COMPARATIVE STUDY OF TERMINATION ARTICLES IN GOVERNMENT WAR CONTRACTS

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The starting point for attorneys in matters concerning the termination of Government war contracts lies in the termination articles, if any, that are contained in the contract. While it is true that many war contracts will, at the time of termination, contain the so-called Baruch article in the case of terminations for the convenience of the Government, there are thousands of prime contracts and many thousands more of subcontracts which will not, for one reason or another, contain this article at the time the Government or the prime contractor desires to “terminate” the contract. Where this

*The article is in no way to be construed as the opinion of the War Department or of any federal agency—Ed.

Those unfamiliar with the subject of termination of war contracts may find a helpful over-all introduction to the subject in my Termination of War Contracts, Nov.-Dec. 1944 Col. L. Rev. and with regard to the matter of current Government policies in the field, my Principles of War Contract Termination, Jan. 1945 JOURNAL OF BUSINESS.

The “basic” documents which are a minimum to a study of the subject are: Contract Settlement Act of 1944, P.L. 395, 78th Cong., 2d sess. (July 1, 1944 effective July 21, 1944). For the legislative history of the Act see: J. E. Murray, Contract Settlement Act of 1944, (1944) 10 LAW AND CONTEMP. PROB. 683.


Treasury Department, T.D. 5,000, as approved by the Secretary of War, August 6, 1940.

War Department Pamphlet No. 34-2. Contractor’s Guide (Suggestions for War Contractors as to methods of and preparation for Contract Terminations applying to Fixed Price Supply Contracts of the War Department) dated June 1, 1944, pp. 48.

Office of Contract Settlement Regulations, issued seriatim.

While the War Department publications just listed apply only to War Department contracts, the other services tend to follow them in detail.

The “legal” bibliography on the subject is collected in my Col. L. Rev. article cited earlier in this note. On the narrower subject of termination articles, the references are: D. S. Frey. Contract Defaults and Cancellation in Wartime, (1943) 38 YLS. L. REV. 167. D. A. Goldman. Termination of War Department Contracts at the Option of the Government, (1944) 42 MICH. L. REV. 735, especially at pp. 742 to 748 and 763 to 772.

*At the outset, it is important to notice that the term “termination of contract” is habitually used very loosely. Actually, the work under the contract is terminated, not the contract itself.
situation prevails, the first problem to confront the contractor, and perhaps the most important problem in which the contractor must lean heavily on his attorney for advice, will be action on the request by the Government to amend the contract to insert the Baruch article. This request follows close on the heels of the termination notice itself. Practically all the existing literature on terminations assumes that the termination is being affected under the Baruch article and the Joint Termination Regulation is almost entirely directed to this situation. However, this paper is directed to an analysis of the comparative advantages and disadvantages of the various termination articles which the contractor may discover in his contract at the time of termination.

Outline of Possible Contractual Situations at the Time the Government Attempts Termination

I If the Government desires termination for default,
A) and the contract contains the standard “Delays-Damages” article, what are the remedies available?
B) if the contract does not contain that article, what “common-law” remedies are available?
C) how is the situation affected by the presence or absence of an article permitting termination for the convenience of the Government?
D) how are the contractual rights of the Government further limited as a matter of policy by regulation?

II If the Government desires termination for convenience
A) in the case of fixed-price contracts
   i) what are the rights of the parties if the contract is completely silent on termination?
   ii) what are the rights of the parties if the contract
       a) contains one of several articles providing for “formula” settlement?
       b) contains the so-called “standard” negotiated settlement article of the War Department?

As directed by JTR-213.

The present discussion, in turn, is not concerned with other legal questions, e.g., whether there is a valid contract, whether defects can be cured, the authority of the Contracting Officer, etc.
c) contains the so-called "uniform" negotiated settlement article (Baruch-Hancock)?

d) contains the "letter contract" article?

iii) how are the contractual rights of the Government affected as a matter of policy by regulation and subsequent legislation?

B) in the case of CPFF contracts

i) same as A) i) above

ii) what are the rights of the parties if the contract contains the "standard" CPFF termination article?

   a) so-called "Ordance" form
   b) so-called "AAF" form
   c) new "JTR" form
   d) "letter contract" form

iii) same as A) iii) above

III If the prime contractor desires to terminate subcontracts, how is his position affected in relation to the subcontractor by his actual or potential contractual relation with the government? Some of the "legal" factors are:

A) whether the prime is a fixed-price or CPFF contract and the type of termination article, if any, that it contains,

B) whether the subcontract is a fixed-price or CPFF contract and the type of termination article, if any, that it contains,

C) whether the subcontractor will accept the "little" Baruch article,

D) whether default of the prime or of the subcontractor is involved

Further, the likelihood of litigation in a termination case is certainly not insignificant. Of 25,000 War Department contracts terminated in World War I and involving settlement questions, better than 3,000 found their way into the dockets of the Court of Claims alone, to say nothing of other courts and of intra-departmental appeals. With an estimated 240,000 War Department prime contracts and at least 1,000,000 significant subcontracts under those primes involved in World War II, the number of cases to reach the courts is likely

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to be greater this time.\footnote{As of September 30, 1944, there already had been 29,788 terminations of War Department contracts alone, totalling $16.9 billions in estimated contract price of items cancelled. "Terminations" includes both "partial" and "total" terminations. \textit{Monthly Status Report, sec. 14A, Contract Terminations, Army Service Forces, War Department, September 30, 1944.}} This is particularly true in view of the much greater amount of subcontracting in the present war.

