AGENDA

• Federal Termination Overview
  o Federal Termination Types: Default vs. Convenience
  o Federal Termination Proposal Types
• Termination for Convenience Responsibilities and Timeline
• Best Practices for Termination Proposals
  o Required Documentation
  o Tactics to Maximize Recoverable Costs
  o Settlement Negotiation Strategies
• Takeaways
Federal Termination Overview
**FEDERAL TERMINATION OVERVIEW**

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<tr>
<th>FAR TERMINATION REGULATIONS AND CLAUSES</th>
<th>DESCRIPTION</th>
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<tr>
<td>FAR Part 49</td>
<td>Termination of Contracts</td>
</tr>
<tr>
<td>FAR Clause 52.249-1</td>
<td>Termination for the Convenience of the Government (Fixed Price) (Short Form)</td>
</tr>
<tr>
<td>FAR Clause 52.249-2</td>
<td>Termination for the Convenience of the Government (Fixed Price)</td>
</tr>
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<td>FAR Clause 52.249-4</td>
<td>Termination for the Convenience of the Government (Services) (Short Form)</td>
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<tr>
<td>FAR Clause 52.249-6</td>
<td>Termination (Cost Reimbursement)</td>
</tr>
<tr>
<td>FAR 12.403</td>
<td>Commercial Item Termination</td>
</tr>
<tr>
<td>FAR Clause 52.212-4(I)</td>
<td>Termination for Convenience - Commercial Items</td>
</tr>
</tbody>
</table>
TERMINATION FOR DEFAULT (T for D) vs. TERMINATION FOR CONVENIENCE (T for C)

In a T for D, the Government may terminate all or part of a contract for anything that is in violation of the contract, including:

- Attempted fraud (think False Claims Act)
- Failure to meet quality requirements
- Failure to deliver the supplies or perform the services within the time specified in the contract
- Failure to make progress and that failure endangers performance of the contract
- Failure to perform any other provisions of the contract
FEDERAL TERMINATION OVERVIEW

TERMINATION FOR DEFAULT (T for D)

FAR Subpart 49.4, Termination for Default

• Government not liable for cost on undelivered work
• Government is entitled to repayment of advance and progress payments
• Government can get surety to complete work (if bonded) or can re-procure at defaulting contractor’s expense. Government is also entitled to other damages (liquidated and administrative) it can prove.
• Cure Notices (10 days generally)
• Reported in Federal Awardee Performance and Integrity Information System (FAPIIS)
• Can lead to contractor debarment
TERMINATION FOR CONVENIENCE (T for C)

- T for C is unique to Government contracting
- In a T for C, the Government may terminate all or part of a contract for the Government’s convenience. Examples include:
  - Requirements changes
  - Bid protests
  - Funding issues
  - Technology changes
- However, the Government’s T for C rationale must be made in “good faith”
  - “Bad faith” rationale causes a contract breach by the Government
FEDERAL TERMINATION OVERVIEW

WHEN CAN A “T for D” BECOME A “T for C”?

If failure of the contractor to perform is excusable, T for D can be treated as T for C. Examples of excusable failure:

- Acts of God, public enemy, or Government
- Fires
- Epidemics
- Strikes
- Freight embargos
- Other conditions that are out of the prime contractor’s control
FEDERAL TERMINATION OVERVIEW

TERMINATION FOR CONVENIENCE (T for C)

FAR Part 49.502, Termination for Convenience (T for C)

- Government must have “reasonable” reason for termination
- Government’s termination objective is to make contractor “whole”, but not “fat”; provide “fair compensation.” Contractor can recover:
  - Its allowable costs incurred in the performance of the work up to the date of termination
  - Profit or fee for work performed (but not anticipated profit or fee)
  - Certain costs that continue after the date of termination (e.g., idle facilities or idle capacity costs, severance pay, storage costs, etc.)
  - So-called “termination settlement expenses” (i.e., contractor costs to terminate the contract and submit a termination proposal to the Government)
- Converts fixed price contract to flexibly priced contract
  - This can cause FAR “reinstatement” issues
FEDERAL TERMINATION OVERVIEW

