

Ch 7 - Pricing Termination Settlements

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7.1 Commercial-Item Contract Termination For Convenience

Simplified Clause ([FAR 12.403](#) and [52.212-4](#)). The FAR Contract Terms and Conditions -- Commercial Items clause includes a paragraph that permits the Government to terminate the contract for the convenience of the Government. That paragraph:

- Is 90 percent shorter than the noncommercial-item fixed-price contract clause examined later in this chapter, and
- Prescribes a settlement process that is much less complex.

Settlement Objective ([FAR 12.403\(d\)](#) and [Part 31](#)).
Negotiate a settlement that pays the contractor:

- The percentage of the contract price reflecting the percentage of work performed prior to the notice of contract termination.
- Any charges the contractor can demonstrate directly resulted from the termination. The contractor:
 - May demonstrate such charges using its standard record keeping system, and
 - Is not required to comply with cost accounting standards or the FAR contract cost principles.

No Government Audit ([FAR 12.403\(d\)\(1\)\(ii\)](#)). The Government does not have any right to audit the contractor's records solely because of the termination for convenience.

Termination Proposal ([FAR 12.403\(d\)\(2\)](#)). Generally, the parties should mutually agree upon the requirements for the termination proposal. The parties must balance the Government's need to obtain sufficient documentation to support payment to the contractor against the goal of having a simple and expeditious settlement.

7.2 Commercial-Item Contract Termination For Cause

Simplified Clause ([FAR 12.403](#) and [52.212-4](#)). The FAR Contract Terms and Conditions -- Commercial Items clause also includes a paragraph that permits the Government to terminate the contract for cause. That paragraph prescribes a settlement process that is 90 percent shorter and less complex than the noncommercial-item fixed-price contract clause examined later in this chapter.

Government Right to Terminate for Cause ([FAR 52.212-4\(m\)](#)). The Government may terminate a commercial-item contract, or any part thereof, for cause if the contractor:

- Defaults;
- Fails to comply with any contract terms and conditions; or
- Fails to provide the Government, upon request, with adequate assurances of future performance.

Government Rights After Termination for Cause ([FAR 12.403\(c\)\(2\)](#) and [52.212-4\(m\)](#)). Under the clause, the Government's rights after a termination for cause include all the remedies available to any buyer in the marketplace.

- The Government is liable to the Contractor for any amount for supplies or services not accepted.
- The contractor liable to the Government for any and all remedies provided by law. The Government's preferred remedy will be to acquire similar items from another contractor and to charge the defaulted contractor with any excess procurement costs together with any incidental or consequential damages incurred because of the termination.

- o Incidental damages are damages that result from a breach of contract, including all reasonable expenses incurred because of the breach, and reasonable costs incurred by the Government in an attempt to avoid further loss.
- o Consequential damages are damages that do not flow directly and immediately from the termination but rather flow from the results of the termination.

Notice of Remedies ([FAR 12.403\(c\)\(3\)](#)). As part of the termination notice, indicate which remedies the Government intends to seek or provide a date by which the Government will inform the contractor of the remedy.

Consult with your legal counsel before issuing the termination notice.

7.3 Noncommercial-Item Fixed-Price Contract Termination For Convenience

Pricing Objective ([FAR 49.201](#)). When pricing noncommercial-item fixed-price terminations for convenience, your primary objective should be to negotiate a reasonable settlement by agreement. The 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.

- Use judgment in arriving at the amount of reasonable compensation.
- Use cost and accounting data as guides, not rigid measures of reasonable compensation.
- Use other types of data, criteria, or standards as guides to fair contractor compensation.
- Agree on the total amount to be paid the contractor. There is no requirement to agree on the particular elements of cost or profit included in the agreement.

Key Points to Consider. As you establish a settlement amount, consider the following key points:

- Maximum settlement amount;
- General settlement proposal requirements;

- Basis used to develop the settlement proposal (inventory, total cost, or other);
- Settlement expenses;
- Settlement profit;
- Adjustment for loss contracts; and
- Deductions from gross settlement amount.

