

Terminations: How to Cope with the Premature Death of Your Contract

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Topics Covered

- ▼ Overview of Terminations
- ▼ Terminations for Convenience (T4C)
- ▼ Partial T4C vs. Deductive Changes
- ▼ Terminations for Default (T4D)
- ▼ Calculating Termination Costs

Overview of Terminations: The Government's Rights

- ▼ In every contract, the Government has the right to T4C and T4D, even if the applicable clauses are omitted from the contract.
- ▼ The Government may issue a T4C at any time for no reason.
- ▼ The Government may issue a T4D only for certain defaults by the contractor. The Government's use of T4D is a last resort and is subject to additional procedural requirements (e.g., an opportunity to cure).

Overview of Terminations: T4C vs. T4D

- ▼ T4C – A settlement should compensate the contractor fairly for the work done and the preparations made for the terminated portions of the contract, including a reasonable allowance for profit. See FAR 49.201(a).
- ▼ T4D – The contractor is liable to the Government for any excess costs incurred in acquiring supplies and services similar to those terminated for default, and for any other damages, whether or not repurchase is effected. See FAR 49.402-2(e).
- ▼ In other words, in a T4C, the contractor is entitled to payment, and in a T4D, the Government is entitled to payment.

Overview of Terminations: Procedures

- ▼ A termination can be effected only by the Contracting Officer's (CO) issuance of a notice of termination.
- ▼ The notice of termination must include:
 - ▼ the effective date of the termination,
 - ▼ the reason/basis for the termination (e.g., T4C or T4D),
 - ▼ the scope of the termination (e.g., total or partial), and
 - ▼ any special instructions and other steps for the contractor.

Overview of Terminations: Procedures

- ▼ **Following the effective date of the termination, the contractor must:**
 - ▼ **Stop work on all terminated work,**
 - ▼ **Terminate all subcontracts (or portions thereof) affected by the termination,**
 - ▼ **Negotiate a settlement of all subcontractor terminations,**
 - ▼ **Notify the CO of any disputes with subcontractors in connection with the termination,**
 - ▼ **Continue performance of all non-terminated work,**
 - ▼ **Protect all Government property,**
 - ▼ **Promptly submit a request for equitable adjustment for any impact on non-terminated work, and**
 - ▼ **Promptly submit a settlement proposal for the termination.**

Overview of Terminations: Procedures

- ▼ All settlement proposals must be supported by accounting data.
- ▼ The FAR's cost principles (Part 31) apply.
- ▼ For all proposals valued at \$100,000 or more, the CO must refer to the applicable audit agency (e.g., DCAA).
- ▼ The audit agency will audit the proposal and make a recommendation to the CO.
- ▼ Ultimately, however, it is the CO's responsibility to approve or disapprove all proposals.

Overview of Terminations: Procedures

- ▼ After the contractor submits its settlement proposal, the contractor and the Government will move forward to settle the termination.
- ▼ The settlement may be accomplished by:
 - ▼ Agreement of the parties,
 - ▼ Determination by the CO,
 - ▼ Costing out under vouchers, or
 - ▼ Some combination of the first three methods.
- ▼ The CO is obligated to hold a conference with the contractor to develop a program to organize the settlement process. Subcontractors may also be invited.

Overview of Terminations: Procedures

- ▼ If the parties are unable to settle the impact of the termination by mutual agreement, the CO may determine the impact.
- ▼ In a CO determination scenario, the contractor is entitled to present evidence, which the CO must consider.
- ▼ After consideration of all evidence, the CO must issue a written determination on the impact, which must include supporting analysis.
- ▼ If contractor is dissatisfied with the CO's determination, the contractor may appeal under the Disputes clause.

Overview of Terminations: Subcontractor Issues

- ▼ The prime contractor must submit all settlements with subcontractors to the Government for approval or ratification.
- ▼ Subcontractors have no privity of contract with the Government and, so, have no rights of recovery against the Government for termination costs.
- ▼ However, the Government has the right to assist the prime in settlement negotiations with its subcontractors.
- ▼ The Government may even intervene by requiring the prime to assign its subcontract rights to the Government.