Also, at the outset, it is important to note that the rights of the contractor, whether prime or sub, to the various forms of interim financing provided by the \textit{Contract Settlement Act of 1944}\footnote{Sections 8 to 10. The same is true of the 60-day plant clearance rule set up in Section 12c. The complete citation of the Act appears in Note 1.} are not affected (at least in theory) by the contractor's decision whether to amend his contract to incorporate the Baruch clause. As a practical matter, however, the degree of cooperation which the Government extends on interim financing may be affected by the attitude of the contractor towards amending his contract.

\textit{Terminations for Default}

The standard "Delays-Damages" article\footnote{The present standard "Delays-Damages" article dates from September 5, 1942 when it was specified by Procurement Regulation 3, paragraph 352 and is derived from the "Delays-Damages" article of the War Department Supply Contract Form No. 1, approved by the Under Secretary of War September 16, 1941.} in a fixed-price contract under which any Government action for default of the contractor is taken, is a carryover from peace-time standard Government forms and substantial variations arise principally 1) due to the shift away from liquidated damages, 2) with regard to the excepted reasons for delay, which have changed from time to time 3) due to change in policy with regard to performance bonds for war contracts and 4) due to changes in the regulations governing the exercise of the Government's right to default.

The problems of war-time procurement present difficulties at many points. Contractors are without cost data to furnish quotations, sometimes being entirely lacking in experience in production of war-time materiel and almost invariably lacking in mass production experience with regard to such materiel. Labor and materiel procurement difficulties undermine estimates. Frequent and immediate changes in design\footnote{See my \textit{Principles of War Contract Termination}, Jan. 1945 \textit{Journal of Business}, section on "Inventories." and H. T. Lewis and C. A. Livesey, \textit{Materials Management in the Airframe Industry}, \textit{Harv. Bus. Rev.} 477 (Summer, 1944).} disrupt whatever planning can be made. Without detailing the difficulties, it can be seen that one of the first points at which the contractor will react will be the contractual provisions govern-
ing default or delay and the resultant question of damages. Tied in immediately is the question of performance bonds.

Since elaborate war controls exist in such matters as wages, priorities, prices, etc., many of the main reasons for performance bonds become less important, particularly when the Government has alternative sources of supply and the right to commandeer. In the interests of speed and to stimulate entrepreneurial action, the performance bond requirement was early dropped\(^\text{10}\) though such a requirement can still be employed in unusual cases.

The elimination of the performance bond only served to intensify the spotlight on questions of default. In peace-time procurement, the Government had employed a "Delays-Liquidated Damages" article. The scope of definition of excepted delays followed general commercial practice. The provision for liquidated damages rather than actual damages served several functions. The damages were reduced to certainty, eliminating the red tape and dangers inherent in settling unliquidated Government claims. At the same time, by a proper gearing of the rate of liquidated damages (usually on a per diem basis), the desired coercion to performance could be exerted on the contractor.

Both the contractor and the Government had reasons for desiring changes in this article. From the contractor's viewpoint, a clearer and broader definition of excepted delays was imperative.\(^\text{11}\) The contractor wanted some of the "unforeseeable" causes of delay definitely expressed and excepted. Delays by subcontractors, delays due to priorities or inability to procure due to maximum prices, delays due to drafting of labor, etc. were specified as excepted delays. In its turn, the Government was aware that while time in war is of the essence and "actual" damage is highly problematical when human lives are at stake in combat, yet the liquidated damage provision

\(^{10}\) By Act of April 29, 1941, c. 81, 55 Stat. 147, 40 U.S.C.A. §270c, the performance bonds required by Act of August 24, 1935, P.L. 321, 74th Cong., 49 Stat. 793, 40 U.S.C.A. §270 (commonly called the Miller Act) amending Act of August 13, 1894, 40 U.S.C.A. §270 (commonly called the Heard Act) are waived for war contracts in the discretion of the Secretary of War or Navy. This discretion in turn was delegated to the Chiefs of Supply Services by War Department Procurement Circular No. 55, dated July 15, 1941, section 1, which now appears in Procurement Regulation 4.

\(^{11}\) Statutory immunity from delays due to preference, priority and allocation orders was granted by the Second War Powers Act, Act of May 31, 1942, 55 Stat. 236. That the contractors' fears about narrow construction of default excuses and exceptions were not visionary is established by a recent decision holding that in the phrase "unforeseeable delay" in the "Delays Damages" article, the adjective "unforeseeable" modified each exception set out in the list following "including." Thus fires, strikes, etc. must be "unforeseeable" to be valid excuses for default. United States v. Brooks-Calloway Co., 318 U.S. 120, 63 S.Ct. 474 (1943).
was not desirable. The use of a "blacklist" of defaulted contractors would provide coercion. Substitute procurement would furnish a measure of damages. In addition, the Government desired alternative remedies: 1) to take over partially completed work and pay for it at cost; 2) where the situation was peculiar, to permit the contractor to continue but to assess damages against him; and 3) the aforementioned remedy of substitute procurement. The contractor was more interested in what would be ground for default; the Government more in what would be the result of a default.