OTHER TERMINATION ISSUES

• Deductive Change Orders vs. T for C
  o Use of type is determined by the Contracting Officer
  o Deductive change typically does not remove entire scope of work, just portions
  o Deductive changes are treated like equitable adjustments (no conversion to costs)
  o May be advantageous for contractor to have T for C instead of a Deductive Change

• Partial Terminations (T for D or T for C)
  o Can require an equitable adjustment for work that is not terminated if there is an impact due to terminated work

April 26, 2016
Termination for Convenience Responsibilities
TERMINATION FOR CONVENIENCE
RESPONSIBILITIES

- **Contracting Officer (CO)**
  - Issues the written notice of termination (T for D or T for C)

- **Terminating Contracting Officer (TCO)**
  - Is responsible for negotiating any settlement with the terminated prime contractor
  - Can request Government audit of contractor’s settlement proposal

- **Prime Contractor**
  - Negotiates settlement of terminated portions of subcontracts and supplier agreements
  - Prepares termination settlement proposal for submission to the Government
  - Tracks settlement costs separately

- **Subcontractor(s)**
  - Have no privity of contract with Government
  - Terminated based on subcontract terms and conditions
TERMINATION FOR CONVENIENCE RESPONSIBILITIES

Keep in mind that the proposal is actually prepared for several customers, not just one. Customers reading the proposal include:

- The Procuring Contracting Officer (PCO), if the termination administration was retained by the office;
- The Termination Contracting Officer (TCO) and staff, if assigned;
- The Defense Contract Audit Agency (DCAA) or customer’s audit firm; and
- The Plant Clearance Office and the local administration office, if assigned.

Remember: The readers’ immediate concern is what the termination settlement is expected to cost!
TERMINATION FOR CONVENIENCE
RESPONSIBILITIES

PRIME CONTRACTOR MUST:

1. Stop work immediately on the terminated portion of the prime contract
2. Terminate all subcontracts related to the terminated portion of the prime contract
3. Immediately advise the TCO of any special circumstances precluding the stoppage of work
4. Perform the continued portion of the contract and promptly submit any request for an equitable adjustment of price for the continued portion of the contract (supported by evidence of any increase in the cost) if the termination is partial
TERMINATION FOR CONVENIENCE RESPONSIBILITIES

PRIME CONTRACTOR MUST:

5. Take necessary or directed action to protect and preserve property in the contractor’s possession in which the Government has or may acquire an interest and, as directed by the TCO, deliver the property to the Government

6. Promptly notify the TCO in writing of any legal proceedings growing out of any subcontract or other commitment related to the terminated portion of the prime contract

7. Settle outstanding liabilities and proposals arising out of termination of subcontracts, obtaining any approvals or ratifications required by the TCO

8. Promptly submit the contractor’s own settlement proposal, supported by appropriate schedules

9. Dispose of termination inventory as directed or authorized by the TCO
TERMINATION FOR CONVENIENCE RESPONSIBILITIES

THE TCO SHOULD:
Promptly hold a conference with the contractor to develop a program for effecting the settlement, including:

1. General principles relating to the negotiation of any settlement proposal, including obligations of the contractor under the termination clause of the contract
2. Extent of the termination; the point at which work is stopped; and the status of any plans, drawings, and information that would have been delivered had the contract been completed
3. Status of any continuing work
4. Obligation of the contractor to terminate subcontracts and general principles to be followed in negotiating subcontractor settlement proposals
TERMINATION FOR CONVENIENCE RESPONSIBILITIES

THE TCO SHOULD:
Promptly hold a conference with the contractor to develop a definite program for effecting the settlement, including:

