

T3.10.6 Termination of Contracts

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## **T3.10.6 Termination of Contracts**

### **A Termination**

#### **1 General Guidance**

a. The FAA termination requirements will:

1. Enable the FAA to establish contract requirements that protect the interests of the FAA;
2. Promote fair and rapid termination settlements;
3. Encourage settlement by agreement rather than by contracting officer's determination.

b. Contracting officer (CO) responsibilities. The CO will:

1. Select and include the appropriate termination clause(s) in contracts to provide the CO authority to terminate contracts for convenience, or for default;
2. Enforce provisions of termination clauses in a manner that is in the best interest of the FAA by terminating in whole or in part, for the convenience of the FAA or for contractor default;
3. Direct the contractor on how to proceed when a contract is terminated;
4. Establish a case file for each termination; retain pertinent documentation in the case file as a record of the activities related to the termination and settlement;
5. Enlist assistance of individuals with special qualifications to assist in the termination in areas such as legal, accounting, distribution, and logistics;
6. Arrange inspection of completed items, as needed;
7. Obtain title to completed end items or termination inventory, as appropriate;
8. Initiate action to obtain, all rights, titles, and interest under any subcontract terminated because of termination of the prime contract if it is in the best interest of the FAA to do so;
9. For construction contracts, direct action for site cleanup, protection of serviceable materials, removal of hazards, and any action necessary to leave a safe site;
10. Examine settlement proposal and subcontract settlement proposals;
11. Recognize the subcontractor's final judgment against the contractor, if any, as a cost of the settlement;
12. Approve subcontract settlement, unless otherwise waived by the contracting officer;
13. Initiate audits on the settlement proposal for prime and subcontractors as deemed necessary to protect the interest of the FAA;
14. Negotiate settlement agreements, when applicable, with prime contractors;
15. Issue a CO determination if a settlement agreement cannot be reached;
16. Reinstate contracts on a bilateral agreement basis when deemed in the best interest of the FAA to do so;
17. Release excess funds as quickly as possible retaining sufficient funds to settle the termination.

c. Contractor responsibilities. The contractor will:

1. Cooperate with the CO in the termination;

2. Comply with the termination clause invoked;
3. Comply with direction of the CO consistent with termination clause;
4. Stop work immediately on the terminated contract, or portion thereof;
5. Terminate all subcontracts related to the terminated portion of the contract;
6. Stop placing subcontracts under the contract or terminated portion;
7. Settle outstanding liabilities and claims arising out of subcontract terminations, with prior approval by the contracting officer;
8. Dispose of termination inventory as instructed or approved by the CO;
9. Take necessary action to protect and preserve property in which the FAA has or may acquire an interest, or, as directed by the contracting officer;
10. Advise the contracting officer of any special circumstances affecting the termination, such as a subcontractor's legal proceedings or other commitments related to the termination;
11. Perform accounting review of subcontractor settlements;
12. Submit subcontractor settlement proposals for CO approval, as requested by the CO, and settle subcontracts without prior consent of the CO;
13. Submit a settlement proposal, supported by accounting data or other data required by the CO to review the proposal;
14. Execute a settlement agreement by negotiation as quickly as possible;
15. Perform continuing portion of the contract, if any;
16. Submit any request for an equitable adjustment of price with respect to the continuing portion.

d. Termination Notices.

The CO may terminate contracts by written notice to the contractor, furnishing copies to any known assignee, guarantor, or surety of the contractor. Termination amendments will also be in written form to the foregoing parties. The CO should transmit the notice in a way to establish the time of receipt by the contractor, such as certified mail with return receipt. The CO will invoke the appropriate termination clause, indicate date of termination, direct the contractor on how to proceed, provide disposition instructions for property in which the FAA has or will have an interest, and otherwise comply with the termination clause.

e. Settlements.

1. General.

Settlements may be used in both convenience and default terminations. A settlement should compensate the contractor promptly for the work done and, possibly, preparations made for the terminated portion(s) of the contract, including a reasonable allowance for profit, when appropriate. Termination clauses define costs that may be considered. Cost principles should govern assertions, negotiations, or cost determinations relevant to termination settlements under contracts with other than educational institutions, and be a guide in negotiation of settlements under contracts for experimental, developmental or research work with educational institutions. Business judgment is an important element, in addition to accounting principles, in achieving a fair settlement.