But there remained an important question that was not settled: what happens to subcontractors in the event the prime is defaulted? The amount of subcontracting in the war program is tremendous. Further, for many reasons, primes have to contract with subs with whom they have had no prior business experience and with whom they may have no post-war contacts. This lack of prior relationship establishes added risks of default to both prime and sub. The risk on one side of the relationship is largely eliminated by excepting primes from liability for the delays of subs. While it can be argued that the risk of a sub in regard to his prime is much less than the reverse risk, nevertheless the sub is entitled to protection—and the Government is often interested in maintaining the sub in war work even if the prime is defaulted. A two-way attack on this problem of saving subs was made. By the alternative remedy (admittedly an expensive method if applied solely to save the sub rather than also to save time, labor and material) the Government could take and pay for, at cost, the work partially completed at the time of default. No contractual right to make direct payments to subs in this situation exists. Such a clause might have been inserted. Some primes may agree to this procedure, however, regardless of the absence of a contractual right in the Government. But if that avenue is not possible, the sub in his reliance on the general financial ability of the prime, may get a sweepstake ticket on the contents of the corporate cadaver after the Government has made its contribution or-demand, as the case may be, on the assets of the prime in bankruptcy.

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The second (and still indirect) effort to meet this difficulty is through the War Department Procurement Regulations on this point, which constitute the policy statements for the benefit of Contracting Officers as to when the Government will or will not exercise its contractual rights of default. By reserving these highly important rules of action for the Regulations rather than inserting them in the contract, the Government can change its attitude without the contractor's consent by relaxing or tightening so long as the effort is not to go beyond the contractual remedies. In these policy considerations, the position of the sub as a result of default of the prime is often a dominant factor although not expressly so stated, the regulations using general language under which other factors in the situation can also be considered.

This leads directly to the matter of the Regulations implementing the contract on the subject of default. Since all contracts in excess of $5,000 are required15 to have the “Delays-Damages” article, the scope in which the “common law” rules of contract can operate is considerably narrowed. The strictly legal problems are those of construction. There is, however, a field for potential litigation, e.g., a case involving the doctrine of anticipatory breach. As the war procurement program progressed and terminations for convenience came to receive more and more attention, contractors were quick to realize that while they were frequently in default, particularly in delivery schedules, and while the procurement agencies were slow in defaulting contractors, perhaps partly due to the dominant emphasis on getting things done, there was a danger that at the time of mass terminations for convenience, an effort might be made to “crack down” by calling defaults which had previously been condoned. This led to the insertion in the Termination for Convenience article of a provision16 restricting the right of the Government to terminate for default when the particular termination was one of a number of terminations covering a similar procurement or was incident to cessation of all or a part of hostilities. Then the default power can only be exercised if the default was 1) gross or willful and 2) caused substantial damage to the Government.

Reverting to the subject of Regulations, the policy governing action to default is stated in Procurement Regulations 379 and 380. When a default exists, the Contracting Officer has a choice of five actions:

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15 Required by Procurement Regulation 3, paragraph 352.
16 In Clause A of the “Termination for Convenience” article used after November 19, 1942.
1) find the contractor in default and follow one of the alternative remedies specified in the contract,

2) find the contractor in default and enter an agreement with the surety to complete the contract and pay damages (rare. since there are few war contracts with bonds),

3) find the contractor in default and excuse the default under certain conditions if the excuse will facilitate the war,

4) extend the time for performance if that was the ground for default,

5) terminate the contract for convenience despite the default if
   a) default was not gross or willful,
   b) default caused no substantial injury to the government,
   c) convenience termination will facilitate the war, and
   d) convenience termination would be more equitable under all the circumstances.

The difference in result between 3) and 5) is, of course, drastic. Under 3) the contractor loses costs and profit on work in process but escapes damages. Under 5) the contractor is paid costs and profit on work in process and also escapes damages. At best, the differences between the tests for two such different results are vague—and in view of the exercise of such jurisdiction by countless Contracting Officers, the application of the tests is bound to preclude contradiction. One of the cures for a lack of uniformity in contract construction was the introduction into the standard Government contract of the "Disputes" article under which the decision of the Contracting Officer in a dispute under the contract could be appealed to the Board of Contract Appeals where a modicum of uniformity might be achieved. The goal of uniformity has been vitiated in such matters as pertain to default policy by retaining the heart of such decisions in the Regulations, not in the contract.

The situation with regard to defaulting cost-plus-a-fixed-fee contracts is similar to that of fixed-price contracts in some respects. The

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17 Such action must be approved by the Director of Purchases, Army Service Forces, unless the Chief of a Technical Service finds one of the following (Procurement Regulations 3, paragraph 379):
   a. the Government no longer needs the supplies,
   b. the supplies can be obtained elsewhere on as favorable terms,
   c. on policy grounds less favorable procurement is desirable,
   d. excess cost of substitute procurement would be nominal,
   e. the contractor employs less than 100 workers or was recommended by the Smaller War Plants Unit and default would hinder war work.
Regulations apply in the same manner. With regard to the contract, that part of the default question concerning the excepted delays is couched in language similar to the fixed-price article but is housed in a separate article. That part of the default question concerning the remedies available to the government on default represents a departure and is housed in the article also covering terminations for the convenience of the Government. If the contract contains the CPFF termination article antedating that specified in the JTR of November 1, 1944, the default results in decreasing the fixed fee (profit) of the contractor on both the completed and the uncompleted work by 10% in the case of AAF contracts or in the amount of the unpaid balance of the fee in the case of Ordinance contracts, but all the allowable costs of the contractor are paid in either case. The article is silent as to any other remedies of the Government except that the Government has the right to take over the work in process (for which it has paid cost). If the contract contains the CPFF termination article specified in JTR-932, the contractor gets that proportion of the fee which the number of units delivered bears to the number called for under the contract, unless the chief of the service or bureau exercises the authority specified in footnote 4 to JTR-932 to insert an individual default provision.

