



UNITED STATES
CIVILIAN BOARD OF CONTRACT APPEALS

DENIED IN PART: February 27, 2015

CBCA 3725

HEARTHSTONE, INC.,

Appellant,

v.

DEPARTMENT OF AGRICULTURE,

Respondent.

Jason S. Randolph, Dandridge, TN, counsel for Appellant.

Jay McWhirter, Office of the General Counsel, Department of Agriculture, Atlanta, GA, counsel for Respondent.

Before Board Judges **SOMERS**, **McCANN**, and **SULLIVAN**.

SULLIVAN, Board Judge.

Hearthstone, Inc. appeals the decision of the contracting officer for the Department of Agriculture, Forest Service, terminating Hearthstone's timber sale contract for default and assessing procurement costs as damages. The parties have submitted the appeal for a decision on the record, pursuant to Rule 19 of the Rules of the Civilian Board of Contract Appeals. 48 CFR 6101.19 (2013). For the reasons that follow, the Board denies in part Hearthstone's appeal and seeks further evidence and briefing from the parties regarding the demand for procurement costs.

Background

I. Contract Terms

Hearthstone was awarded the contract for the White Bull timber sale on September 26, 2006, Appeal File, Exhibit 14¹, with the highest bid of \$349,427.29. Exhibit 7 at 79. Hearthstone, in its bid, matched the advertised rate for each species except for eastern white pine, for which it bid double the advertised rate. *Id.* at 74. The Forest Service estimated that eastern white pine would account for three quarters of the timber to be harvested in the sale. Exhibit 19 at 116. At the time of contract award, Hearthstone paid a bid deposit of \$18,600 and a down payment of \$32,700 and put up a performance bond of \$35,000. Exhibits 10-12.

The original contract termination date was May 31, 2010, and the original date for the initial payment on the contract was July 26, 2008. Exhibit 19 at 120, 122. The contract contained several provisions by which these dates could be extended. Clause BT8.212, Market-Related Contract Term Addition, permitted these dates to be adjusted when “a drastic reduction in wood product prices has occurred.” Exhibit 20 at 148. Changes in the producer price index listed in the contract would be analyzed to determine if a drastic reduction had occurred. 36 CFR 223.52 (2004). If the conditions were triggered, the contract termination date could be extended by up to three years and the dates for periodic payments would be extended by one month for each month the contract term was extended. Exhibit 20 at 149. The contract also permitted Hearthstone to request a rate redetermination during the original term of the contract if the producer price index declined by twenty-five percent or more. *Id.* at 133 (Clause BT3.34, Emergency Rate Redetermination).

During the pendency of the contract, the Food, Conservation, and Energy Act of 2008 (2008 Farm Bill) was enacted. Pub. L. No. 110-246, 122 Stat. 1651 (June 18, 2008). Section 8401(b) of the statute provided that a contractor with a qualifying timber sale contract could request, within ninety days of the enactment of the act, cancellation of the contract, a rate redetermination, or the substitution of the producer price index used on the contract to more accurately reflect market conditions. Section 8401(c) permitted the Forest Service to extend the contract termination date, through the Market-Related Contract Term Addition clause, by four years, instead of three allowed by regulation.

¹ All exhibits are found in the appeal file, unless otherwise noted. The pages numbers cited are the Bates numbers indicated on the exhibits.

II. Events Leading to Contract Default Termination

Hearthstone manufactures log homes and planned to use the eastern white pine that it would harvest in the manufacture of those homes. Exhibits 86 at 337-38, 90 at 354. After the contract was awarded, the economy suffered a significant downturn, which resulted in declines in the producer price index used on the contract. Exhibit 86 at 338. Based upon these declines, the Forest Service notified Hearthstone on seven separate occasions between August 2007 and July 2009 that Hearthstone could request an extension of the contract term due to market conditions as permitted by clause BT8.212. Exhibits 24, 26, 31, 44, 47, 53, 57. The Forest Service also advised Hearthstone of the relief available to it under the 2008 Farm Bill. Exhibits 34, 37. It appears from the record that Hearthstone requested and the Forest Service granted each of these extensions with a commensurate extension of the date by which Hearthstone had to pay the initial payment. Exhibits 27, 28, 33, 35, 40, 41, 55, 60, 75. As a result, the contract termination date was extended to May 31, 2014, and the date by which Hearthstone would have to make its initial payment was pushed to August 23, 2012. Exhibit 76.

