83-1 CDP ¶ 225 (agency prohibited from obligating funds for services involved in solicitation).

⁴³ See, e.g., Total Design Servs., B-257128.2, 94-2 CPD ¶ 142; Digicon Corp., B-256620, 94-2 CPD ¶ 12; Nomura Enters., Inc., B-251889.2, 93-1 CPD ¶ 490.

⁴⁴ See, e.g., Parcel 49C Ltd. P’ship v. United States, 31 F.3d 1147 (Fed. Cir. 1994); 126 Northpoint Plaza Ltd. P’ship v. United States, 34 Fed. Cl. 105 (1995).

⁴⁵ See, e.g., J. Morris & Assoc., B-256840, 94-2 CDP ¶ 47; Moore’s Cafeteria Servs., Inc., B-234063.4, 89-2 CPD ¶ 11.

⁴⁶ See, e.g., E.W. Bliss Co. v. United States, 77 F.3d 445, 447-48 (Fed. Cir. 1996); 28 U.S.C. § 1491(b)(2) (noting “any monetary relief shall be limited to bid preparation and proposal costs”). Reinstatement of the solicitation may also be proper if it would not prejudice other bidders, and if the award under the original solicitation would serve the actual needs of the government. See, e.g., Bilt-Rite Contractors, Inc., B-259106.2, 95-1 CPD ¶ 220.

⁴⁷ See, e.g., Kalvar Corp. v. United States, 543 F.2d 1298, 1301-02 (Ct. Cl. 1976).

⁴⁸ *CW Gov’t Travel*, 46 Fed. Cl. at 559.

⁴⁹ Also, unlike with notices of solicitations, agencies are not required to post notices of cancellations of solicitations. See 48 C.F.R. § 5.207 (“Contracting officers *may* publish notices of solicitation cancellations (or indefinite suspensions) of proposed contract actions in the GPE [governmentwide point of entry].”) (emphasis added). The GPE is currently located at <http://www.fedbizopps.gov>.

⁵⁰ A funding shortfall, in particular, could potentially prompt an agency to exercise an option so as to avoid the costs associated with conducting a new procurement, or because the terms and conditions of the contract under which the option is exercised are particularly advantageous to the government.

⁵¹ 48 C.F.R. § 2.101.

contracts whenever it is “in the Government’s interest” to do so,⁵² and it provides several option clauses that could be used in agency contracts. While these clauses differ depending upon the nature of the option being exercised (e.g., to increase quantity, extend services, or extend the term of the contract), they all provide that the government may, by exercising the option within certain time frames prescribed in the contract, increase the quantity of goods or services purchased under the terms specified in the contract.⁵³

Because the decision to exercise an option rests solely with the government, the contractor is not entitled to recover any lost profits if the government decides not to exercise an option. This is true regardless of whether (1) the government decides to perform the work in-house;⁵⁴ (2) the contractor’s bid was based on the assumption that all of the maximum option quantity would be ordered;⁵⁵ or (3) the government allegedly gave notice of its intent to exercise the option.⁵⁶ One *board of contract appeals* (i.e., an administrative tribunal established to hear disputes between contractors and the government⁵⁷) has suggested that a contractor might be entitled to some recovery if it can show that the government’s decision not to exercise the option was made in bad faith,⁵⁸ but few, if any, contractors appear to have prevailed in challenging the government’s declining to exercise an option under this theory.⁵⁹

Not Allotting Additional Funds to Cost-Reimbursement Contracts

Cost-reimbursement contracts are contracts that provide for the government to pay the contractor, at minimum, any allowable, reasonable, and allocable costs incurred in performing the contract,

⁵² 48 C.F.R. § 17.202. However, the FAR prohibits the use of options in certain circumstances (e.g., market prices for the goods or services are likely to change substantially). 48 C.F.R. § 17.202(c)(1)-(3). *See also* 48 C.F.R. § 17.202(b)(1)-(2) (establishing that the exercise of an option is not normally in the government’s interest in certain circumstances). In addition, “the total of the basic and option periods [or quantities] shall not exceed 5 years.” 48 C.F.R. § 17.204(e). Contracts that extend over multiple years because of the exercise of options are known as *multiple year contracts*, in contrast to the *multi-year contracts*, discussed below. *See infra* notes 66-67.

⁵³ *See* 48 C.F.R. § 52.217-6 (option for increased quantity); 48 C.F.R. § 52.217-7 (option for increased quantity, separately priced line item); 48 C.F.R. § 52.217-8 (option to extend services); 48 C.F.R. § 52.217-9 (option to extend the term of the contract). In the event of a funding gap, in particular, the period within which the government may exercise the option could expire before the funds necessary to exercise the option are appropriated.

⁵⁴ *See, e.g.,* Appeal of Dixon Pest Control, Inc., ASBCA 41042, 92-1 BCA ¶ 24,609.

⁵⁵ *See, e.g.,* Appeal of D & S Mfg. Co., Inc., ASBCA 32865, 87-1 BCA ¶ 19,351. *See also* Gricoski Detective Agency, GSBGA 8901, 90-3 BCA ¶ 23, 131, *on recons.*, 91-1 BCA ¶ 23,347 (1990) (rejecting contractor’s claim to lost profits due to the government’s failure to exercise the second-year option under the contract).

⁵⁶ *See, e.g.,* Integral Sys., Inc. v. Dep’t of Commerce, GSBGA 16321-COM, 2005-1 BCA ¶ 32,984 (declining to recognize the “constructive” exercise of an option by the government doing anything short of strictly following the terms of the contract).

⁵⁷ The boards of contract appeals are administrative boards established in procuring agencies to hear and decide disputes under the Contract Disputes Act of 1978. *See* 41 U.S.C. § 7105. There are currently four such boards: the Armed Services Board of Contract Appeals; the Civilian Agency Board of Contract Appeals; the Postal Service board; and the Tennessee Valley Authority board.

⁵⁸ *See, e.g.,* Appeal of TS Infosystems, Inc., GSBGA 10794-COM, 91-2 BCA ¶ 23,794. In this case, the contractor alleged that the government did not exercise the option because the contractor was bankrupt. The board denied the claim because the contractor did not prove its right to recovery. However, in doing so, the board noted that such a claim might be cognizable in the right circumstances.

⁵⁹ *See, e.g.,* Gov’t Tech. Servs. v. United States, 90 Fed. Cl. 522 (2009) (finding that the U.S. Court of Federal Claims lacked jurisdiction to hear a claim brought under the Administrative Dispute Resolution Act of 1996 alleging bad faith in declining to exercise an option).

up to a total cost specified in the contract.⁶⁰ While the government is generally obligated to pay the contractor's costs up to the total specified in the contract, absent modification or termination of the contract, limitation of cost/limitation of funds clauses⁶¹ included in cost-reimbursement contracts expressly provide that the government is generally *not* obligated to pay costs in excess of this amount, although the contractor is not obligated to continue performance unless the government provides additional funds. Specifically, these clauses state that

Except as required by other provisions of this contract, specifically citing and stated to be an exception to this clause—

(1) The Government is not obligated to reimburse the Contractor for costs incurred in excess of (i) the estimated cost specified in the [contract] or, (ii) if this is a cost-sharing contract,⁶² the estimated cost to the Government specified in the [contract]; and

(2) The Contractor is not obligated to continue performance under this contract ... or otherwise incur costs in excess of the estimated cost specified in the Schedule, until the Contracting Officer (i) notifies the Contractor in writing that the estimated cost has been increased and (ii) provides a revised estimated total cost of performing this contract.⁶³

The contractor is generally not entitled to have additional funds allotted to the contract unless it could not reasonably have known that its costs had exceeded the amount established in the contract.⁶⁴ This is true even if the contractor and the agency anticipated increasing the amount of funds allotted, or the contractor's incurred costs exceed those originally anticipated.⁶⁵ However, a contractor under an incrementally funded cost-reimbursement contract, subject to the limitation of funds clause, could potentially recover termination costs, discussed below, pursuant to the contract, if additional funds are not allotted.⁶⁶ Termination is also possible with fully funded cost-

⁶⁰ Some types of cost-reimbursement contracts also allow for profit by the contractor. *See generally* CRS Report R41168, *Contract Types: An Overview of the Legal Requirements and Issues*, by Kate M. Manuel. Costs are "allowable" if they are reasonable; allocable; comply with any applicable standards promulgated by the Cost Accounting Standards Board; are provided for by the terms of the contract; and meet any limitations set forth in Part 31 of the FAR. 48 C.F.R. § 31.201-2(a)(1)-(5). A cost is "reasonable" if, "in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business." 48 C.F.R. § 31.201-3(a). Costs are "allocable" if they were incurred specifically for the contract; benefit both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or are necessary to the overall operation of the business. 48 C.F.R. § 31.201-4(a)-(c).

⁶¹ The primary difference between these clauses is that the limitation of cost clause is used in contracts that are fully funded, while the limitation of funds clause is used in those that are incrementally funded. *Compare* 48 C.F.R. § 52.232-20 (limitation of cost) with 48 C.F.R. § 52.232-22 (limitation of funds).

⁶² A cost-sharing contract may be used when "the contractor agrees to absorb a portion of the costs, in the expectation of substantial compensating benefits" (e.g., with research and development work). 48 C.F.R. § 16.303(b).

⁶³ 48 C.F.R. § 52.232-20(d) (limitation of cost clause). Identical language is included in the limitation of funds clause. *See* 48 C.F.R. § 52.232-22(f). The implementation of these provisions is facilitated by other provisions in the contract that call for the contractor to inform the government whenever the costs it expects to incur under the contract within the next 60 days (or other applicable period), when added to all costs previously incurred, will exceed 75% (or other applicable percentage) of the total cost specified in the contract. 48 C.F.R. § 52.232-20(b).

⁶⁴ *See, e.g., Gen. Elec. Co. v. United States*, 440 F.2d 420 (Ct. Cl. 1971) (government abused its discretion in failing to fund a cost overrun when the circumstances were such that the contractor could not have known of the overrun).

⁶⁵ *See, e.g., Eyler Assocs., ASBCA 16804*, 75-1 BCA ¶ 11,320 (contracting officer has substantial discretion in determining whether to fund an overrun); *ARINC Research Corp., ASBCA 15861*, 72-2 BCA ¶ 9,721 (same).

⁶⁶ 48 C.F.R. § 52.232-22(e) (providing that the contract will be "terminate[d] ... in accordance with the provisions of the Termination clause of this contract" if additional funds are not allotted). This clause also provides that, if government does not allot sufficient funds to allow completion of the work, the contractor is entitled to a percentage of (continued...)

reimbursement contracts. However, the limitation of cost clause distinguishes between termination and additional funds not being allotted to the contract, and provides for the equitable distribution of “all property produced or purchased under the contract” as the recovery in either case.⁶⁷

Existing Obligations under Contract

The existence of a contract between two parties (including the government) generally serves to constrain their options in so far as they are obligated to perform and/or pay as called for in the contract, absent modifications to the contract or special circumstances.⁶⁸ While this general rule would seem to suggest that the government’s options to reduce procurement spending are significantly more circumscribed with existing obligations under contracts than with prospective obligations, the government has broad contractual and inherent rights that give it some flexibility in responding to funding gaps, funding shortfalls and budget cuts (e.g., by reducing the scope of the contract when there are budget cuts, or delaying performance in anticipation of a potential funding gap). In some cases, these rights reflect the type of contract used. For example, because indefinite-quantity contracts obligate the government to purchase only a minimum quantity of goods or services from the contractor, while allowing it to purchase more, the government could generally forgo purchases in excess of the minimum without incurring liability to the contractor. In other cases, the contract expressly or impliedly includes terms allowing the government to (1) change the scope of the contract, including the quantity of goods or services purchased under it, (2) delay or accelerate performance of a contract, or (3) terminate a contract, all without incurring liability for breach.