Termination for Convenience Where Contract Contains No Termination Article at Time Government Attempts to Terminate

While there will be few contracts lacking a “Delays Damages” article due to the requirement that it be inserted in all contracts over $5,000, there will probably be a considerable number of contracts having no termination for convenience article because a larger situation, a precatory telegram is sent by the Government requesting suspension of work and an effort is made to amend the contract to include the latest form of termination article—the Baruch article. If the contractor rejects this article, a special agreement may be arrived at. If agreement cannot be arrived at JTR-214 (formerly

18 For brevity, the term “termination” hereinafter will be used narrowly, to include only terminations for the convenience of the Government. In such a

19 The principal instances (Procurement Regulation 3, paragraph 324) in which a termination article need not be inserted are contracts: a) under $50,000, b) over $50,000 but under $500,000 if deliveries do not run beyond six months, and c) if the contracts are “open.” Cf. Directive Order No. 2 of Office of War Mobilization dated February 24, 1944 (PR 15-1002).

20 JTR-214 (formerly PR 15-311).
PR 15-311) authorizes "breach of contract" or as will more often be the case, "anticipatory breach of contract." Such a position by a contractor may well work to his advantage since all of the various termination articles deny the contractor a profit on that part of the contract on which he had done no work whereas the common law rule of damages allows recovery of such profits.\(^1\)

"Formula" Termination Articles in Fixed-Price Contracts

Peace-time government contracts do not carry termination articles since the two main reasons for the article are not then present: 1) changes in strategical requirements and 2) total cessation of requirements. The use of termination articles in war contracts was initially prescribed in the present war by Army Regulation 5-140, paragraph 10 c (2) dated May 22, 1940 which was prior to July 1, 1942, the time when the procurement functions were removed from the scope of the Army Regulations and treated in a separate publication, the Procurement Regulations. The first termination article for fixed-price contracts drew upon the experience of World War I with termination articles and provided for a formula settlement which specified payment for completed work at the contract unit price but left for formula settlement the question of both costs of the work in process and profit thereon. Difficulties in the formula were not long in displaying themselves. The formula was somewhat altered at the time the War Department issued Contract Form No. 1 on September 16, 1941. The basic difficulty lay with the definition of the terms of the formula. Such matters as starting-load costs presented a different situation in every contract. In fact the situation changed radically with regard to the same contract depending upon the point at which termination should become operative. The results produced by the formula could best be described as fortuitous. The immediate changes in the article forced by business were 1) more specific definition of what costs were admissible in a termination settlement and 2) admission of all these costs and not application of the formula to determine what percentage of the costs would be paid.\(^2\) The formula

\(^1\) But if the contractor were operating at a loss under the contract, at common law he would recover no damages unless the reasonably foreseeable future of the contract would establish that there would be a profit. In such actions for breach, the ability to establish with reasonable certainty the amount of the damages may be a serious difficulty for the plaintiff. Under the termination article, however, the contractor would sustain the loss on the completed units but not on the work in process, receiving payment of all costs of the work in process though no profit.\(^2\) The earlier formula provided that the payment for uncompleted articles was
settlement of profit while still objectionable to business because of its fortuitous workings was considered a secondary matter at that time. As thus amended the formula provision continued by prescription of PR 324 until November 19, 1942. Many difficulties continued to make the formula unworkable. Unlike CPFF contractors who had daily familiarity with Government accounting, those working under fixed-price contracts had no experience with governmental accounting requirements. All vouchers submitted in a formula settlement are subject to approval by the General Accounting Office. Some contractors lacked the records necessary to prepare vouchers in the form required by the G.A.O. In any event, “finality” was lacking when the contractor considered he had reached an understanding with the Contracting Officer. Elaborate auditing requirements existed. While, under the contract’s “Disputes” article, in the event of disagreement by the Contracting Officer and the contractor, the contractor could take an appeal within the War Department, he could not be sure even after winning an appeal that his claim would clear the G.A.O. Delays could be interminable. And after all these obstacles were surmounted, the result could still be quite fortuitous, at least as to profit.

This led in November, 1942 to the introduction of the negotiated-settlement principle with a proviso that in the event negotiations break down, settlement would be by the formula. Thus the formula

to be that percentage of the contract unit prices established by the ratio of:

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\frac{\text{actual audited costs of uncompleted articles}}{\text{estimated total cost of uncompleted units if they were completed}}
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The later formula provides for payment of all audited costs of the uncompleted articles plus a profit which is determined as follows: the estimated profit if the uncompleted articles had been completed multiplied by the estimated percentage of completion of the uncompleted portion of the contract.

Without going into the language of the later formula, there is an ambiguity: does the phrase “uncompleted portion of the contract” mean all of the work specified in the contract which has not been finished (sometimes the part on which work has not been begun is called the “uncompleted portion of the uncompleted portion”) or does it mean that part of the work specified in the contract on which work has been started but which has not been finished.

