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Comptroller General
of the United States
Washington, D.C. 20548

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Decision

Matter of: Southwest Laboratory of Oklahoma, Inc.

File: B-251778

Date: May 5, 1993

Sally B. Pfund, Esq., Williams & Jensen, P.C., for the protester.
Ken R. Olson and Loni Saatkamp for Data Chem Laboratories, an interested party.
Anthony G. Beyer, Esq., Environmental Protection Agency, for the agency.
Behn Miller, Esq., Ralph O. White, Esq., and Christine S. Melody, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

DIGEST

1. Protest that solicitation lacks consideration for government's right to terminate contract for convenience prior to ordering the specified minimum quantity in an indefinite quantity contract is denied where the solicitation incorporates a termination for convenience clause which by its terms obligates the government to pay the contractor for its costs of standing ready to perform the contract.

2. Clause providing that "should the government fail to affirmatively terminate for convenience then the contractor agrees that the [g]overnment's failure to order the minimum quantity shall be treated as a termination for convenience" is improper--and renders the solicitation defective--since government may not reserve to itself the right to constructively terminate for convenience after expiration of the contract performance period.

DECISION

Southwest Laboratory of Oklahoma, Inc. protests the terms of invitation for bids (IFB) No. D201845R1, issued by the Environmental Protection Agency (EPA) for chemical analytical services for multi-media (i.e., soil, water), multi-concentration inorganic chemical compounds found in samples taken from hazardous waste sites. Southwest contends that the IFB is defective because it contains a clause that improperly reserves to the agency the right to ignore the stated minimum quantity in an indefinite quantity contract.

We sustain the protest.

BACKGROUND

The IFB, issued November 25, 1992, contemplates the award of a 30-month, fixed-price, indefinite quantity contract for one to ten bid lots of laboratory sample services, which are analogous to contract line items. The majority of laboratory samples analyzed under this contract will be collected from known or suspected hazardous waste sites nationwide as part of EPA's enforcement of the Comprehensive Environmental Response, Compensation and Liability Act of 1980, which established a "Superfund" for the clean-up of such sites. See 42 U.S.C. §§ 9601 et seq. (1988).

Under the IFB, the successful contractor will be required to "maintain an acceptable level of technical and management capabilities (personnel, facilities, equipment and systems) . . . throughout the period of contract performance" in order to analyze samples for the presence of 23 elements and cyanide. Each bid lot sets forth a minimum quantity of 480 samples and a maximum quantity of 4,800 samples. The IFB also provides that EPA will purchase a minimum of 1, and a maximum of 10, bid lots. Paragraph B.5.1 further states that "[t]he minimum number of samples which the [g]overnment is obligated to purchase under this contract is 480."

This IFB also includes a solicitation clause used by EPA since 1986 in its indefinite quantity contracts, paragraph B.5.5, which states:

> "If the [g]overnment fails to order the minimum sample quantity as specified in the contract, the [g]overnment reserves the right to terminate for convenience. Should the [g]overnment fail to affirmatively terminate for convenience, then the contractor agrees that the [g]overnment's failure to order the minimum quantity shall be treated as a termination for convenience."

The inclusion of this clause is the basis for Southwest's protest.

DISCUSSION

In its protest, Southwest challenges both features of paragraph B.5.5--i.e., the first sentence of the clause, which reserves to the government the right to terminate the contract for convenience if the agency fails to order the stated minimum quantity; and the second sentence of the clause, which obligates the contractor to agree in advance that the agency's failure to order the minimum quantity will

be construed as a termination for convenience regardless of whether the agency affirmatively terminates the contract. According to Southwest, paragraph B.5.5 renders the solicitation defective because it effectively eliminates the minimum quantity obligation set forth elsewhere in the solicitation. In essence, Southwest contends that EPA has improperly reserved to itself the right to ignore the minimum quantity obligation at any time it chooses.