Limiting Orders Under Indefinite-Quantity Contracts⁶⁹

Certain federal procurement contracts are known as *indefinite-quantity contracts* because they obligate the government to obtain an “indefinite quantity, within stated limits, of supplies or services [from the contractor] during a fixed period.”⁷⁰ Such contracts must provide for a minimum quantity of orders, which the contractor is assured of receiving,⁷¹ and they may provide

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any fee specified in the contract equal to the percentage of work completed. *See* 48 C.F.R. § 52.232-22(l).

⁶⁷ *See* 48 C.F.R. § 52.232-30(h) (“If this contract is terminated or the estimated cost is not increased, the Government and the Contractor shall negotiate an equitable distribution of all property produced or purchased under the contract, based on the costs incurred by each.”).

⁶⁸ *See supra* note 12.

⁶⁹ Orders in excess of the guaranteed minimum are discussed in this section, and not in the prior section on “Prospective Obligations,” because when agencies obligate funds, they typically treat contractors holding indefinite-quantity contracts as receiving the maximum amount of orders possible under the contract. In other words, orders in excess of the minimum are treated as existing obligations, not prospective ones. Reductions in the scope of indefinite-delivery contracts are made pursuant to the changes clause, discussed below. *See infra* note 85-87 and accompanying text.

⁷⁰ 48 C.F.R. § 16.504(a). Quantity may be expressed in terms of a number of units or a dollar value. 48 C.F.R. § 16.504(a).

⁷¹ 48 C.F.R. § 16.504(a)(1). The minimum quantity must be a “more than nominal amount.” *See, e.g.,* Goldwasser v. United States, 325 F.2d 722 (Ct. Cl. 1963) (contract with a minimum quantity of \$100 compared to estimated price of \$40,000 “would have been a one-sided bargain, bordering upon lack of mutuality”); Tennessee Soap Co. v. United States, 126 F. Supp. 439 (Ct. Cl. 1954) (a \$10 minimum order was nominal and thus insufficient). However, recent (continued...)

for a maximum quantity of orders, orders in excess of which the contractor is generally not obligated to fulfill.⁷² However, contractors are not entitled to any orders in excess of the minimum quantity, even if the parties contemplated that the contract would result in additional orders, or the contractor incurs costs due to the lack of orders.⁷³ This inherent flexibility as to quantity built into indefinite-quantity contracts could make such contracts promising vehicles for responding to funding shortfalls and budget cuts, in particular.⁷⁴

Provided that the contractor has obtained the minimum quantity of orders required under the contract, the agency would generally face no liability for failure to place additional orders with the contractor, *per se*, although it could be found to have violated the Federal Acquisition Streamlining Act (FASA)⁷⁵ if the contract is a multiple-award contract, and the agency continues placing awards under the contract without giving the contractor a “fair opportunity to be considered” for such orders. A *multiple-award contract* is one awarded by a federal agency to multiple vendors, each of whom is eligible to receive orders under the contract or blanket purchase agreements placed against it.⁷⁶ As amended, FASA generally requires agencies to provide contractors with a “fair opportunity to be considered” when they issue task or delivery orders valued in excess of \$3,000,⁷⁷ and specifies what constitutes a “fair opportunity to be considered” for orders valued in excess of \$5.5 million.⁷⁸ Thus, an agency arguably could not cease considering one specific vendor under a multiple award contract in the placement of orders

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recommendations by the Government Accountability Office suggest that, at least in some cases, \$500 could be used as the guaranteed minimum, regardless of the maximum ordering limitations or total contract value, in the absence of reliable historical data suggesting otherwise. *See* Library of Congress, B-318046, 2009 U.S. Comp. Gen. LEXIS 126 (July 7, 2009).

⁷² 48 C.F.R. § 16.504(a)(3).

⁷³ *See, e.g.*, *Bliss Co. v. United States*, 74 Ct. Cl. 14 (1932) (government not liable for losses due to the contractor’s plant being idled for lack of orders); *Alta Constr. Co.*, PSCBA 1395, 87-2 BCA ¶ 19,720 (government’s awarding orders to a competitor of the contractor does not give rise to a breach of contract claim).

⁷⁴ *Cf.* *Contractors Will Remain in Limbo*, *supra* note 7 (some commentators predicting that agencies will rely more upon one type of indefinite-quantity contract—the indefinite-delivery/indefinite-quantity (ID/IQ) contract—in the event of sequestration). With ID/IQ contracts, neither the time of performance nor the quantity, above a stated minimum, is specified at the time of contracting. Rather, the government issues orders for supplies or work as needed.

⁷⁵ P.L. 103-355, 108 Stat. 3243 (Oct. 13, 1994) (codified in scattered sections of Titles 10 and 41 of the United States Code). Title 10 applies to the procurements of defense agencies; Title 41 applies to those of civilian agencies.

⁷⁶ FASA establishes “a preference” for multiple-award contracts by requiring agencies to use them, as opposed to single-award contracts, “to the maximum extent practicable.” 10 U.S.C. § 2304a(d)(3) (procurements of defense agencies) & 41 U.S.C. § 4103(d)(4)(A) (procurements of civilian agencies).

⁷⁷ However, FASA does permit agencies to issue orders without providing a “fair opportunity to be considered” if: (1) the agency’s need for the services or property is of such unusual urgency that providing a “fair opportunity to be considered” to all contractors would result in unacceptable delays in fulfilling that need; (2) only one contractor is capable of providing the services or property required at the level of quality required; (3) the task or delivery order should be issued on a sole-source basis in the interest of economy and efficiency because it is a logical follow-on to a task or delivery order already issued on a competitive basis; or (4) it is necessary to place the order with a particular contractor in order to satisfy a minimum guarantee. *See* 10 U.S.C. § 2304c(b)(1)-(4) & 41 U.S.C. § 4106(c)(1)-(4).

⁷⁸ National Defense Authorization Act for FY2008, P.L. 110-181, § 843, 122 Stat. 236-39 (Oct. 14, 2008) (codified at 10 U.S.C. § 2304c(d)(1)-(5) & 41 U.S.C. § 4106(d)(1)-(5) (requiring that agencies generally provide contractors with (1) a notice of the task or delivery order that includes a clear statement of the agency’s requirements; (2) a reasonable period of time to provide a proposal in response to the notice; (3) disclosure of the significant factors and subfactors (including cost or price) that the agency expects to consider in evaluating proposals and their relative importance; (4) a written statement documenting the basis for the award and the relative importance of quality and price or cost factors, if the award is to be made on a best-value basis; and (5) an opportunity for post-award debriefing).

on the grounds that it needs to cut spending, and has already ordered the minimum quantity from the vendor. Rather, the agency would need to partially terminate the contract.

Changes in Scope

Unlike indefinite-quantity contracts, other contracts generally obligate the federal government to purchase a fixed quantity of goods or services from the contractor (e.g., so many computers, so many hours of labor). Such contracts also specify the nature of the products or services to be provided (e.g., wedges composed of molded acrylonitrile butadiene styrene and light blue in color), as well as various other aspects of performance (e.g., time, place, and method of delivery). The general rule is that, absent special circumstances, parties are bound by the terms of their contracts, and one party cannot unilaterally decide that it will purchase fewer goods or services than were contracted for, or otherwise reduce the scope of the contract. Instead, the parties must bilaterally modify the contract. Such bilateral modifications have historically been the government's preferred method of modifying the terms of its contracts.⁷⁹ However, changes clauses, discussed below, generally included in government contracts would permit the government to make certain unilateral modifications to a contract, either by reducing or increasing its scope.

While reductions in scope might be the most likely response to funding shortfalls or spending cuts, in particular, the government could also potentially increase the scope of certain contracts in order to compensate for reductions under other contracts,⁸⁰ or for other reasons.⁸¹ The contractual basis for the government's right to make such changes is generally the same so long as the changes are within the scope of the contract. However, because major reductions are treated differently from other changes to the nature of the work, reductions and increases are discussed separately below. In either case, the government would generally need to compensate the contractor for the changed work, although the basis for and extent of such compensation could vary.

Reductions in Scope

Federal procurement contracts generally include changes clauses, which would permit the government to make certain reductions in the scope of the contract (e.g., purchase fewer goods or services than contracted for).⁸² Different versions of the changes clause are used in different types

⁷⁹ Cf. John Cibinic, Jr., Ralph C. Nash, Jr., and James F. Nagle, *Administration of Government Contracts* 401 (4th ed. 2006). See also 48 C.F.R. § 43.102(b) (indicating that, as a matter of policy, "[c]ontract modifications, including changes that could be issued unilaterally, shall be priced before their execution if this can be done without adversely affecting the interest of the Government").

⁸⁰ See, e.g., Charles S. Clark, Contractors Brace for Coming Defense Cuts, *Gov't Exec.*, Jan. 6, 2012, available at <http://www.govexec.com/defense/2012/01/contractors-brace-for-coming-defense-cuts/35785> (predicting extensive changes to existing contracts, and subsequent protests about cardinal changes, discussed below, as a result of cuts to the defense budget).

⁸¹ For example, assuming that personnel were in place to make such a change, shifting work to an existing contract could be particularly helpful in a funding gap since changes within the scope of the original work under the contract may also be funded with the same funds that were used on that contract. See 23 Comp. Gen. 943 (June 12, 1944).

⁸² The FAR generally requires that the relevant changes clauses be included. See, e.g., 48 C.F.R. § 43.205(a)(1), (b)(1), (c)-(d). But see 48 C.F.R. § 43.205(f) (indicating that contracting officers have discretion as to whether to include the changes clause in question). In addition, it should be noted that the changes clause used in contracts for commercial items permits only bilateral modifications, and that purchase orders do not include changes clauses. See, e.g., 48 C.F.R. (continued...)

(e.g., fixed price⁸³) and kinds (e.g. construction) of contracts.⁸⁴ However, all variants of the changes clause provide that “[t]he Contracting Officer may, at any time, by written order,⁸⁵ ... make changes within the general scope of this contract” to certain terms of the contract, such as

- the contract specifications,
- the method or manner of performing the work,
- any government-furnished property or services to be used in performing the contract,
- the method of shipping or packing,
- the place of delivery,
- the time of performance, for services, and
- the place of performance, for services.⁸⁶

In some cases, the changes clause applies only to changes to specifically enumerated terms of the contract, while in other cases, it is drafted so as to apply to terms of the same general type as those enumerated.⁸⁷ However, “specifications” are included in every case,⁸⁸ and this term has

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§ 52.212-4 (“Changes in the terms and conditions of this contract may be made only by written agreement of the parties.”); Robert W. Patterson, ASBCA 36823, 89-3 BCA ¶ 22,101 (purchase orders).

⁸³ Part 16 of the FAR describes eight different types of “contracts”—fixed-price, cost-reimbursement, incentive, indefinite-delivery, time-and-materials, labor-hour, and letter contracts, and agreements—although not all of these instruments are, in themselves, legally binding.

⁸⁴ See, e.g., 48 C.F.R. § 52.243-1 (standard clause applicable to fixed-price contracts for goods, as well as “alternate” clauses for use in contracts for services, including architect-engineer and professional services); 48 C.F.R. § 52.243-2 (standard clause applicable to cost-reimbursement contracts, as well as “alternate” clauses to be used in contracts for services, for supplies and services, for construction, and for research and development); 48 C.F.R. § 52.243-3 (standard clause applicable to time-and-materials and labor-hour contracts); 48 C.F.R. § 52.243-4 (standard clause applicable to contracts for (1) dismantling, demolition, or removal of improvements, or (2) construction, when a fixed-price contract is contemplated and the contract amount is expected to exceed the simplified acquisition threshold (generally \$150,000)); 48 C.F.R. § 52.243-5 (standard clause used in contracts for construction, when the contract amount is not expected to exceed the simplified acquisition threshold).