From the general governmental policy of not paying “anticipated” profits (as repeatedly stated in JTR), it would seem that the latter meaning is the Government's interpretation, but even that policy does not argue against using the former meaning as a yardstick in this formula. But some aid is furnished (and perhaps the ambiguity is resolved) by the use of the phrase earlier in the article that the Government agrees “... to reimburse the contractor for his expenditures ... in respect to the uncompleted portion of the contract ...” As used in that phrase, the term “uncompleted portion of the contract” seems to mean that part of the contract on which work has been begun. This ambiguous language still persists in the Baruch article formula-settlement option.

Except, of course, the requirements of the Bureau of Internal Revenue and in many cases, the various price Adjustment Boards responsible for Renegotiation.
continues to have more than an historic interest. Assume that the contract at the time of termination has a formula article. To arrive at an intelligent decision whether to accept an amendment of the contract to include the negotiated settlement article in its latest form (Baruch article), the contractor must carefully examine both articles. Even if he finds that by the fortunes of the circumstances, he will gain a higher profit by the application of the formula due to the fact that the new form negotiated-settlement termination article contains a limitation on the profit that can be arrived at under the formula, there are a number of other factors that must be considered. First, even though the contractor desires formula settlement, it may still be to his advantage to accept the new negotiated-settlement article and go through the motions of negotiation and fall back on the formula in the new article because the formula in the new article specifies more exactly what costs are allowable and thus minimizes the contractor's risks as to cost disallowance (or in the event that his contract contains the formula which lumps costs and profit together for the formula, prevent fortuitous shaving of costs by the formula).

Second, in making his selection of termination articles, the contractor must consider his position with regard to Renegotiation. If, for one reason or another, the contract is not renegotiable, there are no problems. But if the contract is renegotiable, the contractor must consider whether he can keep some of his "freak" gains. While current Regulations permit the exemption of termination settlements from renegotiation, the policy is definitely against exemption, though curiously enough the initial impetus for this policy appears to have come from contractors.

If after these considerations, the contractor is undecided, his study of the various articles of the contract places him at an advantage in giving negotiations a fling. He has a bargaining tool in his knowledge. One peculiarity of war procurement may prove to be quite significant. Many corporations, for various reasons, sought to handle war work through a corporation organized specifically for that purpose but using the "know-how," etc. of the "true" corporation. In this situation, many of the practical objections to formula settlement may vanish, e.g., the "alter-ego" corporation may be quite prepared to indulge in prolonged administrative procedures and even extended litigation, adopting something of the current attitude towards "in-

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24 Clause D (2).
24a PR 1204.9 and standard settlement form set out in JTR 981.1, and article 4.
investment in attorneys' fees" for possible recoveries under Section 722 of the Internal Revenue Code relative to excess profits tax refunds.

"Negotiated-Settlement" Termination Articles in Fixed-Price Contracts

The reasons for the supercession of "formula" termination articles by "negotiated-settlement" termination articles have already been discussed. Basically there are two types of "negotiated settlements": 1) the War Department "standard" negotiated-settlement termination article employed from November 19, 1942 to February 20, 1944, and 2) the Baruch-Hancock "uniform" negotiated-settlement termination article employed since February 20, 1944. While the Baruch article has not been modified since its introduction, the old War Department article has numerous variations, the principal one of which is an added clause specifically providing reimbursement to the contractor for all judgments recovered against the prime by subs as a result of work on the contract, provided that the prime notifies the Government of the suit and gives it opportunity to defend. The particular reason why this proviso is important is that primes frequently let contracts to subs with no provisions for termination so that anticipated profits would be an item of recovery in a suit by a sub,—and an item of considerable size where termination occurs early in the life of a very profitable contract. Because primes are often, in a war program, dealing with subs with whom they may never again have business relations, many primes have justifiable fears that they are incurring a heavy risk in the absence of a "recovery for judgments" clause.

The main changes in the Baruch article from the War Department standard article are:

1. The clarification of ambiguities in the War Department standard article,
2. the addition of a clause for equitable adjustment of prices on work to be continued,
3. the incorporation by reference of a Statement of Principles of Costs for formula settlement,
4. a profit limitation on the formula settlement.

PR 15-901 A (Not printed in JTR).
JTR-431.
While this clause does not occur in the Baruch article, the principle is upheld in Directive Order No. 4 of Office of War Mobilization dated May 2, 1944 (PR 15-1004).
Cf. also D.A. Goldman, Termination of War Department Contracts at the Option of the Government, (1944) 42 Mich. L. Rev. 735 at 763-772.
Underlying these four specific changes is the larger purpose of establishing uniformity between the various services (e.g., Army, Navy, etc.). Uniformity facilitates administrative and procedural matters, e.g., where a contractor has contracts with both the Army and the Navy. It avoids inequities, e.g., where two contractors are each devoting their entire effort to the same item, one producing for the Army, the other for the Navy. Under different termination articles, and for that reason alone, the two contractors might easily arrive at substantially different termination settlements.

