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Legal Sidebar

The Government's Broad Power to Terminate Procurement Contracts

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The scope and limits of the federal government's power to terminate procurement contracts is a topic of recurring interest to Congress, federal contracting officers, and federal contractors. As discussed below, the federal government's authority to terminate contracts for its own convenience is quite broad, but not limitless. Courts have generally upheld the federal government's authority to terminate procurement contracts when it is in the government's best interest, without finding the government liable for breach of contract except when a contractor can meet the very high bar of showing that the government acted in bad faith. This Legal Sidebar provides background on the federal government's authority to terminate procurement contracts for its convenience and then explores the limits of that power.

Background on Terminations for Convenience

The federal government enters into hundreds of billions of dollars in contracts for the acquisition of goods and services every year. The complexity of these acquisitions runs the gamut, with services ranging from the provision of housekeeping services and standard office supplies to the launching of a satellite to establish a planetary defense system. Evolving federal interests—such as shifting executive priorities brought on by a change in presidential Administrations and unforeseen events like pandemics, natural disasters, acts of war, and cyberattacks—can substantively alter federal acquisition priorities.

Federal procurement law is designed to provide agencies with the flexibility necessary to adapt to these and other issues that might arise during the procurement contract life cycle. As discussed in this CRS Legal Sidebar, federal law often requires the incorporation of a number of standard clauses into federal procurement contracts—such as Changes, Stop-Work Order, and Excusable Delays clauses—that the government may exercise to adapt to changed circumstances and evolving needs. Arguably the most considerable of these legal tools is the government's right to terminate contracts unilaterally for its own convenience.

Termination for convenience refers to the exercise of the federal government's right to require contractors to halt performance of all or part of the work stipulated by a contract before the contract's expiration "when it is in the Government's interest."

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The federal government's right to terminate contracts for convenience developed from Civil War-era actions designed to allow the government to avoid unnecessary expenditures after the cessation of hostilities. Although these contracts did not expressly include the government's right to terminate contracts, the U.S. Supreme Court nonetheless concluded that agency terminations were legally permitted. The Court reached this conclusion, in part, based on the understanding that "it 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."

Eventually, federal procurement regulations were put in place that generally require federal agencies to include express termination clauses in procurement contracts. A commonly required termination for convenience clause states:

> The Contracting Officer, by written notice, may terminate this contract, in whole or in part, when it is in the Government's interest. If this contract is terminated, the Government shall be liable only for payment under the payment provisions of this contract for services rendered before the effective date of termination.

While most federal procurement contracts include a termination for convenience clause, there are exceptions. For example, General Services Administration (GSA) leases frequently do not incorporate termination for convenience clauses due to the market dynamics for real property leases. Instead, the termination clauses in GSA leases are often specifically negotiated between the parties and typically authorize the government to terminate the lease only after a fixed term of months.

Federal courts—including the Court of Federal Claims, which has jurisdiction over federal procurement contract disputes—and various administrative boards of contract appeals have broadly construed what is "in the government's interest" for a proper exercise of termination of convenience clauses. These interpretations encompass, among other situations, terminations when the agency no longer needs the goods or services; when necessary to remedy an erroneous contract award; when "the business relationship between the parties was ruined"; when the agency decided to change course and use federal employees to perform the contracted duties; when the cost of a contract exceeds expectations; and when contract performance proves "impossible or too difficult."

When a contracting officer notifies a contractor that the government is exercising its rights under a termination for convenience clause, the contractor must, among other things, immediately stop performing the terminated portion of the contract and terminate any subcontracts related to the terminated work. The contractor must also inform the contracting officer of any activities that cannot be immediately halted.

While exercising the right to terminate a contract for convenience allows the government to reduce waste associated with the purchase of supplies or services it no longer needs, a termination for convenience generally does not absolve the government of all liabilities under the terminated contract. The government is typically liable to the contractor for costs, including reasonable profits, for the portion of the contract already performed; certain costs incurred in anticipation of performance; and costs associated with terminating the contract. The government's liability for terminating for convenience, however, is more limited than what would be applicable to a non-sovereign party that unilaterally terminates a contract without cause, which would typically be a breach of contract that could subject the party to liability for compensatory damages, liquidated damages, or other forms of relief.

Limits on Terminations for Convenience

The government has wide latitude to terminate contracts when it determines the termination is in its best interest. The U.S. Court of Appeals for the Federal Circuit (Federal Circuit) has stated that, "[i]n the absence of bad faith or clear abuse of discretion, the contracting officer's election to terminate for the

government's convenience is conclusive." Plaintiffs have only rarely succeeded in showing that, in terminating the contract, the government acted in bad faith or clearly abused its discretion. In those circumstances, which are discussed below, the termination will be considered a breach of contract, and plaintiffs may be awarded anticipatory profits. Courts and boards of contract appeals have also occasionally held that the government improperly purported to terminate contracts for convenience without finding a breach, for example, when the contract was fully performed and the government purported to terminate the contract retroactively to avoid certain costs under the contract. In general, however, the few instances in which the government has been held liable for breach of contract for the way it terminated a contract have typically involved governmental bad faith.