Maximum Settlement Amount ([FAR 52.249-2\(f\)](#) and [\(g\)](#)). The maximum amount of a termination settlement may not exceed the sum of:

- Total contract price as reduced by:
 - The amount of any payments previously made, and
 - The contract price of any work not terminated; plus
- Reasonable settlement costs including:
 - Accounting, legal, clerical, and other expenses reasonably necessary for preparation of termination settlement proposals and supporting data;
 - The termination and settlement of subcontracts (excluding the amounts of such settlements); and
 - Storage, transportation, and other incurred costs reasonably necessary for the preservation, protection, or disposition of the termination inventory.

General Proposal Requirements ([FAR 49.206-1](#) and [49.602](#)). Subject to the provisions of the termination clause, the contractor should promptly submit a settlement proposal for the amount claimed because of the termination. Settlement proposals:

- Must be submitted within one year from the effective date of the termination, unless the period is extended by the termination contracting officer (TCO).
- May include termination charges from two or more divisions or units of the prime contractor under a single prime contract consolidated and included in a single settlement proposal.
- Must cover all cost elements including settlements with subcontractors and any proposed profit.
 - With TCO consent, proposals may be filed in successive steps covering separate portions of the contractor's costs.

- Each interim proposal must include all costs of a particular type, unless otherwise authorized by the TCO.
- Must be on the FAR-prescribed forms unless the forms are inadequate for the contract involved.
- Must be made in reasonable detail and supported by adequate accounting information.
 - Actual, standard (appropriately adjusted), or average costs may be used in preparing settlement proposals if they are determined under generally recognized accounting principles consistently followed by the contractor.
 - When actual, standard, or average costs are not reasonably available, estimated costs may be used if the TCO approves the method of arriving at the estimates.
 - Never require contractor to maintain an unduly elaborate cost accounting system merely because its contracts may be terminated.
- Must include one [SF 1439](#), Schedule of Accounting Information, per termination, unless the contractor uses a [SF 1438](#), Settlement Proposal (Short Form).
 - Unless otherwise instructed by the TCO, the contractor may use the SF 1438 for any total proposal less than \$10,000.
 - Settlements that would normally be included in a single proposal (e.g., a series of separate orders for the same item under one contract), should be consolidated whenever possible and not divided to bring them below the threshold for SF 1438 use.

Inventory Basis ([FAR 49.206-2\(a\)](#)). The inventory basis is the preferred basis for settling most complete and partial terminations for convenience. Under the inventory basis, the settlement proposal:

- May only propose costs allocable to the terminated portion of the contract, and the settlement proposal must separately itemize all of the following costs:
 - Raw materials, purchased parts, metals, work in process, finished parts, components, dies, jigs, fixtures, and tooling at purchase or manufacturing cost;
 - Charges such as engineering costs, initial or start-up costs, and general and administrative costs;

- Costs of settlements with subcontractors;
 - Settlement expenses; and
 - Other properly allocable charges.
- Must make an allowance for profit (or adjustment for loss) to complete the gross settlement proposal.
- Must deduct all unliquidated advance and progress payments and all disposal and other credits known when the proposal is developed from the gross settlement proposal.

Total Cost Basis ([FAR 49.206-2\(b\)](#)). The total cost basis of settlement pricing is preferred for complete terminations of construction and lump-sum professional services contracts. For other terminations, the TCO may approve contractor use of the total cost basis, when use of the inventory basis is not practical or will unduly delay settlement.