Some of the ambiguities in the War Department article clarified by the Baruch article will be briefly pointed out. Clause B of the Baruch article spells out in detail the actions to be taken by the contractor on termination, particularly with a view to clarifying the matters in which the contractor has "the burden of going forward." Clause C specifies that the negotiated settlement is not to be hampered by anything in the formula option (thus excluding the application of the Statement of Principles of Costs from a negotiated settlement). Clause E further specifies the limitations on the Government's obligation to pay by limiting claims of the Government that can be offset to claims arising out of the same contract. Clause E also adds that the Government can exclude any subcontractor from the settlement and can secure an assignment of rights involved in such a case. Clause G makes clear the previously doubtful and certainly vague rights to partial payments in settlement. This clause of the Baruch article is made obsolete by the additional rights conferred by the Contract Settlement Act of 1944. Under all previous termination articles, the stock phrase "accepted accounting practice" has been used in connection with the definition of the formula-settlement option. The Baruch article incorporates by reference a Statement of Principles of Costs which is subject to revision and binding as revised though not retroactively. Clause C now makes provision for a negotiation of part of the termination and formula settlement of the balance.

An effort was made in the Baruch article to control the admittedly fortuitous possibilities of formula settlement by including a profit
limitation clause applicable to formula settlements. Under this clause, the contractor receives for his unfinished work: the cost of materials not processed by the contractor plus not to exceed 2% profit thereon, plus the remainder of allowed costs and not to exceed 8% thereon (except subcontractor amounts) as profit, but the total profit not to exceed 6% on total costs, and the total payments (including payments previously made, i.e., unit payments plus costs of unfinished work plus profit on unfinished work) not to exceed the contract price. The expense of termination (e.g. legal fees, accounting costs, etc.) are paid and are not included when determining whether the payments exceed the contract price.

The termination article regularly used in letter contracts is not as specific as the Baruch article and had one principal difference (until a revised article was authorized by JTR-935)—no profit was allowed on the work done unless a) in the case of amendment after termination to so provide, particular clearance of the case was obtained based on special facts the most usual of which is that the government delayed prompt conversion of the letter contract into a definitive contract, or b) in the case of initial agreement or amendment before termination, profit could be allowed in unusual circumstances. As a result of the new termination article for letter contracts authorized by JTR-935, provision is made for allowance of profit in a negotiation. If the profit clause was in the contract, or if the new article is added and negotiations break down, the contractor is paid his costs and either subcontractors' claims are paid or the Government assumes the claims of the subcontractor. As profit, such amount is allowed as the contracting Officer finds reasonable—no formula is applied. If there is no profit clause in the letter contract and the new article is not inserted, the same payment is made except that no profit is allowed.

Termination of a letter contract may occur a) by direction of the Government (which is the situation discussed so far), or b) by the terms of the contract itself when no definitive document is executed before the lapse date specified in the letter contract. In the second situation, the settlement is that described above without profit. Letter contracts, being unusual instruments, have frequent variations in termination articles from the standard form just described.

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33 Required by PR 303A in the form set out in PR 1307.6 and JTR-935.
34 Letter contracts are preliminary contractual documents providing for expenditure of a given sum to get a contract underway while the definitive document is in preparation or delayed by such matters as prices or specifications.
The Effect of the Contract Settlement Act of 1944 and of the Joint Termination Regulation on Termination Articles

In order to evaluate termination articles, it is important to know how the contractual provisions are enlarged to the advantage of the contractor by a) the Contract Settlement Act of 1944 (hereinafter called "the Act") and b) the policies announced in the Joint Termination Regulation. It is also important to realize that the JTR as currently constituted does not fully implement the rights conferred on the contractor by the Act. This always raises a question, from the contractor's point of view, of expediency in asserting rights not implemented by the JTR since the particular Contracting Officer handling the case will ordinarily request clearance by higher authority in such situations. The magnitude of the JTR (284 finely printed pages) precludes an effort in this paper to trace its effects in enlarging contractual rights.

However, something can be said of the enlargements effected by the Act. For example, the rights conferred by Clause C of the Baruch article relative to partial payments are greatly enlarged by the Act. Similarly, Section 12 c of the Act gives the contractor a right to plant clearance within 60 days after filing an inventory in proper form. Nothing is stated in the termination article on this point. Section 13 of the Act gives the contractor appeal privileges in addition to those specified in the contract. Section 7 f of the Act gives additional protection to subcontractors by permitting the Government to pay twice despite legal defenses to a second payment in situations where the original payment intended for the sub has been "short-circuited."

Termination Articles in CPFF Contracts Prior to JTR-932

The special conditions of war production made the introduction of the cost-plus-fixed-fee contract inevitable. The policy has been to prefer the fixed-price contract to the CPFF contract and currently the policy is to avoid the CPFF contract entirely in new procurement and to convert existing CPFF contracts into fixed-price contracts.

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1 The provisions of the termination article cannot be varied, once effective as a part of the contract, to the contractor's disadvantage without his consent.

2 However, one illustration can be given. Where the old War Department standard negotiated-settlement article provided in Clause B that completed articles were to be paid for at the contract unit price, the Baruch article is silent on the matter. However, the series of settlement-proposal forms (JTR-961 ff.) provides for the continuation of payment for finished items at the contract unit price.


4 PR 233.1.
since sufficient experience and data are now available to guide pricing and other difficulties have been minimized.

There are essential differences in the matter of termination articles between CPFF and fixed-price contracts although the recent effort has been to develop at least the same procedure for termination of both types of contract. Because of the greater risks to the Government in CPFF contracts and because of their generally higher commitment values, it is highly unlikely that any CPFF contracts lack a termination article. In any event, the problems inherent in a CPFF termination where the contract lacks a termination article are similar to the same situation already discussed with regard to fixed-price contracts.