Abuse of Discretion

When assessing whether the government abused its discretion, courts and boards of contract appeals evaluate four general factors. These factors are not specific to terminations for convenience, but are rather generally applicable factors that can be relevant to determining whether activities are arbitrary and capricious and amount to an abuse of a government official's discretion. The factors are (1) whether the government engaged in bad faith when terminating the contract, such as by favoring one contractor to the prejudice of another; (2) whether there was a reasonable basis for the government to terminate the contract; (3) the extent to which the terminating official had discretion to make the decision; and (4) whether, in terminating the contract, the terminating official violated any laws or regulations.

Showing that a contracting official abused his discretion in exercising a termination for convenience is difficult for several reasons. As discussed more fully below, courts have imposed a very high evidentiary bar to show bad faith in this context because courts presume that government officials act in good faith. Regarding factors two and three, as previously mentioned, the courts have recognized that the government has broad discretion in determining when terminating a contract is in its best interest, making it difficult for a plaintiff to prove that the government lacked a reasonable basis for the termination. Finally, under the fourth factor, most federal contracts are required by law or regulation to include termination for convenience clauses, so the exercise of these clauses will not commonly violate a law or regulation.

Bad Faith

In order to prevail on a claim of bad faith, plaintiffs must overcome the presumption that government officials act in good faith. This is a very high bar to overcome. The courts are "loath to find to the contrary [of good faith], and it takes, and should take, well-nigh irrefragable proof to induce us to do so." The courts have clarified that this "well-nigh irrefragable" proof standard is akin to clear and convincing evidence. Clear and convincing evidence is "evidence which produces in the mind of the trier of fact an abiding conviction that the truth of a factual contention is *highly probable*" (emphasis in original). To meet this burden, courts generally have required a showing that the government acted with animus toward or with an intent to injure the plaintiffs.

For example, the Federal Circuit has held that the government acted in bad faith and in breach of contract when it entered into a contract with no intent of actually honoring it. That plurality decision, *Torncello v. United States*, involved a maintenance contract that the Navy entered into with the plaintiff company knowing at the time that it could get the same services more cheaply from a different vendor. The Navy, ultimately, did not make any orders under the contract with the more expensive company, instead relying exclusively on the cheaper contractor. When the plaintiff contractor complained that the Navy was failing to uphold its obligation in breach of contract, the Navy argued that its failure to make orders under the contract amounted to a constructive termination for convenience. Although the Federal Circuit has since disagreed with the reasoning of the *Torncello* plurality opinion, the court has repeatedly agreed with the holding in that case. The Federal Circuit has explained:

> [*Torncello*] stands for the unremarkable proposition that when the government contracts with a party knowing full well that it will not honor the contract, it cannot avoid a breach claim by adverting to the convenience termination clause.

The United States Civilian Board of Contract Appeals (CBCA) reached a similar conclusion in *Sigal Construction Corp. v. General Services Administration*. In that case, GSA entered into a contract with Sigal for various construction projects. While Sigal was performing the contract, a GSA employee contacted another contractor to perform portions of what GSA had contracted Sigal to perform. GSA then prevented Sigal from performing that portion of the contract. The CBCA concluded that, in so doing, GSA had constructively terminated part of Sigal's contract for convenience. The CBCA held

> One of the few limitations on the Government's right to terminate for convenience is that the Government may not terminate simply to get a better price for performing needed work. That is what GSA did here. It was a breach of contract. (internal citations omitted)

Sigal was thus entitled to an award for anticipatory profits.

Considerations for Congress

As the preceding discussion makes clear, the federal government has broad discretion to terminate most procurement contracts for its convenience without suffering legal liability for breach of contract. If Congress wishes to change the status quo, it could pass legislation designed to limit the permissible reasons for terminating contracts (or a class of contracts) or that requires or encourages federal agencies to incorporate contract terms that would require additional compensation to contractors in the event that a contract is terminated for convenience. Alternatively, Congress might desire to strengthen federal agency authority in this space even further by, for instance, statutorily barring the availability of breach remedies even when an agency terminates a contract in bad faith or in an abuse of discretion.

GSA maintains data on most federal contract awards in the publicly accessible Federal Procurement Data System (FPDS) database. When a procurement contract is terminated, its status as such is eventually updated in FPDS. Congress can use FPDS data to aid its oversight of executive branch agency contract terminations. Congress might also consider enacting additional transparency measures to aid its oversight of termination actions by, for instance, requiring agencies to notify congressional committees of jurisdiction within a specific number of days before or after the terminations of all contracts or of specific classes of contracts (e.g., those above a certain monetary threshold).

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