Overview of Terminations: Commercial Contracts

- ▼ Most government contract terminations are governed by FAR Part 49. But terminations of commercial contracts are governed by FAR Part 12.
- ▼ Similar to Part 49, the Government has the right under Part 12 to terminate for its convenience and for cause.
- ▼ However, the terms and procedures are somewhat different.
- ▼ And the Government has discretion to customize the termination clause in commercial contracts.

T4C: Common Reasons for Termination

- ▼ The Government does not need a reason to T4C a contract.
- ▼ As a practical matter, though, the Government will typically only terminate for convenience when:
 - ▼ Its requirements are reduced or eliminated,
 - ▼ Its funding is reduced or eliminated, or
 - ▼ Its procurement has been challenged in a bid protest.

T4C: The Contractor is Entitled to Payment

- ▼ T4C – A settlement should compensate the contractor fairly for the work done and the preparations made for the terminated portions of the contract, including a reasonable allowance for profit. See FAR 49.201(a).

T4C: Contract Clauses

▼ Fixed Price:

- ▼ 52.249-1 Short Form (at or below the simplified acquisition threshold)
- ▼ 52.249-2 Above the simplified acquisition threshold
- ▼ 52.249-4 Services Short Form (at or below the simplified acquisition threshold)

▼ Cost Reimbursement:

- ▼ 52.249-6 (which also addresses T4D under cost-reimbursement contracts)

▼ Other, more specialized clauses also exist.

T4C: Fixed Price Contracts

- ▼ Profit is allowed on work done and preparations made, but no anticipated profits on work not completed.
- ▼ Factors to determine the amount of profit include:
 - ▼ Percentage and difficulty of work completed,
 - ▼ Rate of profit both parties anticipated at the time of award,
 - ▼ Rate of profit if the contract had been completed, and
 - ▼ Other factors.

T4C: Cost-Reimbursement

- ▼ The most significant basis of recovery will be the increase on the contractor's indirect rates.
- ▼ To accommodate this, the parties can:
 - ▼ Negotiate the impact (including by use of the contractor's historical billing rates), or
 - ▼ Delay settlement pending final determination of the contractor's indirect rates.

Partial T4C vs. Deductive Change: Rules for When Applicable

- ▼ **Partial T4C is appropriate when:**
 - ▼ Reductions in the number of units or supplies to be delivered,
 - ▼ Elimination of major portions of work with no additional work substituted,
 - ▼ Elimination of identifiable work, or
 - ▼ Reduction in the quantity of work required under the contract.
- ▼ **Deductive change is appropriate when:**
 - ▼ There is a decrease in the contract's required specifications, cost, or performance time.
- ▼ **Contractor can appeal under disputes clause if it disagrees with the CO's characterization.**

Partial T4C vs. Deductive Change: Impact with Partial T4C

▼ In a profitable contract:

- ▼ Quantum of profit is reduced proportionally to the amount of work terminated;
- ▼ No profit is allowable on unperformed work (anticipatory profit);
- ▼ No increase in profit margin.

▼ In an unprofitable contract:

- ▼ The Contractor's loss is reduced proportionally to the amount of work terminated.

Partial T4C vs. Deductive Change: Impact with Deductive Change

▼ In a profitable contract:

- ▼ The contractor's total compensation is reduced by what the eliminated work would have cost. (the contract price is irrelevant.)
- ▼ The result is that the contractor keeps most of its anticipated profits and, as a result, experiences a higher profit margin on a smaller amount of work.

▼ In an unprofitable contract:

- ▼ Again, the contractor's total compensation is reduced by what the eliminated work would have cost.
- ▼ The result is that the contractor experiences the same quantum of loss on a smaller amount of work.

Partial T4C vs. Deductive Change: Takeaway

- ▼ If the contract is profitable, the contractor would prefer a deductive change.
- ▼ If the contract is unprofitable, the contractor would prefer a partial T4C.
- ▼ Again, the CO's characterization is appealable under the Disputes clause.

T4D: Reasons for Termination

- ▼ **The Government may T4D if the contractor fails to:**
 - ▼ Deliver the supplies or perform the services within the time specified,
 - ▼ Make progress, so as to endanger performance, or
 - ▼ Perform any other provisions of the contract.
- ▼ **Procedural Note: The Government is required to issue a cure notice and give the contractor 10 days to cure the default, except in the instance of failure to provide the supplies or services within the time specified.**

T4D: The Government is Entitled to Payment

- ▼ T4D – The contractor is liable to the Government for any excess costs incurred in acquiring supplies and services similar to those terminated for default, and for any other damages, whether or not repurchase is effected. See FAR 49.402-2(e).