- Consider use of the total cost basis in situations such as those where:
 - Production has not begun and the accumulated costs represent planning and preproduction (get ready) costs.
 - The contractor's accounting system cannot readily establish the unit costs for work in process and finished products.
 - The contract does not specify unit prices.
 - The termination involves complete termination of a letter contract.
- For complete terminations, the contractor must:
 - Itemize all costs incurred under the contract up to the effective date of the termination.
 - Add the costs of settlements with subcontractors and applicable settlement expenses.
 - Make allowance for profit (or adjustment for loss).
 - Deduct the contract price for all end items which have been or are to be delivered and accepted.
 - Deduct all unliquidated advance and progress payments, as well as disposal and other credits known when the proposal is submitted.
- For partial terminations, the contractor must:
 - Not submit the settlement proposal until completion of the continued portion of the contract.
 - Prepare the settlement proposal in accordance with the procedures for a complete termination

except that all costs incurred to the date of completion of the continued portion of the contract must be included.

Other Basis ([FAR 49.206-2\(c\)](#)). Contractor use of any basis for termination settlement other than the inventory basis or the total cost basis must be approved in advance by the chief of the cognizant contracting activity or contract administration office.

Settlement Profit ([FAR 49.202](#)). Profit consideration is an integral part of the settlement process whether you are using the inventory basis or the total cost basis.

- Allow profit on preparations made and work accomplished by the contractor on the terminated portion of the contract, considering the following factors:
 - The extent and difficulty of the work done by the contractor as compared with the total work required by the contract (engineering estimates of the percentage of completion ordinarily should not be required, but if available should be considered).
 - Engineering work, production scheduling, planning, technical study and supervision, and other necessary services.
 - Efficiency of the contractor, with particular regard to:
 - Attainment of quantity and quality production.
 - Reduction of costs.
 - Economic use of materials, facilities, and manpower.
 - Disposition of termination inventory.
 - Amount and source of capital and the extent of risk assumed.
 - Inventive and developmental contributions, and cooperation with the Government and other contractors in supplying technical assistance.
 - Character of the business, including the source and nature of materials and the complexity of manufacturing techniques.
 - The rate of profit that the contractor would have earned had the contract been completed.
 - The rate of profit both parties contemplated at the time the contract was negotiated.

- Character and difficulty of subcontracting, including selection, placement and management of subcontracts, and effort in negotiating settlements of terminated subcontracts.
- For construction contracts:
 - Allow profit on the prime contractor's settlements with construction subcontractors for actual work in place at the job site, but
 - Exclude profit on the prime contractor's settlements with construction subcontractors for materials on hand and for preparations made to complete the work.
- Do not:
 - Allow profit on settlement expenses.
 - Allow anticipatory profits on work not accomplished or consequential damages.
 - Base profit for contractor effort in settling subcontractor proposals on the dollar amount of the subcontract settlement, but you should consider the contractor's efforts when determining the overall profit rate allowed.
 - Allow the contractor profit for material or services that, as of the effective date of the termination, had not been delivered by a subcontractor, regardless of the completion percentage.

Inventory Basis Adjustment for Loss Contracts ([FAR 49.203](#)). If the contractor was performing the contract at a loss, the contractor should not be able to "get well" because of the termination for convenience. If the termination is being settled using the inventory basis, calculate the adjusted settlement using the following formula, less all disposal credits and unliquidated advance and progress payments:

$$S = E + D + \left(I \times \frac{P}{C + F} \right)$$

Where:

S = Adjusted Settlement -- still subject to the deductions described later in this section

E = Settlement Expenses -- negotiated or determined

D = Contract Price (as adjusted) for acceptable completed items

I = Remainder of the inventory basis settlement amount otherwise agreed upon or determined

P = Contract Price

C = Incurred Costs before contract termination

F = Estimated Cost to Complete the contract

$$\frac{P}{C + F}$$

Note: The expression $\frac{P}{C + F}$ is referred to as the loss ratio. It is to the contractor's advantage to understate the estimate to complete, to avoid application of the loss ratio and possibly earn profit. You must therefore review the estimate to complete carefully to ensure that it is reasonable and accurately reflects the current contract status.

For example: What would be the settlement given the following information?