⁸⁵ Language purporting to require that changes be in writing is generally not strictly enforced. See, e.g., *W.H. Armstrong & Co. v. United States*, 98 Ct. Cl. 519 (1943); *C.A. Logeman Co.*, ASBCA 5692, 61-2 BCA ¶ 3,232; *A.L. Harding, Inc.*, DCAB PR-44, 65-2 BCA ¶ 5,261, *recons. denied*, 66-1 BCA ¶ 5,463; *Lincoln Constr. Co.*, IBCA 438-5-64, 65-2 BCA ¶ 5234, *recons. denied*, 66-1 BCA ¶ 5,343. *Constructive changes*—or changes that occur when the contract work is actually changed, but the procedures of the changes clause have not been followed—are also possible, and could be particularly likely to occur as budget cuts cause changes to government operations that affect contract performance. See, e.g., *T&M Distribs., Inc.*, ASBCA 51405, 00-1 BCA ¶ 30,677 (constructive change found where the closing of a government supply depot greatly altered the mix of bulk shipments versus single shipments for a contractor supplying parts to the agency). Similarly, any contract language requiring the contractor to provide written notice if it believes it is entitled to an equitable adjustment, discussed below, will generally not be strictly enforced against the contractor, unless the lack of notice was prejudicial to the government. See, e.g., *Golden W. Env’tl Servs.*, DOTBCA 2895, 00-2 BCA ¶ 30,990; *Valley Asphalt, Inc.*, AG-BCA 97-118-1, 97-2 BCA ¶ 28,997; *Chimera Corp.*, ASBCA 18690, 76-1 BCA ¶ 11,901; *Weaver Constr. Co.*, ASBCA 12577, 69-1 BCA ¶ 7,455; *Precision Tool & Eng’g Corp.*, ASBCA 14148, 71-1 BCA ¶ 8,738.

⁸⁶ See, e.g., 48 C.F.R. § 52.243-1(a).

⁸⁷ Compare 48 C.F.R. § 52.243-2 (permitting the contracting officer to make changes within the general scope of the contract “in any one or more of the following: (1) [d]rawings, designs, or specifications when the supplies to be furnished are specifically manufactured for the Government in accordance with the drawings, designs, or specifications[;] (2) [m]ethod of shipment or packing[;] (3) [p]lace of delivery”) with 48 C.F.R. § 52.243-4 (permitting (continued...))

been construed broadly to encompass changes in quantity, as well as in certain other aspects of the work to be performed (e.g., product features).⁸⁹ Changes are “within the general scope of the contract” when the parties should have “fairly and reasonably” contemplated them at the time when they entered the contract.⁹⁰ Reductions that would not have been fairly and reasonably contemplated by the parties are generally treated not as changes, but as partial terminations for convenience, as discussed below.⁹¹

In determining whether particular reductions in scope would have been fairly and reasonably contemplated by the parties at the time of contracting, the focus is largely upon the magnitude of the work deleted as compared to the total work.⁹² For example, deletion of a requirement that the contractor remove brick veneer from two walls of a building was found to be within the scope of the contract where the deletion involved only 400 square feet of the 1,600 square feet of bricks whose removal and replacement the parties had contracted for.⁹³ The same was true of the deletion of 47 of the 48 hours of instructional services that a contractor was to provide as part of a contract for extensive repairs and improvements to a federal facility.⁹⁴ In contrast, deletion of more than 73% of unit-priced electrical and telephone outlets from a contract for mechanical, electrical and plumbing work at a federal facility was found to be beyond the scope of the changes clause,⁹⁵ as was deletion of approximately 50% of the work on a contract for cleaning, inspecting, and coating the roofs of family housing units.⁹⁶ As these examples suggest, while there is no “bright-line test” for determining when a change is within the scope of the contract, the greater the magnitude of the change, in comparison to the total work called for, the more likely it is that the change will be found to be beyond the scope of the contract.⁹⁷

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the contracting officer to make changes within the general scope of the contract, “including changes—(1) [i]n the specifications (including drawings and designs); (2) [i]n the method or manner of performance of the work; (3) [i]n the Government-furnished property or services; or (4) [d]irecting acceleration in the performance of the work”).

⁸⁸ *Specifications* are descriptions of the work to be performed under the contract. See, e.g., John Cibinic, Jr. & Ralph C. Nash, Jr., *Formation of Government Contracts* 348 (3d ed. 1998). Specifications can be *design specifications*, describing “in precise detail the materials to be employed and the manner in which the work is to be performed.” *Blake Constr. Co. v. United States*, 987 F.2d 743, 744 (Fed. Cir. 1993). They can be *performance specifications*, which “set forth an objective or standard to be achieved, and the successful bidder is expected to exercise his ingenuity in achieving that objective or standard.” *Blake Constr.*, 987 F.2d at 744 (internal citations omitted). They can also be *functional specifications*, which describe the work to be performed in terms of the end purpose, or the government’s ultimate objective. *Formation of Government Contracts*, at 351.

⁸⁹ See, e.g., *Basis, Inc.*, GSBGA TD-7, 73-1 BCA ¶ 9,798, *rev’d in part*, 74-1 BCA ¶ 10,565 (finding that the term “specifications” encompasses the amount of work to be done).

⁹⁰ *Freund v. United States*, 260 U.S. 60, 63 (1922).

⁹¹ See *infra* notes 186-197 and accompanying text. Additions or other alterations that fail to meet this test are treated differently. See *infra* note 114-113 and accompanying text.

⁹² Cf. *J.W. Bateson Co. v. United States*, 308 F.2d 510, 513 (5th Cir. 1962) (quoting with approval the district court, which said that “[t]he long and short of it is that the proper yardstick in judging between a change and a termination in projects of this magnitude would best be found by thinking in terms of major and minor variations in the plans”).

⁹³ *Bromley Contracting Co.*, HUDBCA 75-8, 77-1 BCA ¶ 12,232 (characterizing this reduction as “relatively minor”).

⁹⁴ *John N. Brophy Co.*, GSBGA 5122, 78-2 BCA ¶ 13,506.

⁹⁵ *Capital Elec. Co.*, GSBGA 5300, 81-2 BCA ¶ 15,281.

⁹⁶ *Kahaluu Constr. Co.*, ASBCA 33248, 90-2 BCA ¶ 22,663.

⁹⁷ The “sophistication” of the products involved—and, arguably, by extension, the contractors providing them—can also be factor. See, e.g., *General Dynamics Corp. v. United States*, 585 F.2d 457 (1978) (finding that a series of changes that increased the price of the contract by 165% and extended the time of performance by three years were to be expected in a contract for nuclear submarines).

When reductions are within the scope of the changes clause, the government may be entitled to a downward adjustment in the contract price.⁹⁸ All variants of the changes clause expressly contemplate such *equitable adjustments* by providing that

[i]f any such change causes an increase or *decrease* in the cost of, or the time required for, performance of any part of the work under this contract, whether or not changed by the order, the Contracting Officer shall make an *equitable adjustment* in the contract price, the delivery schedule, or both, and shall modify the contract.⁹⁹

Pursuant to this clause, the amount of any downward adjustment is measured by the net cost savings to the contractor.¹⁰⁰ If the contractor saved costs because of the deletion, the deleted work is priced at the amount it would have cost the contractor to perform the deleted work.¹⁰¹ However, if the contractor realized no cost savings from the change, there will be no price reduction,¹⁰² and if the deleted work increased the contractor's costs, the contractor could be entitled to an upward equitable adjustment, as discussed below.¹⁰³ This is true even if the contract price included greater costs than were necessary for performance of the changed work,¹⁰⁴ since the purpose of an equitable adjustment is to maintain the basic profit or loss position of the parties before the change occurred.¹⁰⁵ The fact that reductions in scope could potentially result in no price reduction, or even an increase in price, could potentially complicate the government's efforts to respond to funding shortfalls by reductions under the changes clause. Because reductions in quantity or other aspects of the contract's scope would not necessarily result in savings under every contract, the government would arguably need to ascertain the effects of particular reductions upon contractors' costs.¹⁰⁶

⁹⁸ The changes clause expressly provides only for the contractor to assert its rights to equitable adjustments under the clause. *See, e.g.*, 48 C.F.R. § 52.243-1(c). However, it is widely recognized that contractors have "little incentive" to submit proposals for downward adjustments. *Administration of Government Contracts*, supra note 79, at 409. If such a proposal is not forthcoming, the contracting officer may issue a unilateral modification reducing the price, or issue a final decision under the disputes clause reducing the price. *See, e.g.*, Metric Constructors, Inc., ASBCA 49343, 97-2 BCA ¶ 29,076 (unilateral modification); Bruce-Anderson Co., ASBCA 29412, 89-2 BCA ¶ 21,872 (same); Dawson Constr. Co., VABCA 3558, 94-1 BCA ¶ 26,362 (final decision under disputes clause). The disputes clause implements, in part, the Contract Disputes Act of 1978, as amended, which establishes the procedures to be used by contractors and contracting officers in resolving disputes arising out of and relating to contracts. *See* 48 C.F.R. § 52.233-1.

⁹⁹ *See, e.g.*, 48 C.F.R. § 52.243-1(b) (emphasis added).

¹⁰⁰ *See, e.g.*, Fordel Films W., ASBCA 23071, 79-2 BCA ¶ 13,913; A.A. Beiro Constr. Co., GSBCA 3915, 74-2 BCA ¶ 10,860.

¹⁰¹ *See, e.g.*, Skinker & Garrett, Inc., GSBCA 1150, 65-1 BCA ¶ 4,521.

¹⁰² *See, e.g.*, Temsco Helicopters, Inc., IBCA 2594-A, 89-2 BCA ¶ 21,796 (finding that the contractor had not saved any costs and there should be no downward price adjustment where the contractor did not fire a mechanic who was no longer needed to perform the work as changed because it had employed two mechanics for the duration of the job and would be less able to hire mechanics in the future if it broke its commitment).

¹⁰³ *See, e.g.*, B-E-C-K-Christensen Raber-Kief & Assocs., ASBCA 16467, 73-1 BCA ¶ 9,884.

¹⁰⁴ *Id.*

¹⁰⁵ *See, e.g.*, Pacific Architects & Eng'rs, Inc. v. United States, 491 F.2d 734, 739 (Ct. Cl. 1974) ("It is well established that the equitable adjustment may not properly be used as an occasion for reducing or increasing the contractor's profit or loss, or for converting a loss to a profit or vice versa, for reasons unrelated to a change.").

¹⁰⁶ Suppose, for example, that the government awarded a contract to mow the grass in a field and perform work on a path through the field. Deleting the requirement that grass be mowed could potentially increase the contractor's cost in working on the path if the contractor had counted on mowing to give it access to work on the path.

Increases in Scope¹⁰⁷

While reductions in scope may be the most likely response to funding shortfalls and budget cuts, increases in quantity could also be possible under certain contracts. The various changes clauses, discussed above, would generally accommodate such increases in scope, including quantity, so long as the work done in compliance with the change is “essentially the same work as the parties bargained for.”¹⁰⁸ In determining whether the work, as changed, is essentially the same work that the parties bargained for, the focus is primarily upon the nature of the work, and not the magnitude of the change (or the number of change orders).¹⁰⁹ For example, changes requiring the contractor to use different and, in some cases, more expensive materials in building a hospital were found to be within the scope of a contract to construct a hospital because the completed hospital:

was in the same location, looked the same, had the same number of rooms and floors and the same facilities as the one shown on the original plans and specifications. Apart from the substitution of materials, it differed not at all from the building that had been contemplated when the contract was awarded.¹¹⁰

Similarly, “extensive” changes to the details of a building, requiring over 50% additional performance time, were found to be within the scope of the contract because the resultant building was not substantially different from that contracted for.¹¹¹ In contrast, a change requiring the contractor to provide a worldwide telecommunications system was found to be outside the scope of a contract to provide a telecommunications system in the Washington, D.C., area.¹¹² A change requiring the contractor to redesign part of a building was similarly found to be outside the scope of a contract calling for construction work.¹¹³ Increases in scope that fundamentally change the nature of what the parties contracted for, as in the latter two cases, are known as *cardinal changes* and constitute breaches of contract.¹¹⁴

¹⁰⁷ So long as the orders are below any maximum specified in the contract, there generally would not be a need to modify indefinite-quantity contracts as to quantity. Other aspects of the scope of such contracts could potentially be increased pursuant to the changes clause, however.