2. Termination Settlements.

When contracts are terminated, the CO should settle all outstanding matters in a fair and prompt manner. Settlements should consider rights and liabilities of the parties

such as:

- a. Costs owed the contractor for delivered/accepted supplies or services;
- b. Contractor obligation to reimburse the FAA with interest for overpayments to the contractor;
- c. Materials acquired by the contractor for the contract that may necessitate contractor disposal;
- d. Rights of the parties;
- e. Construction site cleanup;
- f. Some settlement preparation cost.

3. Approaches.

The contracting officer may use various approaches to settle terminated contracts. Approaches that may be used include:

- a. Negotiation,
- b. CO determination,
- c. Cost out under vouchers in a cost-reimbursement contract;
- d. By combination of methods.

4. Settlement Proposal.

The CO should provide the contractor explicit direction on the preparation of the settlement proposal. Contractors should prepare and submit to the CO a settlement proposal on the outstanding liabilities and obligations of the parties. The proposal may be the basis for a negotiated settlement agreement. The proposal should cover all cost elements including settlements with subcontractors and any proposed profit. , With the consent of the CO, the contractor may file proposals in successive steps covering separate portions of the contractor's costs. Such interim proposals should include all costs of a particular type, except as the CO may otherwise authorize.

5. Settlement by Negotiation.

Settlement by negotiation is the preferred method to arrive at a settlement agreement. The CO should document the settlement negotiation in a memorandum or similar documentation describing the principal elements of the settlement and include this as documentation in the termination file.

6. Settlement by determination.(Revised 06/2001)

- a. The CO should issue a determination to the contractor in instances where the FAA and the contractor cannot agree on a termination settlement, or if a settlement proposal is not submitted within the period required by the termination clause. The determination should state:

- i. That it is the Contracting Officer's termination settlement determination, and
- ii. That the amount due the contractor, if any, consistent with the termination clause and any cost principles affecting the contract. The CO should support his/her determination with schedules in sufficient detail to substantiate the basis and rationale for the amount.

- b. The contractor may file a dispute with Office of Dispute Resolution for Acquisition based upon the settlement determination of the Contracting Officer - see termination clauses and Contract Disputes clause at 3.9.1-1.

7. Settlement Agreement.

The settlement agreement should describe the elements of the settlement so that the obligations of the parties are clear and do not create any rights for the parties beyond those in existence before execution of the settlement agreement. The

settlement agreement will be in the form of a contract modification.

8. No cost settlement.

The CO may execute a no-cost settlement agreement if (a) the contractor has not incurred costs for the terminated portion of the contract or (b) the contractor is willing to waive the costs incurred and (c) no amounts are due the FAA under the contract.

9. Partial settlements.

Partial settlements are discouraged. The CO should attempt to settle all rights and liabilities of the parties under the terminated portion of the contract in one agreement. However, when a CO cannot promptly complete settlement under the terminated contract, he/she may enter a partial settlement reserving rights on the unresolved issues to a later time.

10. Settlement Conference.

The CO may hold a conference with the contractor to develop a definite program for effecting the settlement. When appropriate in the judgment of the CO and after consulting with the contractor, principal subcontractors may be requested to attend.

Topics that should be discussed at the conference and documented include-

- a. General principles relating to the settlement of any settlement proposal, including obligations of the contractor under the termination clause of the contract;
- b. Extent of the termination, point at which work is stopped, and status of any plans, drawings, and information that would have been delivered had the contract been completed;
- c. Status of any continuing work;
- d. Obligation of the contractor to terminate subcontracts and general principles to be followed in settling subcontractor settlement proposals;
- e. Names of subcontractors involved and the dates termination notices were issued to them;
- f. Contractor personnel handling review and settlement of subcontractor settlement proposals and the methods being used;
- g. Arrangements for transfer of title and delivery to the FAA of any material required by the FAA;
- h. 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;
- i. Contractor accounting practices and preparation of SF 1439 (Schedule of Accounting Information)
- j. Form in which to submit settlement proposals;
- k. Accounting review of settlement proposals;
- l. Any requirement for interim financing in the nature of partial payments;
- m. 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 to minimize impact upon employees affected adversely by the termination.