Because of the special situations in which the CPFF contract is employed, the great bulk of such contracts in the case of the War Department are entered into either by the Ordnance Department or the Army Air Forces. As a result a “standard” CPFF termination article peculiar to each was in use prior to the new CPFF article set out in JTR-932. The principal difference between these two articles lies in the matter of adjustment of the fixed fee. Under the Ordnance form if the termination is for the convenience of the Government, the contractor is paid the fixed fee that has accrued, but if the termination is for default of the contractor, the contractor loses the accrued but unpaid fixed fee but retains the payments already made on account of the fixed fee. In the AAF form if the termination is for the convenience of the Government, is based on the percentage of completion of the contract, but if the termination is for the default of the contractor, the contractor is paid 10% less than he would have been paid if the termination had been for convenience.

Both forms provide that on termination all costs (and what are admissible costs is defined in another article of the contract) are to be paid by the Government and that “the Government shall assume and become liable for” subcontracts.

Actually there are two termination articles in CPFF contracts. As a matter of Government practice, the article entitled “Termina-

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8 Because the CPFF contract is designed for “special” circumstances, it is only natural that any “standard” CPFF contract articles developed should in turn be more frequently varied in particular cases than is to be expected in fixed-price contract situations. In short, the frequent variations from “standard” CPFF termination articles arise from facts of production in a given case whereas the less frequent variations from standard fixed-price termination articles arise from the frequent changes due to the development of the standard article itself.

9 PR 15-903.

10 PR 15-905.

11 The matter of liability to subcontractors is considered infra.
tion for Convenience of Government" governs the so-called "total" termination while "partial" termination is governed by the article entitled "Changes." Administrative practice of the Government defines a "total" termination as the situation in which no work remains to be done under the contract after the effective date of termination. Any other termination is considered "partial"—and is effected under the "Changes" article. This practice is open to serious legal objection. Looking at the contract as a whole, the "Changes" article seems intended to cover relatively minor "changes," e.g., engineering revisions covering additional or deleted work, changes in the specifications of materials, etc. At most it would appear to cover small changes in quantity, e.g., increasing or decreasing the number of units by 10%. It hardly seems intended to cover major cutbacks, e.g., reducing the number of planes on a contract from 1,000 to two. Such cutbacks, from an examination of the contract as a whole, seem to fall within the scope of the "Termination" article. The reason for the Government practice may be the absence of the phrase "in whole or in part" as a modification of the word "terminate." The "Changes" article merely provides that an equitable adjustment in costs and the fee will be made as a result of the "change." One important difference between the "Termination" article and the "Changes" article is the absence in the latter of the "assumption of liability by the Government" clause with respect to subcontracts.43

Prior to July 21, 1944, the effective date of the Act, PR 15 did not attempt to bring CPFF settlements fully within the scope of the negotiated settlement. In fact, little was stated in PR 15 on CPFF terminations. As a matter of practice, partial terminations were settled by negotiation under the "equitable adjustment" language of the Changes article. In the case of total terminations, the adjustment of the fixed fee was negotiated but costs were settled by regular CPFF audit. Since the Act does not specify that its provisions are limited to fixed-price contracts, all CPFF terminations are now negotiated in the same way as fixed-price terminations.

**New JTR Termination Article for CPFF Contracts**

The chief change effected by the JTR as regards termination articles was the introduction of an approved CPFF termination article set out in JTR-932, which will be offered to contractors in place of the article used up to November 1, 1944. In general, the new article gears the Baruch negotiated-settlement article to the CPFF contract.

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43 See *infra*, section on "Subcontractors."
However, a number of radical changes, from the contractor's point of view, are involved as compared with the old CPFF articles.

First, the new article specifically provides for termination in whole or in part. As a result, the possible distinctions arising under the old articles from the use of the Termination article to effect total terminations and the Changes article to effect partial terminations are wiped out. The principal distinction between the old Termination articles and the Changes articles, namely, the presence in the former of the "assumption of liability by the Government" clause as to subcontractors and its absence in the latter is now done away with.

Second, though this distinction is done away with, the "assumption of liability by the Government" as to subcontractors is cut down. The sub-contractor problem is now treated in Clause (d) (2) and broken down. By Clause (d) (2) (A) of the new article, any settlement "by negotiation or otherwise" with a sub will be paid by the Government if 1) the Contracting Officer has approved or authorized it, or 2) if the amount payable does not exceed that which would be payable under the formula option of the "little" Baruch article discussed below under "Subcontractors." By Clause (d) (2) (B), any judgment recovered by a sub will be paid (if the Government was notified and given opportunity to defend) if 1) the subcontract or its termination article was approved by the Contracting Officer, or 2) the subcontract limits recovery to an amount not greater than the "little" Baruch clause formula option. Thus the "subcontractor" clause of the new article is clearly designed to relieve the Government of the liability which it had under the old article for "anticipated profits" that subs might recover. Since this alone might prove enough of an objection by contractors to acceptance of the new article in an amendment after termination, footnote 1 to JTR-932 authorizes an additional clause cutting down the relief made available to the Government by the new article. Under this "footnote clause" the Government is also liable for any judgments if the subcontract is silent on termination and the approval of the Contracting Officer was not required by the prime contract. The footnote clause will satisfy most contractors since it covers the "ordinary" situation where the subcontracts are silent as to terminations and were approved. (The other "ordinary" situation is where the subcontract contains a clause binding the sub on termination in a manner analogous to that in which the Government binds the prime.) But many subcontractors had refused to take contracts with any termination provisions at all—and some of these were not approved. As a result the prime had
to assume the risk in order to go forward with the job. Thus even with the "footnote clause," the Government is still relieved of considerable liability, particularly because of the matter of approval of subcontracts, unless the theory of implied approval through payment by the Government of vouchers submitted under the "unapproved" subcontracts can be accepted. The new article also relieves the Government of liability for "unusual" termination provisions in the contract (unless there is approval by the Contracting Officer) resulting in payments to the sub in excess of the amount allowed by the little Baruch clause option.