Because of the economic declines in the producer price index for the contract, the contracting officer also notified Hearthstone that it could seek a rate redetermination, pursuant to clause BT3.34. Exhibit 30. After Hearthstone requested the rate redetermination, the Forest Service reappraised the value of the sale and reduced the contract price by \$6550.55. Exhibit 39. The contracting officer also advised Hearthstone that it could reduce temporarily the amount of the down payment and change its performance bond to obtain a refund of some of the bond fees. Exhibits 62, 66. Finally, the contracting officer attempted to obtain a subcontractor for Hearthstone that could begin performance of the contract, but apparently these efforts did not succeed. Exhibits 73, 86.

Despite the relief provided by the terms of the contract and the 2008 Farm Bill, Hearthstone never commenced harvesting the timber and failed to pay the initial progress payment on August 23, 2012. Exhibit 86. Hearthstone explains that, because the log home business was depressed, it did not have the funds necessary to perform the contract. Appellant's Reply to Respondent's Case Submission Brief. After Hearthstone failed to make the initial payment, the Forest Service suspended the contract and gave Hearthstone thirty days to make the payment. Exhibit 85. When Hearthstone still failed to make the initial payment, the contracting officer obtained the concurrence of the regional forester and terminated the sale contract by letter dated January 22, 2013. Exhibit 88.

By letter dated November 13, 2013, the contracting officer sought the payment of damages from Hearthstone, as permitted by clause BT9.4 of the contract. Exhibit 89 at 344-45. The Forest Service put the sale out for re-bid and awarded the contract to another

contractor at a price of \$237,132.10. *Id.* at 346. The Forest Service reports that this contractor was able to harvest the timber. Answer ¶ 6. The Forest Service sought the difference between the bid price Hearthstone offered, as adjusted through the rate redetermination (\$342,876.74), and the highest bid price on the re-sale (\$237,132.10), which totaled \$105,744.64. The contracting officer also sought the administrative costs of resale (\$1826) and interest on the delayed stumpage payments (\$7714.73). After deducting the amounts Hearthstone had on deposit, the Forest Service issued a demand for damages in the amount of \$79,259.37. Exhibit 89 at 349.

Discussion

Burdens of Proof

Hearthstone appeals the contracting officer's decision seeking procurement costs and the underlying termination of the timber sale contract for default. *See C-Shore International, Inc. v. Department of Agriculture*, CBCA 1697, 10-1 BCA ¶ 34,380, at 169,745 (contractors permitted to challenge underlying default termination when appealing contracting officer's decision on procurement costs).² Termination for default is a drastic sanction. *J.D. Hedin Construction Co. v. United States*, 408 F.2d 424, 431 (Ct. Cl 1969). On appeal, the Government bears the burden of proving the propriety of the termination for default and the contractor bears the burden of establishing that its failure to perform should be excused. *CDA, Inc. v. Social Security Administration*, CBCA 1558, 12-1 BCA ¶ 34,990, at 171,971. The Government also bears the burden to prove its claim for procurement costs. *Cascade Pacific International v. United States*, 773 F.2d 287, 293 (Fed. Cir. 1985); *CDA, Inc.*, 12-1 BCA at 171,972.

² As noted in *C-Shore International*, this practice of allowing the contractor to wait until the contracting officer assesses procurement costs to challenge the underlying default termination is known as the *Fulford* doctrine, arising from the decision in *Fulford Manufacturing Co.*, ASBCA 2143, et al., 1955 WL 808 (May 20, 1955). Although the United States Court of Appeals for the Federal Circuit has not yet endorsed this practice, the Board continues to employ the practice as an efficient means of resolving all of the issues arising from a termination for default. *C-Shore International*, 10-1 BCA at 169,745 (citing *Deep Joint Venture v. General Services Administration*, GSBICA 14511, 02-2 BCA ¶ 31,914, at 157,674-75).