E = Settlement Expenses	\$ 7,000
D = Price of Items Delivered and Accepted	\$ 50,000
I = Remainder of Settlement	\$350,000
P = Contract Price	\$700,000
C = Costs Incurred Prior to Termination	\$400,000
F = Estimate to Complete	\$450,000

$$\begin{aligned}
S &= E + D + \left(I \times \frac{P}{C + F} \right) \\
&= \$7,000 + \$50,000 + \left(\$350,000 \times \frac{\$700,000}{\$400,000 + \$450,000} \right) \\
&= \$7,000 + \$50,000 + \left(\$350,000 \times \frac{\$700,000}{\$850,000} \right) \\
&= \$7,000 + \$50,000 + (\$350,000 \times .82) \\
&= \$7,000 + \$50,000 + \$287,000 \\
&= \$344,000 \text{ adjusted settlement amount}
\end{aligned}$$

Total Cost Basis Adjustment for Loss Contracts ([FAR 49.203\(c\)](#)). If the termination is being settled using the total cost basis, calculate the adjusted settlement using the following formula, less all disposal credits, unliquidated advance and progress payments, and all other amounts previously paid under the contract:

$$S = E + \left(T \times \frac{P}{C + F} \right)$$

Where:

S = Adjusted Settlement -- still subject to the deductions described later in this section

E = Settlement Expenses -- negotiated or determined

T = Remainder of the total cost basis settlement amount otherwise agreed upon or determined (includes price of items delivered)

P = Contract Price

C = Incurred Costs before contract termination

F = Estimated Cost to Complete the contract

For example: What would be the settlement given the following information?

P = Contract Price	\$800,000
E = Settlement Expenses	\$10,000
T = Remainder of Settlement	\$500,000

(including price of items delivered and accepted)

C = Costs Incurred Prior to Termination \$500,000

F = Estimate to Complete \$450,000

$$\begin{aligned} S &= E + \left(T \times \frac{P}{C + F} \right) \\ &= \$10,000 + \left(\$500,000 \times \frac{\$800,000}{\$500,000 + \$450,000} \right) \\ &= \$10,000 + \left(\$500,000 \times \frac{\$800,000}{\$950,000} \right) \\ &= \$10,000 + (\$500,000 \times .84) \\ &= \$10,000 + \$420,000 \\ &= \$430,000 \text{ adjusted settlement amount} \end{aligned}$$

Note: Under the inventory basis for settlement, the loss ratio is only applied to the cost of the items not accepted. Under the total cost basis, it is applied to total cost, so the ratio adjustment could potentially have a greater effect on the adjusted settlement amount.

Deductions From Gross Settlement Amount. From the gross settlement amount payable to the contractor, you must deduct:

- The agreed price for any part of the termination inventory purchased or retained by the contractor, and the proceeds from any materials sold that have not been paid or credited to the Government;
 - The fair value, of any part of the termination inventory that, before transfer of title to the Government or to a buyer, is destroyed, lost, stolen, or so damaged as to become undeliverable (normal spoilage is excepted, as is inventory for which the Government has expressly assumed the risk of loss); and
 - Any other amounts as appropriate for the particular termination.
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7.4 Noncommercial-Item Fixed-Price Contract Termination For Default

Government Right to Terminate for Default ([FAR 49.402-1](#) and [52.249-8](#)). When the noncommercial-items fixed-price contract contains the Default clause, the Government has the right, subject to the notice requirements of the clause, to terminate the contract completely or partially for default if the contractor fails to:

- Make delivery of the supplies or perform the services in the time specified in the contract.
- Perform any other provision of the contract.
- Make progress and that failure endangers performance of the contract.

Key Points to Consider. When you are involved in the administration of a noncommercial-items fixed-price termination for default, consider the following key points:

- Government rights;
- Amounts due the contractor;
- Government protection from overpayment; and
- Repurchase against the contractor's account.

Government Rights ([FAR 49.402-2](#)). Under a noncommercial-item fixed-price contract termination for default:

- The Government is not liable for the contractor's costs on undelivered work.
- The Government is entitled to the repayment of advance and progress payments (if any) applicable to the terminated portion of the contract.
- The Government may elect to require the contractor to transfer title and deliver to the Government completed supplies and manufacturing materials as directed by the contracting officer.
 - Never use the Default clause as authority to acquire any complete supplies or manufacturing materials when the Government has title under some other contract clause.
 - Only acquire manufacturing materials under the Default clause for furnishing to another contractor, after considering the difficulties the new contractor may have in using the materials.