EPA's Right to Terminate Without Ordering the Minimum Quantity

Southwest argues that the first sentence of paragraph B.5.5--reserving the right to terminate for convenience in the event the agency fails to order the minimum quantity --effectively nullifies the agency's promise to purchase a minimum quantity stated elsewhere in the IFB.[1] Therefore, Southwest concludes that the solicitation lacks the required mutuality of obligation needed to form a contract between two parties. In Southwest's view, if the agency can terminate the contract prior to purchasing the minimum quantity, its promise to purchase a minimum number of samples is illusory.

A stated minimum quantity in an indefinite quantity contract operates to commit the government to ordering a predetermined minimum amount of goods or services where the government's need for any greater quantity is uncertain. FAR § 16.504(b). As such, the minimum quantity forms the consideration for such a contract instrument, and without a minimum quantity there is no binding contract. See Willard, Sutherland & Co. v. United States, 262 U.S. 489 (1923). However, because of the unique requirement that the government act in the interest of the society it serves, it retains a special power to terminate its contract obligations when such action serves the public interest. See United States v. Corliss Steam-Engine Co., 91 U.S. 321 (1876); Torncello v. United States, 681 F.2d 756 (Cl.Ct. 1982). In our view, this power rests like a mantle over all the other contractual provisions in any government contract

[1]Even without paragraph B.5.5., the solicitation already includes the government's right to terminate the contract for convenience by referencing the standard termination for convenience clause set forth at Federal Acquisition Regulation (FAR) § 52.249-2. In this regard, the termination clause provides that the government "may terminate performance of work under this contract . . . if the [c]ontracting [o]fficer determines that a termination is in the [g]overnment's interests."

and can be summoned during the period of contract performance at any time events require such action.[2]

As explained by the court in Torncello, the termination for convenience doctrine originated as a wartime concept, providing the government a way to avoid the continuance of contracts which the cessation of hostilities had rendered "obsolete or useless." 681 F.2d at 765. By incorporating a termination for convenience clause into the contract, the government could terminate a contractor's performance and settle with the contractor for any performance it had rendered. Id. at 765-766. Thus, the clause's specific purpose--as it has evolved from its wartime origins--is "to allocate the risk of a change in the circumstances of the bargain or the expectation of the parties." Id. at 766.

To the extent that the minimum quantity generally forms the consideration for an indefinite quantity contract, we agree with Southwest that any deviation--such as the government's termination of the contract prior to ordering the minimum quantity--must also be supported by some binding consideration evident from the face of the contract. Id. at 768-770, 772 (the government may "draft for itself some method of exculpation so long as it binds itself to something that will support the contract"). Here, the solicitation contains the standard termination for convenience clause set forth at FAR § 52.249-2, and we conclude that the reimbursement provided to the contractor under that clause in the event of a termination for convenience is adequate consideration.

FAR § 52.249-2 provides that in the event the government terminates a contract for convenience, the government is obligated to pay the contractor its costs of performance incurred up to the time of termination, certain continuing costs, its settlement expenses, and an allowance for profit. The relevant portions of this clause provide:

> "(e) . . . the [c]ontractor and the [c]ontracting [o]fficer may agree upon the whole or any part of the amount to be paid because of the termination. The amount may include a reasonable allowance for profit on work done. . . .

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[2]In fact, the power to terminate is such an intrinsic part of the government's contractual authority, that courts have held it must be considered part of every contract awarded by the government. See G.L. Christian & Assoc. v. United States, 312 F.2d 424 (Ct.Cl. 1963).

"(f) If the [c]ontractor and the [c]ontracting [o]fficer fail to agree on the whole amount to be paid because of the termination of work, the [c]ontracting [o]fficer shall pay the [c]ontractor the amounts determined by the [c]ontracting [o]fficer as follows . . .

"(1) The contract price for completed supplies or services accepted by the [g]overnment . . .