Contract Performance Cannot Be Excused As Commercially Impracticable

The Forest Service terminated Hearthstone's contract when it failed to make the required initial payment and failed to initiate any work to harvest the timber. Exhibit 88. Termination for default is proper when a contractor fails to meet contract requirements and the contracting officer has a reasonable basis for believing that the contractor will be unable to complete the contract in a timely manner. *Lisbon Contractors, Inc. v. United States*, 828 F.2d 759, 765 (Fed. Cir. 1987); *CDA, Inc.*, 12-1 BCA at 171,971-72. The record documents the contracting officer's efforts to obtain assurances from Hearthstone that it would begin performance of the contract as well as the contracting officer's efforts to obtain a subcontractor to begin that effort. Based upon this record, the Forest Service has met its burden of establishing that the termination for default was proper.

Hearthstone does not dispute its failure to perform the contract. Instead, Hearthstone asserts that its failure to perform should be excused due to the financial condition in which it found itself as a result of the economic recession that began in 2008. Exhibit 90 at 354-55; Appellant's Reply. The Board understands Hearthstone's defense to be one of commercial impracticability.

A contractor's non-performance of a contract may be excused pursuant to the doctrine of commercial impracticability if certain criteria are met: "[w]here, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged." *Seaboard Lumber Co. v. United States*, 308 F.3d 1283, 1294 (Fed. Cir. 2002) (citing Restatement (Second) of Contracts § 261 (1981)). To avail itself of this defense, Hearthstone must show that (1) a supervening event made performance impracticable; (2) the non-occurrence of the event was a basic assumption upon which the contract was based; (3) the occurrence of the event was not Hearthstone's fault; and (4) Hearthstone did not assume the risk of the occurrence of the supervening event. *Id.* at 1294-95 (citing *United States v. Winstar Corp.*, 518 U.S. 839, 904-10 (1996)).

Hearthstone cannot establish two of the four prongs of this test. Hearthstone alleges that the economic recession was the supervening event that led to the depressed housing market and decline in timber prices. Exhibit 90 at 354. Clearly, the recession and the resulting timber price declines were not Hearthstone's fault. But the terms of the contract indicate that the parties anticipated the possibility of a decline in timber prices. Clause BT8.212 allowed Hearthstone to extend the termination date for the contract when "the market declines as shown by a twenty-five percent decline in the producer price index." Exhibit 20 at 148. Clause BT3.34 permitted Hearthstone to request a rate redetermination following market declines such as those Hearthstone experienced on its contract. *Id.* at 133.

“The continuation of existing market conditions and of the financial situation of the parties are ordinarily not such assumptions [of a contract] so that mere market shifts or financial inability do not usually effect discharge” under the doctrine of impracticability. Restatement (Second) of Contracts § 261 cmt. b. Based upon these contract clauses, Hearthstone cannot establish that the non-occurrence of a decline in timber prices was a basic assumption of the parties, the second prong of the test for commercial impracticability.

Hearthstone also cannot meet the fourth prong of the test because Hearthstone bore the risk that timber prices would decline. Although the contract contained provisions that permitted the adjustment of the completion date and the bid prices based upon economic declines, the parties’ contract remained a fixed-price contract by which Hearthstone bore the risk of declining prices. *Tangfeldt Wood Products, Inc. v. United States*, 733 F.2d 1574, 1577 (Fed. Cir. 1984) (purchaser on a fixed-price timber contract bears the risk of market decline).

Hearthstone argues that the economic recession of 2008 and the resulting declines in the housing and timber market were greater than the economic conditions that the parties anticipated and that the economic declines overwhelmed the mechanisms in the contract designed to address such occurrences. Exhibit 90 at 355. “A mere change in the degree of difficulty or expense due to such causes as increased wages, prices of raw materials, or costs of construction, unless well beyond the normal range, does not amount to impracticability.” Restatement (Second) of Contracts § 261 cmt. d. Despite the severity of the decline in the housing market and timber prices experienced by Hearthstone, such declines in commodity prices have not been held to be a basis for finding commercial impracticability. *See, e.g., Seaboard Lumber Co. v. United States*, 41 Fed. Cl. 401, 416 (1998), *aff’d*, *Seaboard Lumber*, 308 F.3d at 1294-95 (government policies that reduced demand for housing and lumber and led to “dramatically lower” timber prices did not render performance of contract impracticable); *HLI Lordship Industries, Inc.*, VABCA 1785, 86-3 BCA ¶ 19,182, at 97,025 (1985) (“unusually severe increase” in cost of gold by 210% over period of contract performance found not to render contract impracticable); *Nedlog Company*, ASBCA 26034, 82-1 BCA ¶ 15,519, at 76,986 (1981) (doubling in price of sugar did not render contract impracticable). Moreover, Congress provided additional relief through the 2008 Farm Bill to address the unprecedented conditions caused by the recession about which Hearthstone complains. This relief included the opportunity to cancel the sale with payment of thirty percent of the value of the original contract. 2008 Farm Bill, § 8401(b)(1)(A). Hearthstone chose not to avail itself of this option. The Board is not in a position to provide greater relief than that provided by Congress to address the effects of the recession.