- The contractor is liable to the Government for any excess costs incurred in acquiring supplies or services similar to those required by the contract terminated for default.
- The contractor is liable to the Government for any other damages, whether or not repurchase is affected.

Amounts Due the Contractor ([FAR 52.249-8\(f\)](#)). Under a fixed-price termination for default, the Government:

- Must pay the contract price for completed supplies delivered and accepted.
- Must negotiate an agreement on the amount of payment for:
 - Manufacturing materials (if any) delivered to and accepted by the Government.
 - Protecting and preserving property in which the Government has an interest.
- May withhold from the amounts above any sum necessary to protect the Government against loss because of outstanding liens or claims of former lien holders.

Government Protection From Overpayment ([FAR 49.402-2\(d\)](#)). Protect the Government from overpayment that might result from failure to provide for the Government's potential liability to laborers and material suppliers for lien rights outstanding against the completed supplies or materials after the Government has paid the contractor for them. To accomplish this, take one or more of the following actions before paying for the supplies or materials.

- Ascertain whether payment bonds (if any) provided by the contractor are adequate to satisfy all lienors' claims or whether it is reasonable to obtain similar bonds to cover outstanding liens.
- Require the contractor to furnish appropriate statements from laborers and material suppliers disclaiming any lien rights they may have to the supplies or materials.
- Obtain appropriate agreement by the Government, the contractor, and lienors ensuring release of the Government from any potential liability to the contractor or lienors.
- Withhold from the amount due for the supplies or materials any amount that you determine is necessary to protect the Government's interest, but only if the

above measures cannot be accomplished or are considered inadequate.

- Take other appropriate action considering the circumstances and the degree of contractor solvency.

Repurchase Against the Contractor's Account ([FAR 49.402-6](#)). Generally, the contracting officer will decide before issuing the default termination notice whether or not the supplies or services required by the contract will be repurchased.

- When supplies or services are still required after contract termination, repurchase the same or similar supplies or services against the contractor's account as soon as practicable.
- Repurchase at as reasonable a price as practicable, considering the quality and delivery requirements.
- If the repurchase is for a quantity not over the undelivered quantity terminated for default, the contracting officer is authorized to use any appropriate terms and acquisition method.
 - Obtain competition to the maximum extent practicable for the repurchase.
 - Cite the Default clause as the authority.
- You may repurchase a quantity in excess of the undelivered quantity terminated for default when the excess quantity is needed:
 - Treat the entire quantity as a new acquisition.
 - The excess cost may not be charged against the defaulting contractor's account for more than the undelivered quantity terminated for default (including variations in quantity permitted by the terminated contract).
- If you repurchase at a price over the price of the supplies or services terminated, after completion and final payment of the repurchase contract, make written demand on the contractor for the total amount of the excess, giving consideration to any increases or decreases in other costs such as transportation, discounts, etc.
- If the contractor fails to make payment, follow the FAR procedures for collecting contract debts due the Government.

7.5 Cost-Reimbursement Contract Termination For Convenience

Cost Allowability. Terminations for convenience under a cost-reimbursement contract are subject to the same general rules of allowability as other contract costs.

Key Points to Consider. As you establish a settlement costs and related fee (if any), consider the following key points:

- Complete termination settlement limits;
- Complete termination cost voucher treatment;
- Complete termination settlement proposal;
- Complete termination proposal audit;
- Complete termination indirect cost;
- Complete termination final settlement;
- Partial termination settlement limits;
- Partial termination cost voucher treatment;
- Partial termination settlement proposal; and
- Partial termination final settlement.

Complete Termination Settlement Limits ([FAR 49.301](#)).