There is some ambiguous language in Clause (g) of the article specifying limitations on the liability of the Government in the case of subcontracts. How this language is intended to affect the spelling out of liability for subcontractor claims as dealt with in clause (d) (2) is not clear.

Third, the new article clarifies what had previously been at least ambiguous—the liability of the Government for "momentum" costs, i.e., those costs (such as overhead) which cannot be cut off immediately. In view of the strict definition in the old article of "termination expenses," considerable fears had developed that momentum costs might not be recoverable. The new Clause (d) (1) provides that such costs are reimbursable if the contractor proceeds "as rapidly as practicable to discontinue such costs."

Fourth, Clause (e) adds a provision for an "equitable adjustment" of the fee on the remaining work under the contract in the case of a partial termination. This provision is similar to the same type of clause in the Baruch article.

**CPFF Letter Contracts**

There is no difference between "CPFF" and "fixed-price" letter contracts. The same letter contract is used (except for language as to title to property) whether the contemplated definitive contract will be CPFF or a fixed-price contract.

**Subcontractors**

To speak of the tier upon tier of subcontractors as a labyrinth is a grave understatement. Even the problems are so numerous and

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[48] "The obligation of the Government to make any payments under this Article ... in the discretion of the contracting officer, shall be subject to deductions in respect of any claim of any subcontractor or supplier whose subcontract or order shall have been terminated as provided paragraph (b) (3) except to the extent that such claim covers (i) property or materials delivered to the contractor, or (ii) services furnished to the contractor in connection with the production of completed Articles under this contract."
intricate as to defy a complete listing. For example, there are no end of contractual situations in which a prime may find himself as a result of the varied termination articles, if any, that he put into his subcontracts. Similarly, competitive positions and financial conditions of the subs will cause many problems. Absence of or inadequacy in accounting records of subs causes particular difficulties in clearing sub settlements with the government.

Dependent on whether the Government entered a CPFF or a fixed-price contract with the prime, there is an immediate and marked difference as to subcontracts from the point of view of both the prime and the sub. If the Government entered a CPFF contract, the prime is in the position of a bystander with reference to subs (except in some cases under the new CPFF article). The Government has assumed liability to the subcontractor and in the last analysis these parties must come to a settlement. If no settlement is reached—and the chief bone of contention will undoubtedly be the recovery of “anticipated” profits by the sub—the sub can resort to litigation.

The sub under a fixed-price prime is in an entirely different position, as is the prime. The likelihood of the prime recovering from the Government in the event of a judgment obtained by a sub has already been discussed. The sub, on the other hand, is, unless he can gain the cooperation of the prime, limited by the financial responsibility of the prime.

To achieve the same uniformity in treatment of subs as in treatment of primes, a “little” Baruch article covering a negotiated settlement option has been approved by the Director, Office of War

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4 Under the third party beneficiary doctrine, the sub can collect directly from the Government as required by the CPFF contract. Ordinarily they will have been approved, since at the time of the initial payment to the prime on account of the subcontract, the Government auditor will have verified the fact of Government approval. If the auditor did not verify this fact and payment was nevertheless made to the prime, it would seem that the prime and the sub have grounds to claim that the act of payment under these circumstances was an approval.

The only other difficulty a sub in the lower tiers might have would be to establish that he was in fact a subcontractor under the prime contract—and this would seem to hinge on the ability to trace his product to the prime.
Many subcontractors in the interests of speed and the other advantages to be gained by cooperation will agree to the "little" Baruch article.

The situation of subcontractors on default of the prime has already been discussed. In infrequent cases, CPFF subcontracts have been approved by the Government under CFF primes. The relationship here is sometimes varied in language but the purpose of such arrangements usually is to establish that the CPFF sub shall stand as the CPFF prime in relation to the Government.

It is not wise to attempt further generalizations about the contractual situations of subcontractors on termination; the permutations are too numerous.

Conclusion

It should be clear from this survey of termination articles in war contracts that examination of contracts and the relevant factors by counsel in advance of termination is important—and will be the key to the contractor's termination planning. For the thunderclap of termination to strike the contractor or counsel unprepared will in many cases see the tangible rewards for years of war production washed away in the torrent of demobilization.

The chief difference between the Baruch article and the "little" Baruch article (JTR-936) lies in the 8% profit limitation on work in process in the case of formula settlement under the little Baruch article whereas in the Baruch article the prime gets a figure which is "fair and reasonable" under all the circumstances. But under both articles the 6% overall profit limit on the uncompleted work applies. Even this difference vanishes in most cases since the services have filled in the profit percentage left blank by Baruch and Hancock so that the maximum rate is 8% on work in process.