11. Settlement costs/profit. Settlement costs should be consistent with the termination clause invoked and the cost principles that may apply.

12. Settlement by determination. If the settlement is by determination and there is no appeal within the allowed time, the contractor should submit a voucher or invoice showing the amount finally determined due, less any portion previously paid; or there is

an appeal, the contractor should submit a voucher or invoice showing the amount finally determined due on the appeal, less any portion previously paid. Pending determination of any appeal, the contractor may submit vouchers or invoices for charges that are not directly involved with the portion being appealed, without prejudice to the rights of either party on the appeal.

f. Payments.

1. Partial Payments. The CO may authorize partial payments on settlement proposals before settlement if the contractor requests them and the CO determines that it would not be contrary to the interest of the FAA.
2. Final Payments. After execution of a settlement agreement, the contractor should submit a voucher or invoice showing the amount agreed upon, less any portion previously paid. The CO should attach a copy of the settlement agreement to the voucher or invoice and forward the documents to the CO for payment.
3. Under Construction Contracts. If there are any outstanding labor violations in the case of construction contracts, the CO should withhold an appropriate amount from the final payment pending resolution of the violations.

g. Interest.

The FAA should not pay interest on the amount due under a settlement agreement or a settlement by determination. The FAA may, however, pay interest on a successful contractor appeal from a contracting officer's determination under the Resolution of Protests and Disputes procedures. Interest will be at a rate set by the Secretary of the Treasury under 50 U.S.C. (App) 1215(b)(2).

## **2 Termination for Convenience of the FAA**

The provisions of this section apply to contracts containing Clauses 3.10.6-1 through 3 and Alternates which permit termination for convenience of the FAA.

a. Fixed Price Contracts.

1. Profit. The CO may use any reasonable method to arrive at a fair profit. The CO may allow profit on preparations made and work done by the contractor for the terminated portion of the contract but not on the settlement expenses. Anticipatory profit is not allowed. Profit should not be allowed the contractor for material or services that, as of the effective date of termination, have not been delivered by a subcontractor, regardless of the percentage of completion.
2. Adjustment for Loss. The CO should not allow profit if it appears that the contractor would have incurred a loss had the entire contract been completed. The CO should negotiate or determine the amount of loss and make an adjustment in the amount of settlement based upon the degree of expected loss.
3. The contracting officer should ensure that no portion of an increase in price is included in a termination settlement made or in process.
4. Completed end items. The CO should (a) have completed end items inspected and accepted if they comply with the contract and (b) determine which accepted items

should be delivered under the contract. These items should not be included in the settlement proposal. If accepted items are not to be delivered, the contractor may include them in the settlement proposal at the contract price as adjusted to reduce by freight cost or to add disposal costs, etc. Work in place accepted by the Government under a construction contract is not considered a completed item even though that work may have been paid for at the unit prices specified in the contract.

5. 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.

b. Cost Reimbursement Contracts.

1. Audit. The CO should obtain an audit on the settlement proposal unless only fee is proposed.
2. Final Settlement.
  - a. Settlements of cost reimbursable contracts should not provide for recovery of excess repurchase costs.
  - b. The settlement should not include costs that were disallowed or unallowed under the terms of the contract.
  - c. Settlement does not need to be based on agreement on every element if an overall settlement can be agreed to.
3. Partial Terminations. If the terminated portion is not severable, the settlement in a partial termination should be limited to a fee adjustment and reduction in estimated cost as well as other allowable costs associated with preparing a settlement proposal.
4. Fee. The CO should determine the fee adjustment in accordance with the contract, however, the fee is generally adjusted based upon percentage of completion.

### **3 Termination for Default**

a. General.

1. Termination for default is the exercise of the FAA's contractual right to completely or partially terminate a contract by reason of the contractor's actual or anticipated failure to perform its contractual obligations. When the contracting officer has the right to terminate a contract for default, the total undelivered contract quantity, whether delinquent or not, may be terminated for default.
2. Process.
  - a. Show cause notice. Prior to terminating a contract for default, the CO should issue a show cause notice.
  - b. The "show cause" notifies the contractor of the potential termination and the liabilities to the contractor in a termination for default. The "show cause" notice will request the contractor to explain why the contract should not be terminated. The CO should consider the response, if any, in determining if the failure was excusable or inexcusable.
  - c. If the contractor can establish that its failure to perform arose out of causes beyond its control and without its fault or negligence, and are thus excusable, the default termination will be deemed a termination for the convenience of the

FAA, and the rights and obligations of the parties will be governed accordingly.