Pricing actions with a cost-reimbursement contract termination for convenience, are limited to the settlement of costs and fee (if any) associated with the termination. Consult the contract clauses governing costs to determine what costs are allowable.

Complete Termination Cost Voucher Treatment ([FAR 49.302](#)).

When the contract is completely terminated, the contractor may continue submitting cost vouchers using the Standard Form 1034, Public Voucher for Purchases and Services Other than Personal, until the last day of the sixth month following the month in which the termination is effective. The contractor may elect to stop using vouchers at any time during the 6-month period.

Complete Termination Settlement Proposal ([FAR 49.302](#) and [49.303-1](#)). The contractor must submit a final settlement proposal covering unvouchered costs and any proposed fee within one year of the effective date of the contract termination, unless the period is extended by the TCO.

- The proposal must not include costs that have been:
 - Finally disallowed by the contracting officer.
 - Previously vouchered and formally questioned by the Government but not yet resolved.

- If the contractor has vouchered all costs within the 6-month period, it may limit the settlement proposal to the related fee.

Complete Termination Proposal Audit ([FAR 49.303-3](#)). Unless the proposal is limited to fee only, refer the proposal to the cognizant auditor for review. If the proposal is limited to fee, no referral is required.

Complete Termination Indirect Cost ([FAR 49.303-4](#)). If the contract contains the clause, Allowable Cost and Payment, and it appears that waiting for final indirect costs will unduly delay final settlement, the TCO may (after obtaining information from the cognizant auditor) agree with the contractor to:

- Negotiate the amount of indirect costs for the contract period for which final indirect cost rates have not been negotiated, or to use billing rates as final rates for the period if the billing rates appear reasonable. If you use this method, the contractor must eliminate:
 - The negotiated indirect cost dollars from the indirect cost pool used to calculate final rates applicable to other contracts for the accounting period, and
 - The negotiated indirect cost allocation base from the total indirect cost allocation base used to calculate final rates applicable to other contracts for the accounting period.
- Reserve any indirect cost adjustment in the final settlement agreement, pending establishment of negotiated rates.

Complete Termination Final Settlement ([FAR 49.303-5](#) and [49.305-1](#)). Proceed with the settlement and execution of a settlement upon receipt of the audit report (if applicable) and the contract audit closing statement covering vouchered costs.

- You may include in the final settlement agreement, all demands of the Government and proposals of the contractor under the terminated contract. However, do not allow any disallowed cost or any other cost of the same nature.

- If you and the contractor can reach an overall settlement, agreement on each element of cost is not necessary.
 - Differences may be compromised and doubtful questions settled by agreement.
 - Do not include costs that are clearly unallowable under the terms of the contract.
- Adjust fee in the manner prescribed by the contract. Generally, you should base fee on the percentage of completion. When this basis is used:
 - The percentage of completion may be greater or less than indicated by the percentage of estimated cost expended.
 - Consider factors such as:
 - The extent and difficulty of the work performed by the contractor in comparison with the total work required by the contract.
 - Work performed by the contractor in stopping performance, settling terminated subcontracts, and disposition of termination inventory.
 - Never include an allowance for prime contractor fee based on subcontractor effort included in the subcontractor's settlement proposal.

Partial Termination Settlement Limits ([FAR 49.304-1](#)). In a partial termination, limit the settlement to adjustment of contract fee (if any). With contracting officer concurrence, the TCO may also reduce estimated contract cost to reflect the reduced contract effort.

However, you should process the partial termination following the guidelines for a complete termination, when either of the following situations exist:

- The terminated portion is clearly severable from the balance of the contract; or
- Performance of the contract is virtually complete, performance of any continued portion is only on subsidiary items or spare parts, or performance is otherwise not substantial.

Partial Termination Cost Voucher Treatment ([FAR 49.304-3](#)). When the contractor's proposed partial termination settlement is limited to adjustment of fee, the contractor must continue to submit the [SF 1034](#), Public Voucher for Purchases and Services Other than Personal, for costs that are reimbursable under the contract. Never reimburse the

contractor for costs of settlements with subcontractors unless required approvals or ratifications are received.