T4D: Contract Clauses

▼ Fixed Price:

- ▼ 52.249-8 Supply and Service Contracts above the Simplified Acquisition Threshold
- ▼ 52.249-9 R&D
- ▼ 52.249-10 Construction

▼ Cost Reimbursement:

- ▼ 52.249-6 (which also addresses T4C under cost-reimbursement contracts)

T4D: Contractor Defenses and Strategies

▼ Failure to deliver on specified date:

- ▼ If the due date passes and the Government does not act, the Government has waived its right to T4D.
- ▼ But the Government may revive its right by acknowledging the extension and issuing a new delivery schedule.

T4D: Contractor Defenses and Strategies

▼ Failure to meet specifications:

- ▼ Contractor's alleged failure may be mitigated by interpreting the specifications.
- ▼ If the contractor has “substantially performed,” it is entitled to a reasonable time to cure. “Substantial performance” means:
 - ▼ The contractor has timely delivered with only minor defects in the deliverables, and
 - ▼ The contractor has reasonable grounds to believe the deliverables conformed to the specifications.

T4D: Contractor Defenses and Strategies

▼ Failure to make progress:

- ▼ Government may not T4D without a valid basis “approaching a certainty” that the contractor will not perform.
- ▼ Contractor can show excusable delay, which includes:
 - ▼ Changes to the work,
 - ▼ Government interference with inspection, testing, etc.
 - ▼ Defective specifications/impossibility
- ▼ Contractor can also show that it has cured the failure to make progress by accelerating performance, etc.

T4D: Contractor Defenses and Strategies

▼ Failure to perform other contract provisions:

- ▼ Examples include non-compliance with labor regulations, the Buy America Act, etc.
- ▼ Government must show that the default was material, i.e., prejudicial to the Government.

T4D: Appealing

- ▼ Contractor may appeal to the BCA within 90 days of notice of termination or to the Court of Federal Claims within 1 year.
- It is critical for a contractor to appeal because of the negative impact a T4D will have on the contractor's CPARS and, thus, its ability to win future awards.

T4D: Appealing

- **Remedies:**
 - ▼ **If the contractor prevails, the T4D will be converted to a T4C.**
 - ▼ **Less frequently,**
 - ▼ **The contract may be reinstated,**
 - ▼ **The T4D may be converted to a Government breach, if the Government acted in bad faith, or**
 - ▼ **The T4D stands, but excess procurement costs are not assessed.**

Termination Settlement Methods

▼ Fixed-price contracts:

- ▼ Inventory basis, which is the preferred method, and
- ▼ Total cost basis, which the TCO must approve before the contractor can use it.

▼ Cost-type contracts:

- ▼ Voucher out
- ▼ Settlement proposal

Which Method to Use

- ▼ For fixed-price contracts, the contractor does not select the method (basis). The contractor always uses the inventory basis unless the TCO approves the total cost basis. Use SF 1435.
- ▼ TCO will approve total cost basis and use of SF 1436 when:
 - ▼ Inventory method not feasible or would unduly delay settlement. Criteria include:
 - ▼ Production has not started,
 - ▼ Accounting system doesn't easily establish unit costs,
 - ▼ Unit prices not specified in contract, or
 - ▼ If complete termination of a letter contract.

Which Method to Use

- ▼ **For cost-type contracts, the contractor does select the method to use.**
 - ▼ **If voucher out, is limited to first six months after termination, then must use settlement proposal for any remaining costs**
 - ▼ **If elect use of settlement proposal, it is irrevocable. Must use SF 1437 for costs after election.**

Settlement Costs

- ▼ If significant, should be separately identified and accumulated in accounting records
- ▼ Allowable settlement costs include:
 - ▼ Accounting, legal, clerical, and similar costs reasonably necessary for—
 - ▼ The preparation and presentation of claims
 - ▼ The termination and settlement of subcontracts
 - ▼ Reasonable costs for the storage, transportation, protection, and disposition of property
 - ▼ Indirect costs related to salary and wages incurred above. Normally limited to costs of fringe, occupancy and immediate supervision.