5. Names of subcontractors involved and the dates termination notices were issued to them

6. Contractor personnel handling review and settlement of subcontractor settlement proposals and the methods being used

7. Arrangements for transfer of title and delivery to the Government of any material required by the Government

8. General principles and procedures to be followed in the protection, preservation, and disposition of the contractor’s and subcontractors’ termination inventories, including the preparation of termination inventory schedules
TERMINATION FOR CONVENIENCE
RESPONSIBILITIES

THE TCO SHOULD:
Promptly hold a conference with the contractor to develop a definite program for effecting the settlement, including:

9. Contractor accounting practices and preparation of SF-1439 (Schedule of Accounting Information (FAR 49.602-3))
10. The form in which to submit settlement proposals
11. Accounting review of settlement proposals
12. Any requirements for interim financing in the nature of partial payments
TERMINATION FOR CONVENIENCE RESPONSIBILITIES

THE TCO SHOULD:
Promptly hold a conference with the contractor to develop a definite program for effecting the settlement, including:

13. Tentative time schedule for negotiation of the settlement, including submission by the contractor and subcontractors of settlement proposals, termination inventory schedules, and accounting information schedules (see FAR 49.206-3 and 49.303-2)

14. Actions taken by the contractor to minimize impact upon employees affected adversely by the termination (see paragraph (g) of the letter notice in FAR 49.601-2)

15. Obligation of the contractor to furnish accurate, complete, and current cost or pricing data, and to certify to that effect in accordance with FAR 15.403-4(a)(1) when the amount of a termination settlement agreement, or a partial termination settlement agreement plus the estimate to complete the continued portion of the contract, exceeds the threshold in FAR 15.403-4
TIMELINE FOR TERMINATION FOR CONVENIENCE

UNLESS OTHERWISE NEGOTIATED WITH THE TCO:

• Inventory disposal schedule must be completed within 120 days
• Settlement cost proposal, including subcontractor costs, must be completed within 365 days
Termination Settlement Proposals
TERMINATION SETTLEMENT PROPOSALS

FAR Part 49.206, Settlement Proposals

• **Inventory Basis** (Government-preferred method)
  - Typically used in construction-type contracts, manufacturing-type contracts, and service contracts with unit pricing

• **Total Cost Basis** (typically requires SF-1436, Settlement Proposal)
  - Used when start-up costs are not covered; contractor’s accounting system does not account for “unit” costs; contract does not specify any “units”; or termination of letter contract

• **Other Basis** (requires approval above TCO)
### Applicable Forms Based on Contract Type

#### Fixed Price Contracts

<table>
<thead>
<tr>
<th>Proposal Form</th>
<th>Commercial Contract</th>
<th>Inventory Basis</th>
<th>Total Cost Basis (with TCO Permission Only)</th>
<th>Short Form (&lt; $10,000)</th>
<th>Cost-Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>SF 1439 Schedule of Accounting Information</td>
<td></td>
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<tr>
<td>SF 1440 Application for Partial Payment</td>
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<td><strong>Inventory Schedules - PCARSS</strong></td>
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<tr>
<td>SF 1428 Inventory Schedule B</td>
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<tr>
<td>SF 1429 Inventory Schedule B Continuation Sheet</td>
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<tr>
<td>SF 1434 Inventory Schedule E</td>
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<tr>
<td>FAR 31.205-42 (Explains allowable termination costs)</td>
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Note 1: Commercial contracts are entirely different than cost-based terminations and require only an estimate of the percentage of physical completion plus support for any other charges incidental to the termination (see FAR 52.212-4(l)).
SETTLEMENT PROPOSAL FORMS

Remember: “it’s a proposal,” not a claim, to negotiate what it takes to settle at specific time

Settlement Proposal Standard Forms – 1435, 1436 & 1438

- For use by the Prime or subcontractor in settlement of fixed priced (sub)contracts
- Proposal Number (Select either “Interim” or “Final”)
- Did you attach the Schedule of Accounting Information (SF 1439)? Yes/No
- Section I – Status of contract or order at effective date of termination
  - Finished (Quantity & Dollars $)
  - Unfinished or Not Commenced (Quantity & Dollars $)
- Section II – Proposed Settlement
  - Schedules A through H for ODC, G&A, Profit, Settlement Exp., Subk/Supplier, Disposal & Other Credits
  - Schedules are NOT applicable for 1438 Short Form
Schedule of Accounting Information (SF 1439)