Partial Termination Settlement Proposal ([FAR 49.304-2](#)).

The contractor must submit a final settlement proposal covering unvouchered costs and any proposed fee within one year of the effective date of the contract termination, unless the period is extended by the TCO. The contractor must:

- Limit the settlement proposal to proposed reduction in the amount of contract fee, and
- Substantiate the amount of fee claimed.

Partial Termination Final Settlement ([FAR 49.305-1](#)). As described above, the final settlement for a partial termination is limited to a fee adjustment, and a possible reduction in estimated contract cost. Generally, you will base fee on the percentage of completion. When this basis is used:

- The percentage of completion may be greater or less than indicated by the percentage of estimated cost expended.
- Consider factors such as:
 - The extent and difficulty of the work performed by the contractor in comparison with the total work required by the contract.
 - Work performed by the contractor in stopping performance, settling terminated subcontracts, and disposition of termination inventory.
- Never include an allowance for prime contractor fee based on subcontractor effort included in the subcontractor's settlement proposal.

7.6 Cost-Reimbursement Contract Termination For Default

Principles for Settlement ([FAR 49.403](#)). Settlement of a cost-reimbursement contract terminated for default is subject to the principles for settlement of a termination for convenience, except that:

- The costs of preparing the contractor's settlement proposal are not allowable; and

- The contractor is reimbursed the allowable costs, and an appropriate reduction is made in the total fee (if any).

No Repurchase Against the Contractor's Account ([FAR 49.403\(c\)](#)). A cost-reimbursement contract does not contain any provision for Government recovery of excess repurchase costs after termination for default.

7.7 Equitable Adjustment For Continued Portion Of A Fixed-Price Contract

Need for Equitable Adjustment ([FAR 49.208](#)). After a partial termination of a fixed-price contract, the contractor may request an equitable adjustment in the price or prices of the continued portion. This is not part of the actual termination settlement.

The purpose of an equitable adjustment is to provide for any increases in the unit costs of the continued portion of the contract as a result of the reduction in volume. For example, start-up costs may not have been fully amortized at the time of the termination because of a significant decrease in volume, or the average labor hours necessary to produce each unit may not have decreased as anticipated because of learning or efficiency improvements.

Proposal for Equitable Adjustment ([FAR 52.249-2](#)). The contractor may file a request with the contracting officer for an equitable adjustment of the price(s) of the continued portion of a fixed-price contract partially terminated for the convenience of the Government. Any contractor proposal for an equitable adjustment, must be submitted within 90 days from the effective date of the partial termination unless the period is extended in writing by the contracting officer.

There is no similar provision for an equitable adjustment when a fixed-price contract is terminated for contractor default.

Cost Adjustment. Consider a proposed equitable adjustment related to a partial termination following the same guidelines that you would follow when considering any other equitable adjustment.

Profit Adjustment ([FAR 15.404-4](#)). Consider reasonable adjustments in contractor profit as part of the equitable adjustment.

- Base profit analysis on the cost effects considered in the equitable adjustment.
- Develop a profit objective considering the FAR profit factors and applicable agency guidance.

No Settlement/Adjustment Duplication ([FAR 49.208](#)). When the contracting officer responsible for negotiating the equitable adjustment and executing a supplemental agreement is not the TCO, the contracting officer must ensure that no part of the equitable adjustment is included in a termination settlement made or in process.

The TCO must also ensure that no portion of the costs included in an equitable adjustment are included in a termination settlement.

Timing. Although the termination settlement and the equitable adjustment, may be negotiated by separate contracting officers and require separate agreements, both negotiations should normally be completed at the same time.

- Clear separation of the costs associated with the termination settlement and costs associated with the equitable adjustment may be difficult at any point of time. The different contracting officers involved may have differing opinions about which costs should be considered where.
- As the time between the two negotiations increases, it becomes increasingly difficult to assure that all cost effects are covered by the settlement or the adjustment, but there is no duplication.