¹⁰⁸ *Aragona Constr. Co. v. United States*, 164 Ct. Cl. 382, 390-91 (1964) (“Plaintiff has no right to complain if the project it ultimately constructed was essentially the same as the one it contracted to construct. . . . In contrast, the cases that have held the changes ordered by the contracting officer to be cardinal changes and, hence, not permitted under the contract, have involved changes that altered the nature of the thing to be constructed.”).

¹⁰⁹ See, e.g., *Akcon, Inc., ENGBCA 5593*, 90-3 BCA ¶ 23,250 (characterizing a cardinal change as one that requires the contractor to do something “wholly different” than the parties originally provided for). It is important to note, however, the a cardinal change could be found to have occurred even if there is no change in the final product because “it is the entire undertaking of the contractor, rather than the product, to which we look.” *Rumsfeld v. Freedom NY, Inc.*, 329 F.3d 1320, 1332 (Fed. Cir. 2003).

¹¹⁰ *Aragona Constr. Co.*, 164 Ct. Cl. at 391.

¹¹¹ *Wunderlich Contracting Co. v. United States*, 351 F.2d 956 (Ct. Cl. 1965).

¹¹² *Info. Sys. & Networks Corp.*, ASBCA 46119, 02-2 BCA ¶ 31,952.

¹¹³ *Hughes-Groesch Constr. Corp.*, VABCA 5448, 00-1 BCA ¶ 30,912.

¹¹⁴ See, e.g., *Air-A-Plane Corp. v. United States*, 408 F.2d 1030, 1033 (Ct. Cl. 1969) (“[A] fundamental alteration of this type is a contract breach, entitling the contractor to breach damages.”). When a cardinal change is made, there is also the possibility that a third party could protest on the grounds that the modification circumvents the statutory requirements for competition in the award of federal contracts. See, e.g., *AT&T Commc’ns, Inc. v. WilTel, Inc.*, 1 F.3d 1201, 1205 (Fed. Cir. 1993). In such cases, the terms of the solicitation are considered along with the terms of the contract, and the key question is whether the solicitation for the original contract “adequately advised” offerors of the possibility that changes of the type made could occur. See, e.g., *Neil R. Gross & Co.*, B-237434, 90-1 CPD ¶ 212.

Much as the government may be entitled to a reduction in price when work is deleted, the contractor may be entitled to additional compensation when work is added. The basis for such compensation, however, depends upon whether the changes were within or beyond the scope of the changes clause. Where the work is within the scope of the changes clause, the contractor could potentially be entitled to an equitable adjustment if the change caused an increase in the cost of performing any part of the work under the contract.¹¹⁵ An *equitable adjustment* is a fair adjustment intended to cover the contractor's costs, as well as profit on the work performed.¹¹⁶ The amount of recovery is based upon the "difference between what it would have reasonably cost to perform the work as originally required and what it reasonably cost to perform the work as changed."¹¹⁷ If there was no increase in cost, then the contractor is not entitled to an upward adjustment,¹¹⁸ although it may be entitled to additional time to perform, as discussed below.¹¹⁹ If there is an increase in cost, the contractor could be entitled to an upward adjustment, although there are two potentially significant limitations upon the amount recoverable. First, the contractor is only entitled to those costs that a reasonable contractor in the contractor's situation would have incurred.¹²⁰ It cannot simply assert that these were the costs it incurred, and therefore is entitled to, unless it can be established that it behaved reasonably—given its situation—in incurring these costs. Further, costs must generally be *allowable* (i.e., permissible) under the Cost Accounting Standards (CAS) in order to be recoverable.¹²¹ The CAS are a series of accounting standards originally issued by the Cost Accounting Standards Board to promote "uniformity and consistency" in "estimating, accumulating, and reporting costs in connection with the pricing, administration, and settlement" of certain federal contracts and subcontracts.¹²² The CAS generally only apply to *cost-reimbursement contracts* (i.e., contracts that provide for the

¹¹⁵ See 48 C.F.R. § 52.243-1(b) ("If any such change causes an increase or decrease in the cost of, or the time required for, performance of any part of the work under this contract, whether or not changed by the order, the Contracting Officer shall make an equitable adjustment in the contract price, the delivery schedule, or both, and shall modify the contract."). An increase in the total cost of performance is not required, in part, because the changes clause is intended to keep the basic profit or loss position of the parties the same as it would have been but for the change. See, e.g., *Pacific Architects & Eng'rs*, 491 F.2d at 739.

¹¹⁶ See, e.g., *United States v. Callahan Walker Constr. Co.*, 317 U.S. 56, 61 ("An 'equitable adjustment' of the [contractor's] additional payment for extra work involve[s] merely the ascertainment of the cost [of the work] and the addition to that cost of a reasonable and customary allowance for profit.").

¹¹⁷ *Modern Foods, Inc.*, ASBCA 2090, 57-1 BCA ¶ 1,229.

¹¹⁸ See, e.g., *Lectro Magnetics, Inc.*, ASBCA 15971, 73-2 BCA ¶ 10,112.

¹¹⁹ See, e.g., *Simmel-Industrie Meccaniche Societa per Azioni*, ASBCA 6141, 61-1 BCA ¶ 2,917 ("pure" delays, resulting in an increase in the contractor's costs, but without a change in the work, are outside the coverage of the changes clause).

¹²⁰ See, e.g., *Bruce Constr. Corp. v. United States*, 324 F.2d 516, 518-19 (1963) ("Use of the 'reasonable cost' measure does not constitute 'an objective and universal procedure, involving the determination of the reasonable value (or reasonable cost of any contractor similarly situated) of the work involved;' but determination of reasonable cost requires, in and of itself, an objective test. The particular situation in which a contractor found himself at the time the cost was incurred ... and the exercise of the contractor's business judgment ... are but two of the elements that may be examined before ascertaining whether or not a cost was 'reasonable.' But the standard of reasonable cost 'must be viewed in the light of a particular contractor's costs, and not the universal, objective determination of what the cost would have been to other contractors at large.'") (internal citations omitted).

¹²¹ Previously, in equitable adjustments under fixed-price contracts, contractors could recover types of costs that were unallowable under the CAS. See, e.g., *Joseph Bell v. United States*, 404 F.2d 975 (1968) (interest); *Luzon Stevedoring Corp.*, ASBCA 11650, 68-2 BCA ¶ 7,545 (entertainment, contributions, advertising). However, changes made to federal procurement regulations since the early 1970s have removed this difference between costs recoverable under fixed-price contracts and those recoverable under cost-reimbursement contracts.

¹²² An Act to Amend the Defense Production Act of 1950, and for Other Purposes, P.L. 91-379, § 103, 84 Stat. 797 (Aug. 15, 1970).

government to pay the contractor, at a minimum, allowable costs incurred in performing the contract up to a total cost specified in the contract).¹²³ However, the FAR requires that “applicable subparts” of the FAR pertaining to the CAS be used in pricing fixed-price contracts, subcontracts, and modifications to contracts whenever ... a fixed-price contract clause requires the determination or negotiation of costs.”¹²⁴

When the changes are cardinal changes and the contractor does not accept the changes,¹²⁵ the contractor could potentially recover damages for breach.¹²⁶ In theory, this could mean (1) *expectancy damages*, or damages designed to give the injured party the benefit of the bargain; (2) *reliance damages*, or damages designed to compensate injured parties for their damages in performing the contract, or in anticipation of performance; or (3) *restitutionary damages*, or damages based on the amount of benefit conferred by the non-breaching party upon the breaching party. In practice, parties and courts generally do not explicitly identify claims for damages as belonging to one of these three types, at least not when addressing cardinal changes to government contracts, and contractors’ actual recovery often resembles that under an equitable adjustment or termination settlement.¹²⁷ For example, in one case where the government, among other things, doubled the length of the levee that the contractor was to construct, the court found that the contractor was entitled to recover damages in an amount equivalent to the costs of performing certain work required by the changes.¹²⁸ In another case, the court found that the contractor was entitled to recover “damages as if the contract had been terminated for the government’s convenience” where the government improperly terminated a contractor for default after it refused to perform as required by an order that constituted a cardinal change.¹²⁹ However, in other cases, courts have awarded, or recognized an entitlement to, damages more like those typically awarded in breach of contract suits. Such awards have included anticipatory profits;¹³⁰

¹²³ See 48 C.F.R. § 30.000 (expressly excluding sealed-bid contracts and contracts with small businesses).

¹²⁴ 48 C.F.R. § 31.102(a).

¹²⁵ See, e.g., *Silberblatt & Lasker, Inc. v. United States*, 101 Ct. Cl. 54 (1944); *Ashton-Mardian Co., ASBCA 7912*, 1963 BCA ¶ 3836, *reh’g denied*, 1963 BCA ¶ 3,928. To avoid having the possibility of a suit for breach foreclosed, the contractor could reserve its rights while performing as required. See, e.g., *Discount Co. v. United States*, 554 F.2d 435, *cert. denied*, 434 U.S. 938 (1977).

¹²⁶ See, e.g., *Embassy Moving & Storage Co., Inc. v. United States*, 424 F.2d 602, 607 (1970) (“[W]hether the change be formal or constructive, when the ordered ‘changes’ amount to a drastic modification beyond the scope of the contract, this court has held that the Changes article is not applicable. Such a fundamental alteration is a breach of contract, entitling the contractor to damages.”). It is also possible that, in certain circumstances, particularly where cardinal changes are involved, the government might be able to avoid liability by asserting that it acted in its sovereign capacity. See, e.g., *Horowitz v. United States*, 267 U.S. 458 (1925) (holding that, to the degree that sovereignty is involved, there can be no recovery upon a theory of breach of contract for a loss caused by a public and general act of the government). See *infra* notes NUMBERS and accompanying text.

¹²⁷ Cf. *Administration of Government Contracts*, *supra* note 79, at 678 (“In most instances, the measure of damages for breach of contract would be essentially the same as that for a claim for a price adjustment under one of these clauses.”). However, the “Cost Principles” in Subpart 31 of the FAR do not appear to be applicable in suits for damages. See, e.g., *Meva Corp. v. United States*, 511 F.2d 548 (1975).

¹²⁸ *P.L. Saddler v. United States*, 287 F.2d 411, 416 (1961).

¹²⁹ *Airprep Tech., Inc. v. United States*, 30 Fed. Cl. 488, 507 (1994). The contractor is generally not required to continue performance in the event of a “material” breach of the contract. See, e.g., *Allied Materials & Equip. Co. v. United States*, 569 F.2d 562, 563-64 (Ct. Cl. 1978).

¹³⁰ See, e.g., *Allied Materials*, 569 F.2d at 564 (“We have certainly never intimated ... that the contractor is limited to a suit for extra costs incurred in performing duties outside of the scope of the contract.”). See also *Big Chief Drilling Co. v. United States*, 26 Cl. Ct. 1276, 1320 (1992) (contractor entitled to recover the profit it would have realized but for the government’s breach).