"(2) The total of--
(i) the costs incurred in the performance of the work terminated, including initial costs and preparatory expense allocable thereto . . .
(ii) The cost of settling and paying termination settlement proposals under terminated subcontracts that are properly chargeable to the terminated portion of the contract if not included in subdivision (i) above; and
(iii) A sum, as profit on subdivision (i) above, determined by the [c]ontracting [o]fficer under 49.202 of the [FAR], in effect on the date of this contract, to be fair and reasonable . . .

"(3) The reasonable costs of settlement of the work terminated, including--
(i) Accounting, legal, clerical, and other expenses reasonably necessary for the preparation of termination settlement proposals and supporting data;
(ii) The termination and settlement of subcontracts (excluding the amounts of such settlements); and
(iii) Storage, transportation, and other costs incurred, reasonably necessary for the preservation, protection, or disposition of the termination inventory."

FAR § 52.249-2(h) also incorporates by reference the cost principles in FAR part 31, including § 31.205-42, which acknowledges that "[c]ontract terminations generally give rise to the incurrence of costs or the need for special treatment of costs that would not have arisen had the contract not been terminated" and which set forth specific "cost principles peculiar to termination situations [which] are to be used" in calculating termination settlements. As

specified in FAR § 31.205-42, a contractor is entitled to be reimbursed for:

> "(b) Costs continuing after termination . . . [which] [d]espite all reasonable efforts by the contractor . . . cannot be discontinued immediately after the effective date of termination . . . .
>
> "(c) Initial costs . . . including starting load and preparatory costs . . . .
>
> "(d) Loss of useful value . . . [for] special tooling, and special machinery and equipment . . . .
>
> "(e) Rental under unexpired leases . . . [which is] shown to have been reasonably necessary for the performance of the terminated contract . . .
>
> "(f) [The contractor's] [a]lterations of leased property [costs] . . . [which] were necessary for performing the contract.
>
> "(g) Settlement expenses . . . including . . .
> (i) Accounting, legal, clerical, and similar costs reasonably necessary for--
> (A) The preparation and presentation, including supporting data, of settlement claims to the contracting officer; and
> (B) The termination and settlement of subcontracts.
> (ii) Reasonable costs for the storage, transportation, protection, and disposition of property acquired or produced for the contract.
> (iii) Indirect costs related to salary and wages incurred as settlement expenses . . . .
>
> "(h) Subcontractor claims . . . including the allocable portion of the claims common to the contract and to other work of the contractor . . . ."

Thus, by incorporating FAR § 52.249-2 into the solicitation, EPA has clearly offered consideration to support its right to terminate the contract prior to ordering the specified minimum quantity. Under these circumstances, where an IFB provides a stated minimum quantity, and provides that in the event that the government terminates for convenience prior to ordering the specified minimum the government will reimburse the contractor for the costs described above, we conclude that there is adequate consideration for terminating an indefinite quantity contract prior to ordering the stated

minimum. Accordingly, we see no basis for objecting to the first portion of clause B.5.5.

Availability of Constructive Termination Where Agency Fails to Order the Minimum Quantity

In the second sentence of paragraph B.5.5, EPA seeks advance agreement from its potential contractors to construe any failure by the agency to order the minimum quantity as a termination for convenience, even though the agency issues no such affirmative termination. As explained below, we agree with Southwest that this provision seeks to convert a breach of contract by EPA into a termination for convenience in contravention of the decision of the United States Court of Appeals for the Federal Circuit in Maxima Corporation v. United States, 847 F.2d 1549 (Fed. Cir. 1988). See also PHP Healthcare Corp., ASBCA No. 39207, Dec. 28, 1990, 91-1 BCA ¶ 23,647. Accordingly, the provision is improper and the solicitation defective.

At issue here is whether the government can take no action--and issue no affirmative termination--and at the same time be found to have constructively terminated its agreement prior to the time the agreement expires. In both Maxima and PHP, agencies sought to retroactively assert termination for convenience rights after the expiration of an indefinite quantity contract where the agency had breached the contract by failing to purchase the minimum quantity. In each case, that although the government was aware that it had not complied with its minimum quantity obligation during the contract's performance period--and knew that its needs had changed--it never affirmatively terminated the contract for convenience during the period of performance. Rather, the government allowed the contract to expire, and then attempted to retroactively--and thereby constructively--terminate the contract.