Hearthstone highlights an “unprecedented drop” in eastern white pine timber prices, Exhibit 90 at 354, which is shown by the change in the advertised rates for white pine

between the original sale and the re-offered sale (\$57.08 versus \$28.19). *Compare* Exhibit 6 at 64 *with* Exhibit 89 at 346. Although the almost fifty percent decrease in white pine prices is significant, this decrease does not create a situation of “commercial senselessness” that is required to find a contract impracticable to perform. *Raytheon Co. v. White*, 305 F.3d 1354, 1368 (Fed. Cir. 2002) (declining to find commercial impracticability based upon a fifty-seven percent cost increase). When the market declined, the harvest became unprofitable for Hearthstone and Hearthstone would have performed the contract at a loss, given the premium that Hearthstone placed in its bid on the eastern white pine it expected to harvest to use in its manufacture of log homes. Unprofitability does not equate with commercial impracticability because “the Government does not guarantee the contractor’s profit.” *Natus Corp. v. United States*, 371 F.2d 450, 458 (Ct. Cl. 1967). In light of the allocation of risk in the contract and the foreseeability of market declines, Hearthstone’s performance cannot be excused as commercially impracticable. *Seaboard Lumber*, 308 F.3d at 1295.

Hearthstone also argues that the producer price index that the Forest Service used to determine whether the contract dates should be extended did not adequately reflect the decline and continued lower price of eastern white pine. Exhibit 90 at 354. According to Hearthstone, because the price index did not accurately capture the value of white pine, the price of eastern white pine remained low although the value of the index cycled upward. Based upon this asserted disconnect between the price of white pine and the softwood lumber index, Hearthstone alleges that the “intent of the contract” could not be achieved.

By “intent of the contract,” the Board understands Hearthstone to be arguing that it could not obtain all of the relief under the contract that it should have received given the lower market price of white pine. Hearthstone’s argument is unavailing for two reasons. One, the 2008 Farm Bill permitted purchasers with qualifying contracts (which Hearthstone had) to request the substitution of a producer price index that more accurately reflected the products to be manufactured from the timber to be harvested. § 8401(b)(2). That request had to be submitted within ninety days of the enactment of the 2008 Farm Bill, however. *Id.* The record does not reflect that Hearthstone sought to change the index to be used when advised of the relief available under the 2008 Farm Bill. Having failed to seek the relief provided by statute, Hearthstone cannot seek to challenge the index used or the composition of that index in this appeal. Two, even if Hearthstone could challenge the index to be used on the contract, such a challenge would not result in greater relief to Hearthstone. As noted above, as the result of the declines in the value of the price index over consecutive quarters, the Forest Service notified Hearthstone that the dates for the termination of the contract and initial payment could be extended. The termination date was extended by four years, the maximum time period permitted by the 2008 Farm Bill. Thus, even if a different index had been used or the index had more accurately captured the continued lower price of white pine,

Hearthstone would not have been able to obtain any additional relief pursuant to the terms of the contract and the 2008 Farm Bill.

In its reply, Hearthstone also alleges that its performance should be excused because the contract was impossible to perform. The doctrine of impossibility does not apply to this situation because Hearthstone has not alleged that it was physically impossible to perform, only that it did not have the necessary financial resources to perform. Although the doctrines of impossibility and impracticability are often used interchangeably and analyzed under the same structure, *see, e.g., Singleton Enterprises v. Department of Agriculture*, CBCA 2136, 12-1 BCA ¶ 35,005, at 172,039 (using the test for impracticability set forth in *Seaboard Lumber* to analyze claim of impossibility), the doctrine of impossibility is better applied to cases in which actual impossibility of performance is at issue, such as cases involving a defective specification. In those cases, it is alleged that the contract was truly impossible to perform because of the defect in the specification. *See, e.g., id.* (citing *Ordnance Research, Inc. v. United States*, 609 F.2d 462, 479 (Ct. Cl. 1979); *Maxwell Dynamometer Co. v. United States*, 386 F.2d 855, 872 (Ct. Cl. 1967)).