“monetary damages not to exceed the cost of the contract,”¹³¹ and (3) direct losses due to the change, coupled with anticipated profits and overhead.¹³² The possibility that the contractor could recover anticipatory profits in the event of a cardinal change suggests that the government would need to exercise some caution in determining which contracts to add work to, or otherwise modify, in response to spending cuts or other budgetary issues. Contracts with arguably broader scopes might be the preferred vehicles for any such changes because there would be less likelihood that these changes would be beyond the contract’s scope, and contractors are only entitled to an equitable adjustment when the changes are within the contract’s scope.¹³³ While contractors receiving equitable adjustments are entitled to profit, it is profit only on the work performed; it does not include anticipatory profit.¹³⁴ Consequential damages are also excluded from equitable adjustments, but have seldom been recovered in suits against the government for breach in any case.¹³⁵

It should also be noted that certain contracts include terms that could obligate the contractor to perform even if the government breaches the contract by a cardinal change or otherwise.¹³⁶ Such contracts include a variant of the disputes clause which provides that

[t]he Contractor shall proceed diligently with performance of this contract, pending final resolution of any request for relief, claim, appeal, or action arising under or *relating to the contract*, and comply with any decision of the Contracting Officer.¹³⁷

This clause avoids the operation of the general rule that the non-breaching party need not continue performance when the other party breaches the contract.¹³⁸ However, contractors whose contracts are modified by changes within the scope of the contract must generally continue performance pending a formal change order, in the case of *constructive changes* (i.e., changes that are not ordered pursuant to the procedures established in the contract), or agreement upon the amount of any equitable adjustment. Failure to do so could result in their being terminated for default, as discussed below, or subjected to other sanctions under the contract (e.g., liquidated damages, excess costs of reprocurement).¹³⁹

¹³¹ *Int’l Electronics Corp. v. United States*, 1980 U.S. Ct. Cl. LEXIS 1072, at *59 (May 30, 1980). The court did not attempt to determine the damages, but instead remanded the case to the Board for a determination.

¹³² *Gen. Contracting & Constr. Co., Inc. v. United States*, 84 Ct. Cl. 570, 575 (1937).

¹³³ To the degree that contracts that are smaller in value are also smaller in scope, such contracts could be less likely to be targeted for modification by the government. Smaller contracts are often awarded to small businesses.

¹³⁴ *See, e.g., Callahan Walker Constr. Co.*, 317 U.S. at 61.

¹³⁵ *Cf. Administration of Government Contracts*, *supra* note 79, at 719.

¹³⁶ According to the FAR, the clause in question is to be used when “it is determined under agency procedures that continued performance is necessary pending resolution of any claims arising under or relating to the contract.” 48 C.F.R. § 33.215.

¹³⁷ 48 C.F.R. § 52.233-1, Alternate 1 (emphasis added). The standard disputes clause does not include such a provision, but rather requires only that the contractor diligently proceed with performance “pending final resolution of any request for relief, claim, appeal, or action *arising under the contract*.” 48 C.F.R. § 52.233-1(i). Cardinal changes, by definition, are not made under the contract, but do relate to it.

¹³⁸ *See, e.g., Airprep Tech.*, 30 Fed. Cl. at 505 (“A contractor is not ... obligated to undertake ‘cardinal changes’—drastic modifications beyond the scope of the contract work.”).

¹³⁹ *See, e.g., Discount Co. v. United States*, 554 F.2d 435 (contractor properly terminated for default for failing to proceed with work called for under a unilateral change order that provided for no increase in price); *Swiss Prods., Inc.*, ASBCA 40031, 93-3 BCA ¶ 26,163 (same).

Table 2. Tabular Comparison of Reductions or Additions Under Existing Contracts

Type of Change	Treatment	Compensation (if any)
Reduction	Under changes clause, if minor	Equitable adjustment (could be upward or downward) based on the cost of the deleted work
	As partial termination for convenience, if major	Under termination settlement, as discussed below
Addition or other change	Under changes clause, if not a “cardinal change”	Equitable adjustment (could be upward or downward) based on the costs incurred in performing the changed work and profit thereon
	Cardinal change	Damages for breach

Source: Congressional Research Service

Alterations in Performance Period

Alterations in the performance period (i.e., postponing performance or requiring performance more quickly than is required or permitted under the contract) is also possible in response to funding shortfalls and budget cuts.¹⁴⁰ Because partial or complete performance of the contract’s requirements by the contractor is often a precondition to payment, altering the time frame for performance could, in some cases, help the government control when funds are paid out, which could be helpful in the event that the debt limit is not increased, for example. Similarly, delaying or accelerating performance that would otherwise be scheduled to begin during a possible funding gap could also help avoid damages potentially incurred by any delays in accessing government facilities or property that a shutdown might cause.¹⁴¹

On their face, such alterations in performance period might seem to fall within the scope of the changes clause, discussed above, because the performance schedule is part of the specifications, and specifications are included in all variants of the changes clause.¹⁴² Some alterations in performance period are, in fact, so treated, although generally only if the delay or acceleration is linked to a change in the work performed. Otherwise, “pure delays” are handled under a number of other, more specific, clauses which could permit the contractor to recover certain costs arising from the delay and/or additional time to perform, free from sanctions for late performance.

¹⁴⁰ See, e.g., Short- and Long-Range Impact, *supra* note 10.

¹⁴¹ It is possible that a government shutdown could be found to constitute a sovereign act, in which case the government could potentially avoid liability for certain costs that the contractor incurred due to the shutdown. See, e.g., Legal Ramifications of the Government Shutdown, 37 *Gov’t Contractor* ¶ 587 (Nov. 22, 1995).

¹⁴² 48 C.F.R. § 52.243-1 (standard clause used in fixed-price contracts for goods or services); 48 C.F.R. § 52.243-2 (standard clause used in cost-reimbursement contracts for goods or services); 48 C.F.R. § 52.243-3 (standard clause used in time-and-materials and labor-hour contracts); 48 C.F.R. § 52.243-4 (standard clause used in construction contracts whose value is expected to exceed the simplified acquisition threshold (generally \$150,000)); 48 C.F.R. § 52.243-5 (standard clause used in construction contracts whose value is not expected to exceed the simplified acquisition threshold).

Postponing Performance

There are three standard contract clauses addressing the compensability of government-caused delays in contractor performance that could potentially appear in government contracts. These clauses differ in the types of contracts in which they are used and in their specific provisions as to the recoverability of particular costs. One of these clauses—the suspension of work clause—applies only to construction contracts, and authorizes the contracting officer to order the contractor¹⁴³ to suspend, delay, or interrupt “all or any part of the work of this contract for the period of time that the Contracting Officer determines appropriate for the convenience of the Government.”¹⁴⁴ The clause further provides that the contractor is entitled to an adjustment for any increase in the cost of performing the contract if performance of “all or any part of the work” is suspended, delayed, or interrupted for an “unreasonable period of time” by (1) an act of the contracting officer in the administration of this contract, or (2) the contracting officer’s failure to act within the time specified in this contract (or within a reasonable time, if a time is not specified in the contract).¹⁴⁵ *Adjustments* pursuant to this clause generally cover costs incurred due to the suspension, although the contractor has a duty to mitigate its damages.¹⁴⁶ Allowance for profit, however, is expressly excluded from adjustments pursuant to the suspension of work clause.¹⁴⁷ The clause also does not make any provision for the contractor to receive an adjustment in schedule as a result of the government-ordered delays, which means that contractors would generally need to seek such an extension under one of the “excusable delay” provisions, discussed below.¹⁴⁸ In addition, the clause expressly provides that it does not apply to any suspensions, delays or interruptions for which an equitable adjustment is “provided for or excluded under any other term or condition of the contract,”¹⁴⁹ such as the changes clause, discussed above.¹⁵⁰

When contracts other than construction contracts are involved, two different clauses could apply, depending upon whether the delay is *ordered* (i.e., made pursuant to the notice procedures required under the contract) or *constructive* (i.e., not made pursuant to such procedures). The stop-work order clause permits the contracting officer “stop all, or any part, of the work called for by this contract for a period of 90 days after the order is delivered to the Contractor, and for any further period to which the parties may agree.”¹⁵¹ This clause applies only to ordered delays, in part because it requires that any such “order[s] shall be specifically identified as . . . stop-work

¹⁴³ The suspension of work clause says that such orders must be in writing, but also encompasses constructive suspensions. See 48 C.F.R. § 52.242-14(c) (excluding claims resulting from a suspension order from the prohibition upon claims for costs incurred more than 20 days before the contractor was to have notified the contracting officer of the act, or failure to act, involved).

¹⁴⁴ 48 C.F.R. § 52.242-14(a).

¹⁴⁵ 48 C.F.R. § 52.242-14(b). The delay must be due solely to the government’s action, and cannot have any other cause, including the contractor’s negligence or fault. See 48 C.F.R. § 52.242-14(c). Whether the extent of the delay was unreasonable is determined based upon the totality of the circumstances, including the duration of the delay. See, e.g., Davho Co., VACAB 1005, 72-2 BCA ¶ 9,683. For example, a delay of three weeks in issuing a corrective re-design was excessive where a little more than four months remained on the contract. See Conner Bros. Constr. Co., VABCA 2504, 95-2 ¶ 29,910, *aff’d*, 113 F.3d 1256 (Fed. Cir. 1997).

¹⁴⁶ See *infra* note 164.

¹⁴⁷ 48 C.F.R. § 52.242-14(b). See also Dravo Corp., ENGBCA 3915, 79-1 BCA ¶ 13,603.

¹⁴⁸ See *infra* note 169 and accompanying text.

¹⁴⁹ 48 C.F.R. § 52.252-14(b) (emphasis added).

¹⁵⁰ See *supra* notes 82-87 and accompanying text.

¹⁵¹ 48 C.F.R. § 52.242-15(a).

order[s] issued under this clause.”¹⁵² The delay need not be “unreasonable,” as with the suspension of work clause. After 90 days (or any extension of time agreed to by the parties), the stop-work order shall be canceled, or the work covered by the order shall be terminated for default or convenience, as discussed below.¹⁵³ If the work is resumed, the contractor is entitled to an equitable adjustment in contract price and/or delivery schedule to cover the costs allocable to the work covered by the order during the period of work stoppage.¹⁵⁴ *Equitable adjustments* include allowance for profit, unlike *adjustments* under the suspension of work clause. Also unlike the suspension of work clause, the stop-work order clause does not expressly exclude delays for which equitable or other adjustments are provided or excluded under other terms of the contract.

The government delay of work clause, in contrast, applies to constructive delays under contracts for goods and services (other than construction). It provides that, if the performance of “all or any part of the work of this contract” is delayed or interrupted due to (1) an act of the contracting officer that is not expressly or impliedly authorized by the contract, or (2) the failure of the contracting officer to act with the time specified by the contract (or within a reasonable time, if no time is specified), the contractor is entitled to an “adjustment” to the contract price, the delivery or performance date, and/or “any other contractual term or condition affected by the delay or interruption.”¹⁵⁵ Because this is an “adjustment,” and not an “equitable adjustment,” no allowance is made for profit.¹⁵⁶ The clause also expressly provides that it does not apply to any delays “for which an adjustment is provided or excluded under any other term or condition of this contract.”¹⁵⁷

Table 3. Tabular Comparison of Clauses Addressing Compensability of Delays

Clause	Applicability	Compensation
Suspension of Work	Construction contracts	Adjustment (excluding profit) No provision for additional time, would need to be obtained under other provisions (e.g., excusable delay provisions, discussed below)
Stop-Work Order	Contracts for goods and services other than construction; ordered delays only	Equitable adjustment (including profit) Additional time

¹⁵² 48 C.F.R. § 52.242-15(a).