Provide details of your accounting system: 1435, 1436 & 1437

- Requires answers to 30 questions
- Provide general information on your company’s accounting practices and external oversight
- Includes Certificate – signed by a supervisory accounting official, certifying to the veracity of the information provided on the form

Why and what do the readers want to know about your accounting system?
Best Practices for Termination Proposals
BEST PRACTICES TERMINATION PROPOSALS

T FOR C PROPOSAL DOCUMENTATION REQUIREMENTS

Overview and Summary

• Background
  o Tell the story of your contract
  o How you performed and tracked the work
  o What impact the termination had on the work, your company, and your subcontractors

• Contract Information
  o Type of contract (Firm Fixed Price or Flexibly Priced)
  o Commercial
  o Negotiated

• Status at Termination
  o What was left to be accomplished
  o How many contractor and subcontractor resources were affected
  o What property remains and needs to be dispersed or disposed
Proposing Cost Estimates

• Clearly describe and identify estimates in your proposals with how, what and when the costs were estimated – mark cost estimates
• Estimate areas that are not resolved and submit the termination settlement proposal with the time required
• Failure to submit the termination settlement proposal on time may lead to serious consequences, like unilateral determination with no right to appeal under the Disputes clause, FAR49.109-7(a).
BEST PRACTICES TERMINATION PROPOSALS

T FOR C PROPOSAL DOCUMENTATION REQUIREMENTS

Cost Proposal Summary – Heart of the Termination Proposal

• Introduction
• Settlement proposal (on appropriate SF form)
• Cost summary roadmap
• Supporting calculations
• *Cost and pricing certification for non-exempt proposals over $750,000*
• Other Direct Costs – Project Startup Costs, Specialized Equipment, etc.
• G&A
• Material Disposition
• Termination Inventory
• Common Items Disposals and Credits.
BEST PRACTICES TERMINATION PROPOSALS

T FOR C PROPOSAL DOCUMENTATION REQUIREMENTS

• Material Disposition (PCARSS)
  o Inventory disposal schedule (on appropriate SF form)
  o Explanatory inventory details
    ▪ Explain any need for continued storage and security
    ▪ Explain any need for completion of product to ensure total cost recovery

• Program Accomplishments
  o Progress at time of termination
  o Basis for proposed margin (fee)

• Summary and Exhibits
FAR 31.205-42 TERMINATION COSTS

Special Treatment of (Eight) Cost Elements

• **Common Items** – reasonably usable on other work, with exceptions
• **Costs Continuing after Termination** – Not negligent or willful failure to discontinue
• **Initial Costs** – nonrecurring and starting load costs not absorbed or included as indirect costs
• **Loss of Useful Value** – special equipment, tooling and machinery not already expensed
• **Rental Under Unexpired Leases** – given efforts to reduce the costs
• **Alteration of Leased Property** – alteration were necessary
• **Settlement Expenses** – Accounting, legal and clerical costs necessary (See next slide)
• **Subcontractor Claims** – allocable portion plus your applied indirect costs
Special Treatment of Settlement Expenses

(1) Settlement expenses, including the following, are generally allowable:
   (i) Accounting, legal, clerical, and similar costs reasonably necessary for
       (A) The preparation and presentation, including supporting data, of
           settlement claims to the contracting officer; and
       (B) The termination and settlement of subcontracts.
   (ii) Reasonable costs for the storage, transportation, protection, and
        disposition of property acquired or produced for the contract.
   (iii) Indirect costs related to salary and wages incurred as settlement
        expenses in (i) and (ii); normally, such indirect costs shall be limited to
        payroll taxes, fringe benefits, occupancy costs, and immediate
        supervision costs.