Both the Federal Circuit and the Armed Services Board of Contract Appeals (ASBCA)--relying on the holding in Torncello that the government cannot use the termination for convenience clause to exculpate itself from liability for breach--held that the termination for convenience clause does "not authorize unilateral renegotiation of a contract after it has been fully performed." Maxima Corporation, 847 F.2d at 1555; PHP Healthcare Corp., 91-1 BCA ¶ 23,647 at p. 118,451. Rather, both forums stated that the clause "is not an open license to dishonor contractual obligations." Maxima Corporation, 847 F.2d at 1553; PHP Healthcare Corp., 91-1 BCA ¶ 23,647 at p. 118,451. In the words of the ASBCA, "[e]xpiration of the basic performance period is the demarcation line." PHP Healthcare Corp., 91-1 BCA ¶ 23,647 at p. 118,451.

As a practical matter, an indefinite quantity contractor is obligated to stand ready to provide an uncertain quantity of goods and services the government will require--within preestablished limits--from the time of award until the time the contract expires. FAR § 16.504(a). At any point during that period, the government has the right to place an order with the contractor, and the right to expect that the order will be filled at the agreed-upon price.

The impropriety evident in the second sentence of paragraph B.5.5 is that the government does not actually exercise its right to terminate the contract. The terms of EPA's indefinite quantity contract require a minimum number of samples. Yet, with no communication pursuant to the termination for convenience clause, the government would claim the same rights when it breaches this contractual obligation as if it had complied with the termination clause. It is only when the contract period expires, and the government has breached its obligation to order the minimum quantity, that the contractor learns that the government will not honor its obligation to procure the minimum quantity. Thus, in our view, paragraph B.5.5 necessarily violates the requirement that an agency must affirmatively terminate for convenience prior to the end of performance and not after.

It is not clear from the record whether EPA drafted the challenged clause in order to minimize its damages from an occasional failure to monitor contract performance (resulting in a breach of contract) or in order to revise more generally its obligations under the standard provisions of indefinite quantity contracts. FAR § 16.504 (a) requires such contracts to state minimum quantities of supplies or services that the government must buy and the contractor must provide. One way in which EPA could achieve its goal of limiting its damages for breach of indefinite quantity contracts would be to change the nature of the minimum obligation, creating a contract in which the government is obligated to either order a minimum or pay the contractor necessary consideration such as that available under a termination for convenience. However wise or unwise such an instrument might be, it would require either revision of the applicable regulation or authority under the FAR deviation procedures set forth in FAR subpart 1.4. IBI Sec. Serv., Inc., 69 Comp. Gen. 707 (1990), 90-2 CPD ¶ 205, aff'd and modified, General Services Administration--Recon., B-239569.2, Feb. 13, 1991, 91-1 CPD ¶ 163; Burroughs Corp., 56 Comp. Gen. 142 (1976), 76-2 CPD ¶ 472, aff'd, Honeywell Info. Sys., Inc., B-186313, Apr. 13, 1977, 77-1 CPD ¶ 256; Lecher Constr. Co., B-224357, Sept. 30, 1986, 86-2 CPD ¶ 369.

CONCLUSION AND RECOMMENDATION

Under Torncello, Maxima, and PHP, the termination for convenience clause does not confer upon the government a unilateral right to abandon its contractual obligations after the period of contract performance has expired. Since we find that the second sentence of paragraph B.5.5 improperly attempts to modify the resulting contract after the contract period has expired, we recommend that EPA amend the IFB to delete the second sentence of paragraph B.5.5. We also find that Southwest is entitled to recover the costs of filing and pursing this protest, including reasonable attorneys' fees. 4 C.F.R. § 21.6(d) (1993).

The protest is sustained.

Milton J. Socolar

Acting Comptroller General
of the United States