¹⁵³ 48 C.F.R. § 52.242-15(a)(1)-(2). If the stop-work order is not canceled and the work covered by the order is terminated, the contracting officer is to make allowance for “reasonable costs” resulting from the stop-work order in the termination settlement or other compensation. 48 C.F.R. § 52.242-15(c)-(d). See *infra* notes 176-197 and accompanying text for more on terminations for default and convenience.

¹⁵⁴ 48 C.F.R. § 52.242-15(a). The stop-work order clause expressly requires the contractor to “take all reasonable steps to minimize the incurrence of costs,” but such a duty would generally be implied in any case.

¹⁵⁵ 48 C.F.R. § 52.242-17(a). The contractor may be required to provide notice of alleged causes of delay in order to recover. See 48 C.F.R. § 52.242-17(b).

¹⁵⁶ 48 C.F.R. § 52.242-17(a). In fact, profit is expressly excluded. *Id.*

¹⁵⁷ 48 C.F.R. § 52.242-17(a). Delays due to any other cause, including the fault or negligence of the contractor, are also excluded. *Id.*

Clause	Applicability	Compensation
Government Delay of Work	Contracts for goods and services other than construction; constructive delays only	Adjustment (excluding profit) Additional time Adjustment to other affected contractual terms and conditions

Source: Congressional Research Service

Depending upon the circumstances, these three clauses could potentially allow contractors to recover certain costs associated with government-caused delays, such as might result from funding gaps or shortfalls. However, the use of such clauses is optional in certain contracts,¹⁵⁸ unlike with the variants of the changes clauses, discussed above, which are generally required.¹⁵⁹ While one *board of contract appeals* (i.e., an administrative tribunal established to hear disputes between contractors and the government¹⁶⁰) has found that, in the absence of a clause giving government the right to order a suspension of work, the government has the inherent right to do so,¹⁶¹ the general rule appears to be that in the absence of a contract clause dealing with the suspension of work, the contractor is generally not entitled to compensation for delays unless they are the fault of the government.¹⁶² When the delay is compensable, the contractor can generally recover those costs that resulted from the lack of productivity during the period of delay, including the costs of performing otherwise unnecessary work, altering the sequence of its operations, using inefficient methods of performance, working in later time periods, etc.¹⁶³ However, it is important to note that the contractor is required, whether as an express or implied term of the contract, to mitigate its damages in the event of delay.¹⁶⁴ This means that the contractor may need to seek alternate work, give workers other things to do, etc., in order to

¹⁵⁸ See 48 C.F.R. § 42.1305(a) (requiring use of the suspension of work clause in all fixed price construction or architect-engineer contracts); 48 C.F.R. § 42.1305(b) (authorizing the use of the stop-work order clause in negotiated supply, services, or research and development contracts, but requiring its use, along with its “Alternate 1,” if the contract is cost-reimbursement); 48 C.F.R. § 42.1305(c) (requiring use of the government delay of work clause in fixed-price contracts involving non-commercial items, and authorizing its use for fixed-price contracts for commercial or modified commercial items).

¹⁵⁹ See *supra* note 82.

¹⁶⁰ See *supra* note 57.

¹⁶¹ Robert A. & Sandra B. Moura, PSBCA 3460, 96-1 BCA ¶ 27,956 (holding that the government had an inherent right to order a suspension because it had the contractual right to terminate the contractor for default on one day’s notice, and this right necessarily encompassed the lesser right to suspend performance temporarily).

¹⁶² See, e.g., *Fritz-Rumer-Cooke v. United States*, 279 F.2d 200 (6th Cir. 1960). However, recovery could be allowed, even if the delay were not due to the fault of the government, if the contract contains a representation that constitutes a warranty, or the government breaches an implied duty to cooperate with the contractor. See, e.g., *Scott Corp. v. United States*, 439 F.2d 185 (1971) (warranty); *Cedar Lumber, Inc. v. United States*, 5 Cl. Ct. 539 (1984) (unreasonable delay).

¹⁶³ See, e.g., *Youngdale & Sons Constr. Co. v. United States*, 27 Fed. Cl. 516 (1993) (work out of planned sequence and in bad weather); *Luria Bros. & Co. v. United States*, 369 F.2d 701 (1966) (loss of efficiency); *Eichleay Corp.*, ASBCA 5183, 60-2 BCA ¶ 2,688, *recons. denied*, 61-1 BCA ¶ 2,894 (unabsorbed overhead (i.e., additional overhead costs incurred when the contract period is extended, or on the theory that the contract has not absorbed its share of overhead during the period when no work, or a lesser amount of work than planned, has been accomplished); *Hardeman-Monier-Hutcherson (JV)*, ASBCA 11785, 67-1 BCA ¶ 6,210 (idle labor and equipment); *Louis M. McMaster*, AGBCA 76-156, 79-1 BCA ¶ 13,701 (disruption made planned simultaneous work impossible); *Excavation-Constr., Inc.*, ENG-BCA 3858, 82-1 BCA ¶ 15,770, *recons. denied*, 83-1 BCA ¶ 16,338 (escalation of labor rates and material prices); *Marlin Assocs., Inc.*, GSBCA 5663, 82-1 BCA ¶ 15,739 (remobilizing and demobilizing contractor’s workforce).

¹⁶⁴ This duty is expressly noted in the stop-work order clause, but would be implied elsewhere. See, e.g., *Hardeman-Monier-Hutcherson (JV)*, ASBCA 11785, 67-1 BCA ¶ 6,210.

recover its costs.¹⁶⁵ If it fails to do so, the amount of its recovery could be reduced.¹⁶⁶ In addition, the government could potentially avoid liability for certain costs because it acted in its sovereign capacity. For example, in *Contractors Northwest, Inc.*, the Department of Agriculture Board of Contract Appeals denied the contractor's claim for damages allegedly resulting from a 39-day suspension of work due to a fire on the grounds that the government acted in a sovereign capacity when it suspended work.¹⁶⁷ While the government may be unlikely to act in a sovereign capacity when it orders a delay due to budget issues, it is possible that budget issues could prompt changes in government programs or operations that could constructively delay work,¹⁶⁸ in which case the "sovereign acts doctrine" could potentially be relevant.

However, even in situations where the contractor is not entitled to compensation for a government-caused delay, it could potentially be entitled to additional time to perform its obligations under the contract. Federal procurement contracts can include a number of "excusable delay" provisions that allow the contractor to avoid the potentially severe consequences for late performance provided for in the contract (e.g., termination for default) when their performance is delayed due to certain causes specified in the contract. "[A]cts of the Government in either its sovereign or contractual capacity" are invariably among the causes listed.¹⁶⁹ While such clauses may have limited applicability in the case of delays ordered for budgetary reasons, they could potentially come into play if contractors' performance is constructively delayed due to budget-related changes in government operations, for example.¹⁷⁰

Acceleration of Performance

While postponing performance is one possible response to funding shortfalls and budget cuts, another possible response is accelerating or speeding up performance, so as to complete it before a possible funding gap occurs, for example. Actual acceleration occurs when an agency expressly requires a contractor to complete some or all of the work sooner than required under the contract. *Constructive acceleration*, in contrast, occurs when an agency effectively requires a contractor to speed up work to meet the current contract schedule in the face of excusable delays.¹⁷¹

¹⁶⁵ See, e.g., *Melka Marine, Inc. v. United States*, 187 F.3d 1370 (Fed. Cir. 1999) (holding that the contractor could not recover damages for unabsorbed home-office overhead costs incurred during periods in which it was able to perform work that was not dependent upon a permit which the government had failed to obtain).

¹⁶⁶ *Id.*

¹⁶⁷ AGBCA 97-101-1, 97-1 BCA ¶ 28,847. See also *Conner Bros. Construction Co., Inc. v. Geren*, 550 F.3d 1368 (Fed. Cir. 2008) (denying recovery where a contractor was barred from accessing a construction site on a military base for 41 days following the terrorist attacks of September 11, 2001, on the grounds that the government acted in a sovereign capacity when restricting access to the base). The contractor's primary claim in the latter case appears to have been that the government breached the contract by denying it access. However, it also argued that the government unreasonably failed to issue a suspension-of-work order.

¹⁶⁸ See, e.g., *T&M Distribs., Inc.*, ASBCA 51405, 00-1 BCA ¶ 30,677 (constructive change found where the closing of a government supply depot greatly altered the mix of bulk shipments versus single shipments for a contractor supplying parts to the agency).

¹⁶⁹ See, e.g., 48 C.F.R. § 52.249-14(a) (excusable delays clause used in cost-reimbursement contracts, among others); 48 C.F.R. § 52.249-10(b)(1) (default clause used in fixed-price construction contracts).

¹⁷⁰ See, e.g., *CJP Contractors*, ASBCA 50076, 00-2 BCA ¶ 31,119 (contractor granted a one-week time extension because the building it was renovating was shut down, and the government told the contractor that it could take the week off).

¹⁷¹ See, e.g., *Fermont Div., Dynamics Corp. of Am.*, ASBCA 15806, 75-1 BCA ¶ 11,139, *aff'd*, 216 Ct. Cl. 448 (1978) (identifying the components of constructive acceleration as follows: (1) an excusable delay exists; (2) the government knows of such delay; (3) a statement or act by the government (e.g., threatening termination for default) can be (continued...)

Acceleration is generally treated as a change under the changes clause.¹⁷² Some changes clauses address this explicitly.¹⁷³ In other cases, courts and boards of contract appeals have found that the performance schedule is part of the contract's specifications, which are included in all variants of changes clause.¹⁷⁴ The contractor could potentially also recover under the suspension of work clause if costs were incurred in mitigation of a government-caused delay, but the work was not changed.

Termination and Cancellation of the Contract

In addition to changing or delaying performance under the contract, the government could also terminate or cancel the contract in response to funding shortfalls or budget cuts. Terminations can be of two types—based on the contractor's default, or for the government's convenience—depending upon the circumstances, and some commentators have suggested that the government may be more assertive in exercising its right to terminate on both grounds if sequestration occurs.¹⁷⁵ Government contracts grant the government the right to terminate its contracts for either default or convenience, but the government has also been found to have an inherent right to terminate contracts for its convenience, regardless of whether the contract provides for this right.¹⁷⁶ But for these contractual and/or inherent rights, the government could potentially be found liable for breach, even if the termination were based on the contractor's default (i.e., breach).¹⁷⁷ While the common law of contracts does permit a party to cease performance when the other party anticipatorily repudiates or materially breaches the contract, that party does so at the risk of being incorrect as to whether repudiation or a material breach occurred.¹⁷⁸ However, the government avoids the operation of this principle by providing, as a term of its contracts, that any termination for default found to be improper will be converted into a termination for convenience. Recovery in the event of a termination for convenience is generally less than that for breach. Termination differs from cancellation primarily in that cancellation occurs between years on a multi-year contract, whereas termination can occur at any time on multi-year or other contracts.

(...continued)

construed as an acceleration order; (4) the contractor provides any required notice that the order is a constructive change; and (5) additional costs are incurred due to the order).

¹⁷² See, e.g., Neil R. Gross & Co., Inc., B-237434, 90-1 CPD ¶ 212, *aff'd*, 90-1 CPD ¶ 491.

¹⁷³ See, e.g., 48 C.F.R. § 52.243-4(a)(1) ("The Contracting Officer may, at any time, without notice to the sureties, if any, by written order designated or indicated to be a change order, make changes in the work within the general scope of the contract, including changes ... [d]irecting acceleration in the performance of work.").

¹⁷⁴ See *supra* notes 86-87 and accompanying text.

¹⁷⁵ See, e.g., Attorneys Predict More Risk, Less Reward, *supra* note 9 (suggesting that the "federal government will be looking for 'any possible basis' to terminate contracts for default instead of convenience, in order to save costs"); Short- and Long-Range Impact of Budget Cuts, *supra* note 10 (increased use of termination for convenience).