(2) If settlement expenses are significant, a cost account or work order shall
    be established to separately identify and accumulate them.
MAXIMIZING RECOVERABLE T FOR C COSTS

Allowable Costs in Termination Proposal

- Project costs up to date of termination (including subcontractor costs) less deductions and adjustment for loss
- Adjusted fee
- Proposal settlement costs (legal and management costs in preparation and negotiation of termination proposals, including subcontractor proposals)
- Equitable adjustment for continuing work, if impacted
- Other continuing costs:
  - Severance Pay
  - Completion of components to avert “total loss”
  - Storage and/or protection of property produced for the contract prior to disposition
  - Disposal costs
BEST PRACTICES TERMINATION PROPOSALS

MAXIMIZING RECOVERABLE T FOR C COSTS

FAR Part 49.207, Limitation on Settlements
The total amount payable to the contractor for a settlement, before deducting disposal or other credits and exclusive of settlement costs, must not exceed the contract price less payments otherwise made or to be made under the contract.

FAR Part 49.208, Equitable Adjustment After Partial Termination
Under the termination clause, after partial termination, a contractor may request an equitable adjustment in the price or prices of the continued portion of a fixed-price contract. The TCO shall forward the proposal to the contracting officer except when negotiation authority is delegated to the TCO. The contractor shall submit the proposal in the format provided by FAR 15.408 Table 15-2.

DON’T FORGET!
BEST PRACTICES TERMINATION PROPOSALS

SETTLEMENT NEGOTIATION STRATEGIES

• Document all communications with the Government!
  o Follow up all oral communications with an email summarizing what was “decided” and request confirmation that the understanding is correct

• Create a separate chart of accounts for termination settlement costs

• Subcontracts
  o A subcontractor has no contractual rights against the Government when a prime contract is terminated (privity)
    ▪ Flowing down termination clauses to subcontractors helps mitigate prime contractor liability
    ▪ Failure of the prime contractor to include an appropriate termination clause in a subcontract does not affect the Government’s termination rights!
    ▪ In unusual cases and with consent from the prime contractor, the Government may assist in the settlement of subcontracts
Takeaways
## TAKEAWAYS

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<tr>
<th>TAKEAWAY</th>
<th>DESCRIPTION</th>
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<tbody>
<tr>
<td>Develop a Settlement Proposal Plan</td>
<td>Assign personnel, schedule due dates and responsibilities, use proper forms</td>
</tr>
<tr>
<td>Notify Subcontractors and Suppliers</td>
<td>Issue stop work order, ask for immediate notification of any continuing costs, get confirmation of communications</td>
</tr>
<tr>
<td>Meet Deadlines</td>
<td>Per FAR or as modified per TCO agreement</td>
</tr>
<tr>
<td>Keep Good Records</td>
<td>Document conversations, special settlement costs, inventory and material turnover</td>
</tr>
<tr>
<td>Track Costs</td>
<td>Setup unique project number to track settlement costs</td>
</tr>
<tr>
<td>Reduce Costs</td>
<td>Transfer common items, return supplies, stop subcontract work, protect assets from damage, etc.</td>
</tr>
<tr>
<td>Leave Positive Impression</td>
<td>Remember that the termination proposal will reflect on your company</td>
</tr>
</tbody>
</table>
References/Resources
REFERENCES/RESOURCES

• BizFilings.com: What to Know When a Government Contract is Terminated
• Hill AFB FARSite: FAR Part 49, Termination of Contracts
• ACQpedia: Contract Termination
• Congressional Research Service: T for C FAQs
• SBA: Your Responsibilities as a Contractor
• Construction Advisory Report: Contract Termination
RESOURCES

Darrell Hineman, CPA, Director
darrell.hineman@cohnreznick.com
(703) 286-1722

Rebecca Kehoe, Esq., Manager
rebecca.kehoe@cohnreznick.com
(703) 847-4431

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