Moreover, to establish the defense of impossibility, Hearthstone would have to show that performance was objectively impossible. *Seaboard Lumber*, 308 F.3d at 1294 (citing *Jennie-O Foods, Inc. v. United States*, 580 F.2d 400, 409 (Ct. Cl. 1978)). Under this standard, Hearthstone would have to show that other timber sale contractors also would have been unable to perform the contract. *See Rowe Inc. v. General Services Administration*, GSBCA 14211, 01-2 BCA ¶ 31,630, at 156,276. “The ability of other contractors to perform disputed work is persuasive evidence that the contract was not impossible to perform.” *Singleton Enterprises*, 12-1 BCA at 172,039 (citing *Jennie-O Foods*, 580 F.2d at 410). Hearthstone has not provided any evidence regarding the performance of other contractors on this or other timber sales. For these reasons, Hearthstone’s performance cannot be excused under the doctrine of impossibility.

Demand for Reprourement Costs

As noted, Hearthstone’s appeal arises from the contracting officer’s decision assessing reprourement costs following the default termination. Exhibit 89. To recover reprourement costs from Hearthstone, the Forest Service must establish that (1) the follow-on sale was substantially similar to the sale on which Hearthstone defaulted, (2) the Government incurred costs as a result of the follow-on sale, and (3) the Government acted reasonably to mitigate its damages. *Cascade International*, 773 F.2d at 294. The Government must also show that the reprourement was conducted within a reasonable time after the default. *NEH Logging*, AGBCA 76-187, 77-2 BCA ¶ 12,850, at 62,549.

Neither party has addressed the Government's reprourement cost claim in the submissions to date, leaving the Board unable to adjudicate the Government's claim on the current record. Although Board Rule 4(a) requires the respondent agency to include "all documents and other tangible things on which the contracting officer relied in making the decision," the Forest Service did not include any documents or other evidence underlying the contracting officer's decision regarding the calculation of reprourement costs. The appeal file contains the contracting officer's decision from which Hearthstone took the present appeal, Exhibit 89, but does not contain any of the contracts, bills, or other information necessary to evaluate the demand for reprourement costs. *See, e.g., John S. Davis, AGBCA 78-185, 79-2 BCA ¶ 14,130* (board examined bids and other documents supporting the computation of damages by contracting officer).

While challenging the underlying termination, Hearthstone has failed to challenge the composition or calculation of the contracting officer's demand for damages. Exhibit 90; Appellant's Reply. If the Government had met its burden to establish the elements of its reprourement costs claim, Hearthstone's failure to address the Government's claim in its briefing would be fatal to its appeal given the Board's decision that the termination for default was proper. *Pickett Enterprises, Inc., GSBCA 9472, et al., 92-1 BCA ¶ 24,668, at 123,095* (1991) (citing *General Floorcraft, Inc., GSBCA 11112, 91-2 BCA ¶ 24,026, at 120,295*) ("Once a contractor loses on the merits concerning the default termination decision and fails to challenge the reprourement specifically, a cost assessment will stand."). However, since the Forest Service bears the initial burden to prove its claim, which it has not met, Hearthstone should have another opportunity to address this issue.

Rule 4(e) provides that the Board may, "at any time during the pendency of the appeal, require any party to file other documents and tangible things as additional exhibits." To be able to resolve this appeal, the Board exercises its authority under this rule and orders the parties to submit evidence and briefing regarding the Government's claim. The schedule and specific requirements for these submissions are set forth in a separate order issued today.

Decision

Hearthstone's appeal of the contracting officer's termination for default is **DENIED IN PART**. The parties will submit further evidence and briefing on the Government's claim for reprourement costs.

MARIAN E. SULLIVAN
Board Judge

We concur:

JERI KAYLENE SOMERS
Board Judge

R. ANTHONY McCANN
Board Judge