¹⁷⁶ See *supra* notes 27-28 and accompanying text.

¹⁷⁷ For a discussion of this issue as to terminations for convenience, see *supra* notes 22-26 and accompanying text.

¹⁷⁸ See *supra* note 24 and accompanying text.

Terminations for Default

A termination for default occurs when the government exercises its contractual right to terminate a contract, in whole or in part, due to the contractor's failure to perform its obligations.¹⁷⁹ It does not automatically occur when the contractor is in default; rather, the contracting officer must affirmatively determine that the contract should be terminated for default, and it is in the government's interest to do so.¹⁸⁰ For a fixed-price contract, the FAR lists factors that the contracting officer must consider, including the contractor's specific failure and any excuses for it, as well as the urgency of the need for the supplies or services and the time it would take to get them from someone else.¹⁸¹ If a termination for default is found to be improper for any reason, it will generally be converted to a termination for convenience,¹⁸² which would allow the contractor to recover under the termination for convenience clause, as discussed below.

When the termination for default is proper, the contractor is generally entitled to some recovery, although the basis and amount of the potential recovery differ depending upon the type of the contract. For example, the standard default clauses for fixed-price contracts generally provide that the amount the contractor may recover is the contract price for completed supplies or work, as well as certain other costs (e.g., for materials and protection or preservation of property).¹⁸³ The clauses generally allow the government to charge the contractor with the excess costs of any reprocurement,¹⁸⁴ or to recover common law damages.¹⁸⁵ In contrast, the standard default clause

¹⁷⁹ See 48 C.F.R. § 49.101(a). The failure can be actual or anticipated. See also 48 C.F.R. § 52.249-8(a)(1)(i)-(iii) (government may terminate a fixed-price supply or services contract if the contractor fails to deliver or perform within the specified time; make progress, so as to endanger performance of the contract; or perform other provisions of the contract); Precision Products, ASBCA 25280, 82-2 BCA ¶ 15,981 (contractor must have failed to perform a material requirement of the contract).

¹⁸⁰ See, e.g., 48 C.F.R. § 49.402-3; see also *Schlesinger v. United States* 390 F.2d 702 (Ct. Cl. 1968) (while contractor was technically in default, decision to terminate was improper because contracting officer and his superiors had failed to exercise discretion and instead behaved, after receiving a congressional letter suggesting termination, as if they had no choice to terminate once the contractor defaulted); *National Medical Staffing, Inc.*, ASBCA No. 40391, 92-2 BCA ¶ 24,837 ("It is well established in the default termination aspect of the Government contract law arena that the contracting officer must 'reasonably' exercise his or her discretion in order to make sure that default termination is in the best interest of the Government.").

¹⁸¹ 48 C.F.R. § 49.402-3(f) (the factors are (1) the contract's terms, laws, and regulations; (2) the contractor's specific failure and excuses for it; (3) the availability of the supplies or services from other sources; (4) the urgency of the need for the supplies or services and how long it would take to obtain them from other sources or from the contractor; (5) the contractor's essentiality in the government acquisition program and the effect of a termination for default upon its capability as a supplier under other contracts; (6) the effect of a termination on the contractor's ability to liquidate guaranteed loans, progress payments, or advance payments; and (7) any other pertinent facts and circumstances).

¹⁸² See 48 C.F.R. § 52.249-6(b); 48 C.F.R. § 52.249-8(g); 48 C.F.R. § 52.249-9(g); 48 C.F.R. § 52.249-10(c). See also *Universal Shelters of America, Inc. v. United States*, 87 Fed. Cl. 127, 144 (2009) ("Where that discretion has been abused, or exercised in an arbitrary and capricious manner, the appropriate remedy is to convert the termination for default into one for the convenience of the Government").

¹⁸³ See 48 C.F.R. § 52.249-8(f) (for fixed-price supply and service contracts, "[t]he Government shall pay contract price for completed supplies delivered and accepted. The Contractor and Contracting Officer shall agree on the amount of payment for manufacturing materials delivered and accepted and for the protection and preservation of the property."); 48 C.F.R. § 52.249-9(f) (for fixed-price research and development contracts, "[t]he Government shall pay the contract price, if separately stated, for completed work it has accepted and the amount agreed upon by the Contractor and the Contracting Officer for (1) completed work for which no separate price is stated, (2) partially completed work, (3) other property described above that it accepts, and (4) the protection and preservation of the property.").

¹⁸⁴ See 48 C.F.R. § 52.249-8(b); 48 C.F.R. § 52.249-9(b); 48 C.F.R. § 52.249-10(a).

¹⁸⁵ See 48 C.F.R. § 52.249-8(h) ("The rights and remedies of the Government in this clause are in addition to any other rights and remedies provided by law or under this contract."); 48 C.F.R. § 52.249-9(h) (same); 48 C.F.R. § 52.249- (continued...)

for a cost-reimbursement contract permits the contractor to recover allowable costs plus any fee.¹⁸⁶ The allowed fee will generally be proportionate to the portion of the contract that was actually completed.¹⁸⁷ Furthermore, in the event of a partial termination, the standard clause requires the contracting officer and contractor to agree to any equitable adjustment for the fee for the continued (i.e., non-terminated) part of the contract.¹⁸⁸

Terminations for Convenience

Under the standard termination for convenience clauses, the government has the unilateral right to terminate contracts when it is in its interest to do so.¹⁸⁹ The government has broad discretion to terminate a contract for convenience,¹⁹⁰ although it may not do so if it is an abuse of discretion or done in bad faith.¹⁹¹ As with terminations for default, the contractor is generally entitled to some recovery, although the basis and extent of recovery differ depending upon the type of contract, as discussed below. As a rule, however, contractors recover more in the event of terminations for convenience than in terminations for default.

Under the standard long-form termination for convenience clause for fixed price contracts, the contractor is entitled to recover its allowable costs, as well as a reasonable profit.¹⁹² The FAR provides that standard cost principles are to be used when determining the allowability of

(...continued)

10(d) (same). *See also* Birken Mfg. Co., ASBCA No. 32651, 88-1 BCA ¶ 20,385 (“It is well established as a matter of law that the Government may recover common law damages for breach of contract pursuant to paragraph (f) of the ‘Default’ clause when there has been no reprourement of the defaulted supplies and no assessment of excess costs of reprourement ... Common law damages are recoverable to the extent they are foreseeable, direct, natural and proximate results of the breach.”).

¹⁸⁶ *See* 48 C.F.R. § 52.249-6(g) & (h). Additionally, “[t]he cost principles and procedures in part 31 of the Federal Acquisition Regulation ... shall govern all costs claimed, agreed to, or determined under this clause.” 48 C.F.R. § 52.249-6(i). Certain amounts are deducted from the amount due the contractor: unliquidated advance or other payments to the contractor under the contract’s terminated portion; any claim of the government against the contractor under the contract; and the agreed price for, or the proceeds of sale of, materials, supplies, and other things acquired by the contractor or sold and not recovered by or credited to the government. *See* 48 C.F.R. § 52.249-6(k).

¹⁸⁷ *See* 48 C.F.R. § 52-249-6(h)(4)(ii) (“If the contract is terminated for default, the total fee payable [as determined by the contracting officer] shall be such proportionate part of the fee as the total number of articles (or amount of services) delivered to and accepted by the Government is to the total number of articles (or amount of services) of a like kind required by the contract.”)

¹⁸⁸ *See* 48 C.F.R. § 52-249-6(l).

¹⁸⁹ *See* 48 C.F.R. § 52.249-1; 48 C.F.R. § 52.249-2(a); 48 C.F.R. § 52.249-6(a). Even absent these provisions, courts have recognized that the government has an inherent right to terminate a contract when in the government’s best interest. *See, e.g.,* *United States v. Corliss Steam Engine Co.*, 91 U.S. 321 (1875).

¹⁹⁰ *See, e.g.,* *Nolan Bros. Inc. v. United States*, 405 F.2d 1250, 1253 (Ct. Cl. 1969) (termination for convenience “was an action the [government] had a full right to take under the contract which lodged in the contracting officer the fullest of discretion to end the work in the best interests of the Government”) (internal quotations omitted). Further, “[t]he mere existence of a default by the Government” does not prevent a termination for convenience. *Id.*

¹⁹¹ *See, e.g.,* *Kalvar Corp. v. United States*, 543 F.2d 1298 (Ct. Cl. 1976); *Rafael Francis*, DOTCAB 1566, 85-3 BCA ¶ 18339.

¹⁹² *See* 48 C.F.R. § 49.201(a); 48 C.F.R. § 52.249-2(g) & (h). Relevant factors in determining the contractor’s profit include (1) the extent and difficulty of the work performed as compared with the total work required by the contract; (2) the rate of profit the contractor would have earned had the contract been completed, as well as the rate the parties contemplated at the time it was negotiated; and (3) character and difficulty of subcontracting, including selection, placement, and management of sub-contracts, and effort in negotiating settlements of terminated subcontracts. *See* 48 C.F.R. § 49.202(b).

settlement costs, subject to the general principle that the purpose of a termination settlement is to “fairly compensate” the contractor¹⁹³ (i.e., the principles will not be strictly applied).¹⁹⁴ In the event of a partial termination, the standard clause provides that the contractor may file a claim for an equitable adjustment of the prices under the contract’s continued portions (i.e., “reprice” the non-terminated part of the contract), out of recognition that a partial termination could increase the costs to the contractor of performing the remaining parts of the contract.¹⁹⁵ The standard clause does not allow the contractor to recover anticipated profits.¹⁹⁶ Furthermore, a contractor is generally not allowed to recover any profit if the contract would have been performed at a loss.¹⁹⁷ Rather, the government may adjust the termination settlement to account for the loss, thus reducing the contractor’s recovery.¹⁹⁸

The standard termination clauses for cost-reimbursement contracts generally provide that the contractor may recover allowable costs plus a fee, if any.¹⁹⁹ In the event of a partial termination, the termination contracting officer is required to “limit the settlement to an adjustment of the fee, if any, and with the concurrence of the contracting office, to a reduction in the estimated cost.”²⁰⁰

Table 4. Tabular Comparison of Various Types of Terminations

Type	Compensation
Termination for Default	Contract price for completed supplies or work (fixed-price contracts)
	Costs plus any fee (cost-reimbursement contracts)
Termination for Convenience	Costs plus reasonable profit (no anticipatory profit) (fixed-price contracts)
	Costs plus any fee (cost-reimbursement contracts)

Source: Congressional Research Service

¹⁹³ See 48 C.F.R. § 49.113; 48 C.F.R. § 49.201(a). See also 48 C.F.R. § 31.205-42 (requiring special treatment of certain termination costs).

¹⁹⁴ See 48 C.F.R. § 49.201(a) (“The use of business judgment, as distinguished from strict accounting principles, is the heart of a settlement.”).

¹⁹⁵ See 48 C.F.R. § 52.249-2(l); see also *Drain-A-Way Sys., Inc., GSBCA No. 7022, 84-1 BCA ¶ 16,929* (“The customary Termination For Convenience clause permits repricing the continued portion of a contract where performance is made more costly, or less profitable, as a result of a partial termination.”).

¹⁹⁶ See 48 C.F.R. § 49.202(a); see also *Best Foam Fabricators, Inc. v. United States*, 38 Fed. Cl. 627, 637-38 (1997) (“Anticipatory profits and consequential damages are not recoverable.”); *Nolan Bros., Inc. v. United States*, 405 F.2d 1250 (Ct. Cl. 1969) (contractor cannot recover common law damages for a breach of contract when a termination for convenience occurs).

¹⁹⁷ See 48 C.F.R. § 52.249-2(g)(2)(iii).

¹⁹⁸ However, the loss adjustment provision may not apply if the loss was caused by the government. See, e.g., *Western States Painting Co., ASBCA 13843, 69-1 BCA ¶ 7616* (loss adjustment provision did not apply when the government changed a defective paint specification and the changed specification was also defective).

¹⁹⁹ See 48 C.F.R. § 49.301; 48 C.F.R. § 52.249-6(h). See also 48 C.F.R. § 49.305-1(a) (“The TCO shall determine the adjusted fee to be paid, if any, in the manner provided by the contract. The determination is generally based on a percentage of completion of the contract or of the terminated portion.”).

²⁰⁰ 48 C.F.R. § 49.304-1(a) (“The TCO shall adjust the fee as provided in 49.304-2 and 49.305, unless—(1) The terminated portion is clearly severable from the balance of the contract; or (2) Performance of the contract is virtually complete, or performance of any continued portion is only on subsidiary items or spare parts, or is otherwise not substantial); see also 48 C.F.R. § 52.249-6(h).

Cancellation of Multi-Year Contracts

While the prototypical federal contract is for one year (potentially extended to five years through the exercise of options²⁰¹), certain contracts are *multi-year contracts* in that their term extends for more than one year without the government having to establish and exercise an option for each program year after the first.²⁰² Because authority to contract is distinct from the availability of appropriations, and appropriations are generally annual,²⁰³ multi-year contracts contain clauses that generally authorize the government to cancel the contract if “funds are not available for contract performance for any subsequent program year,” or if the contracting officer “fails to notify the Contractor that funds are available for performance of the succeeding program year requirement.”²⁰⁴ The government generally has broad discretion as to the use of any available funds. However, multi-year contracts are viewed as “single, indivisible entities,”²⁰⁵ and the government could be found to have partially terminated the contract for convenience, as discussed above, if it awards a new contract for goods or services similar to those provided for in a multi-year contract that was canceled for lack of funds.²⁰⁶ The rationale for this is that the “contract binds the Government to purchase the entire multi-year procurement quantity and to fund successive Program Years. This obligation is mandatory unless there is an appropriate and justified cancellation or the bona fide unavailability of funds.”²⁰⁷

When the government does properly exercise its right to cancel a multi-year contract, the contractor is generally paid a “cancellation charge.” This charge covers only:

- (1) costs (i) incurred by the Contractor and/or subcontractor, (ii) reasonably necessary for performance of the contract, and (iii) that would have been amortized over the entire multiyear contract period but, because of the cancellation, are not so amortized, and
- (2) a reasonable profit or fee on the costs.²⁰⁸

²⁰¹ See 48 C.F.R. § 17.204(e) (“[T]he total of the basic and option periods shall not exceed 5 years in the case of services, and the total of the basic and option quantities shall not exceed the requirement for 5 years in the case of supplies.”). The word “prototypical” is used here to indicate that the one-year contract is viewed as the norm in federal procurement. It is unclear whether one-year contracts represent the majority of all federal contracts, in number or value.

²⁰² 48 C.F.R. § 17.103. Multi-year contracts are, thus, distinct from *multiple year contracts*, or contracts which last more than one year because of the government’s exercise of options. See *supra* note 52 and accompanying text. Other contracts exceed one fiscal year in that their period of performance spans more than one year. See, e.g., 10 U.S.C. § 2410a (authorizing defense agencies to enter into contracts for the procurement of “severable services,” or the lease of real or personal property, that begin in one fiscal year and end in the next). However, the maximum term of such contracts does not exceed twelve months.

²⁰³ Multi-year and “no year” appropriations are available in some cases. See generally *Principles of Federal Appropriations Law* Vol. 1, at 5-3 to 5-11 (3d ed. 2004), available at <http://www.gao.gov/special.pubs/d04261sp.pdf>.

²⁰⁴ 48 C.F.R. § 52.217-2(a). Cancellation must occur within particular time frames, specified in the contract. See *id.*

²⁰⁵ *Beta Sys., Div. of Velcon Filters, Inc. v. United States*, 16 Cl. Ct. 219, 228 (1989).

²⁰⁶ *Varo, Inc., ASBCA 13739*, 70-1 BCA ¶ 8,099.

²⁰⁷ *Beta Sys., Div. of Velcon Filters*, 16 Cl. Ct. at 228.

²⁰⁸ 48 C.F.R. § 52.217-2(d). The cancellation charge is computed and claimed as if it were a claim made under the termination for convenience clause. 48 C.F.R. § 52.217-2(e). Such claims may include: (1) reasonable nonrecurring costs that are applicable to and normally would have been amortized in all supplies and services which are multiyear requirements; (2) allocable portions of the costs of facilities acquired or established for the conduct of the work, to the extent it is impracticable for the contractor to use the facilities in commercial work, and the costs are not charged to the contract through overhead or otherwise depreciated; (3) costs incurred for the assembly, training, and transportation to and from the job site of a specialized workforce; and (4) costs not amortized solely because cancellation had precluded anticipated benefits of contractor or subcontractor learning. 48 C.F.R. § 52.217-2(f)(1)-(4). Claims may not include: (1) (continued...)

Moreover, the charge generally cannot exceed the “cancellation ceiling” specified in the contract.²⁰⁹ This ceiling represents the maximum amount that the contractor may recover, but the contractor will not necessarily recover this amount.²¹⁰ The ceiling is lowered each year to exclude amounts allocable to items included in the prior year’s program requirements.²¹¹

Concluding Observations

The contractual and other rights that the government could exercise in modifying procurement spending in light of funding gaps, funding shortfalls, or budget cuts are arguably well-established. Determining what the exercise of these rights might mean for federal contractors and, particularly, federal spending on procurement contracts is, in contrast, less clear for multiple reasons. First, individual contracts could contain specific terms that are contrary to the standard terms discussed here, and that would generally be found to prevail over the standard terms.²¹² For example, while the suspension of work clause, discussed above, would generally not allow contractors to recover costs resulting from the impact of a government-caused delay upon the vendor’s other contracts, some contracts expressly allow for such costs.²¹³ Second, there is incredible variation in the types, terms, and performance of individual contracts, and in how particular government actions might affect the contractors’ costs and/or schedule. Two contractors performing apparently identical functions for an agency could potentially be doing so under fundamentally different contracts, and the same agency action (e.g., reductions in scope, issuance of a stop-work order) could have profoundly different effects upon them depending upon how they planned to perform, where they are in the course of performance, and other aspects of their business operations (e.g., availability and desirability of other work). Relatedly, the government often has multiple ways, pursuant to its contracts, to get to the same outcome (e.g., a reduction in the quantity of goods or services to be supplied under the contract).²¹⁴ Depending upon the circumstances, it could potentially be more beneficial to treat such a reduction as a partial

(...continued)

labor, material, or other expenses incurred by a contractor or subcontractor for performance of the canceled work; (2) any costs already paid to the contractor; (3) anticipated profit or unearned fees for the canceled work; or (4) for service contracts, the remaining useful commercial life of facilities. 48 C.F.R. § 52.217-2(g)(1)-(4).

²⁰⁹ 48 C.F.R. § 52.217-2(c).

²¹⁰ Continental Elecs. Mfg. Co., ASBCA 14749, 71-2 BCA ¶ 9,108.

²¹¹ *Id.*

²¹² Moreover, as some commentators have noted, it is often unclear precisely what the parties’ responsibilities under a contract may be until a court or board construes the meaning of any disputed provisions. *See, e.g., Administration of Government Contracts*, *supra* note 79.

²¹³ Ingalls Shipbuilding Div., Litton Sys., Inc., ASBCA 17579, 78-1 BCA ¶ 13,038, *recons. denied*, 78-1 BCA ¶ 13,216 (discussing a variant of the suspension clause used in shipbuilding contracts that allowed for “such adjustment in the contract price as will equitably compensate the Contractor for the increased costs incurred by it arising out of such suspension”). *See also* Con-Seal, Inc., ASBCA 41544, 97-1 BCA ¶ 28,819 (two clauses requiring contractor to assume the costs of hurricane preparation prevailing over “excused delays” clause); J.C. Equip. Corp., ASBCA 42879, 72-2 BCA ¶ 29,197, *aff’d*, 360 F.3d 1311 (Fed. Cir. 2004) (contractor “responsible” for storm protection, dewatering, and ensuring that the trench was suitable for laying pipe under the contract); Housatonic Valley Constr. Co., AGBCA 1999-181-1, 00-1 BCA ¶ 30,869, *recons. denied*, 00-2 BCA ¶ 31,043 (contractor not entitled to an adjustment for a government suspension of work due to wet ground because the contract included a “Suspension for Other than the Convenience of the Government” clause, which provided that the government would not be liable for suspensions ordered to prevent environmental damage).

²¹⁴ *See, e.g.,* Piracci Constr. Co., GSBCA 3477, 74-2 BCA ¶ 10,800 (recognizing that a claim for delay expense is cognizable under the changes clause, the suspension of work clause, and potentially other clauses).

termination for convenience or as a change, and the government has some discretion in determining how to proceed, provided the change is “minor.”²¹⁵ Finally, government contracts are subject to interpretation by various courts and boards of contract appeals, which have had differing opinions on various questions, such whether contingent costs may be recovered as part of an adjustment.²¹⁶

In short, individual contractors could be more or less affected by individual government actions in this area, depending upon the terms of their contract, the course of performance, the nature of the government action, and the tribunal hearing their case, among other things.²¹⁷ The government’s spending upon procurement contracts could similarly be more or less affected, depending upon how it exercises its rights. For example, reductions in scope effectuated pursuant to the changes clause might or might not lead to savings, depending upon the effects that the reductions have upon contractor costs. If reductions could be targeted to contracts where contractors’ costs would decrease due to the reduction, the government could potentially realize savings through reductions. If, however, the reductions were not so targeted, the government might save nothing, or even incur higher costs.

Author Contact Information

Kate M. Manuel
Legislative Attorney
kmanuel@crs.loc.gov, 7-4477

Erika K. Lunder
Legislative Attorney
elunder@crs.loc.gov, 7-4538

²¹⁵ For example, if the contractor is operating at a loss, handling a reduction under the changes clause, rather than as a partial termination for convenience, could be beneficial because the termination settlement would be adjusted to reflect the loss, while an equitable adjustment pursuant to the changes clause includes reasonable overhead and profit on the changed work, regardless of whether the contractor was performing at a loss. *See, e.g.,* Roscoe Eng’g Corp., ASBCA 4820, 61-1 BCA ¶ 2,919 (termination settlements); G&M Elec. Contractors, Inc., GSBCA 4771, 78-2 BCA ¶ 13,452, *motion for recons. denied*, 79-1 BCA ¶ 13,791 (adjustments). In contrast, contractors cannot recover excess costs under the change clause, but they could do so in some cases, particularly with respect to unchanged work, under the termination for convenience clause. *See, e.g.,* Nolan Bros., Inc., ASBCA 4378, 58-2 BCA ¶ 1,910.

²¹⁶ *Compare* Cottrell Eng’g Corp., ENGBCA 3038, 70-2 BCA ¶ 8,462 (permitting a contingency factor for the contractor’s potential liability resulting from the performance of hazardous work) *with* C.F. Bean Corp., ENGBCA 4537, 86-3 BCA ¶ 19,283 (refusing to include a contingency for weather in an adjustment being made after the work was accomplished).

²¹⁷ The collective impact of government actions upon contractors is another question, beyond the scope of this report. *See, e.g.,* Charles S. Clark, Contractors Respond Warily to Pentagon Vow to Preserve Industrial Base, *Gov’t Exec.*, Feb. 8, 2012, available at <http://www.govexec.com/contracting/2012/02/contractors-respond-warily-pentagon-vow-preserve-industrial-base/41138>.