- d. If the failure was not excusable, the CO may proceed to terminate the contract for default
3. Options in Lieu of Termination for Default. The CO may consider alternatives other than termination for default if in the best interest of the FAA to do so. Prospective alternatives may be to terminate for the convenience of the FAA if the failure to perform was beyond the control of the contractor; consider a surety or guarantor to complete the work; allow the contractor to use a third party to perform. Other reasonable and viable alternatives may also be considered.
4. The FAA may, in appropriate cases, exercise termination or cancellation rights in addition to those in the contract clauses (see, for example Clause 3.10.6-4, Default (Fixed Price Supply and Service)).
5. Damages. If a contract is terminated for default, or if a procedure in lieu of termination for default is followed, the contracting officer may consider FAA's entitlement to damages. Damages are in addition to repurchase costs, when repurchase costs are applicable.
6. Sureties. Prior to terminating fixed price contracts for contractor default, the CO should notify sureties of the impending termination prior to issuing the actual termination notice. In addition, the contracting officer should consider proposals from sureties to complete the work.

b. Fixed-Price Contracts Terminated for Default.

1. FAA Rights and Obligations. Clauses 3.10.6-4 through 6 covering Termination for Default (Fixed Price) provide the FAA the right to terminate all or any part of a contract when the contractor:
  - a. Fails to make delivery or perform services according to contract schedule or
  - b. Fails to complete any material requirement of the contract within the time specified in the contract or
  - c. Fails to make progress to a degree that this failure endangers performance of the contract or
  - d. Fails to perform any other contract provision or
  - e. Fails to meet contractual obligations.

The FAA is not liable for the contractor's costs on undelivered work and is entitled to repayment of payments to the contractor for undelivered work. The CO may direct the contractor to transfer title and deliver to the FAA completed supplies and manufacturing materials. The supplies and manufacturing materials transferred from the contractor to the FAA may be used in continuing the terminated contract work or for use under another contract.

2. The FAA should pay the contractor the contract price for any supplies or services completed and delivered, and the amount agreed upon by the contracting officer and the contractor for any manufacturing materials obtained by the contractor.
3. The FAA should be protected from overpayment that might result from failure to provide for the FAA's potential liability to laborers and material suppliers for lien rights outstanding against the completed supplies or materials after the FAA has paid the contractor for them. To accomplish this, before paying for supplies or materials, the contracting officer shall take one or more of the following measures:

- a. (a) Ascertain whether the payment bonds, if any, furnished by the contractor are adequate to satisfy all lienors' claims or whether it is feasible to obtain similar bonds to cover outstanding liens.
  - b. (b) Require the contractor to furnish appropriate statements from laborers and material suppliers disclaiming any lien rights they may have to the supplies and materials.
  - c. (c) Obtain appropriate agreement by the FAA, the contractor, and lienors ensuring release of the FAA from any potential liability to the contractor or lienors.
  - d. (d) Withhold from the amount due for the supplies or materials any amount the contracting officer determines necessary to protect the FAA's interest, but only if the measures in subparagraphs (d)(1), (2), and (3) above cannot be accomplished or are considered inadequate.
  - e. (e) Take other appropriate action considering the circumstances and the degree of the contractor's solvency.
4. Repurchase Against Contractor's Account. When supplies or services are still required after termination for default, the contracting officer may repurchase the same or similar supplies or services against the contractor's account as soon as practicable. The repurchase must be at as reasonable a price as possible considering the quality required by the FAA and the time within which the supplies or services are required. Whenever practicable, the contracting officer should make necessary repurchase decisions before issuing the termination notice. If repurchase is made at a price higher than the price of the terminated supplies or services, the contracting officer must--after final payment of the repurchase contract-- make a written demand on the contractor for the excess amount, taking into account any increases or decreases in cost due to transportation charges, discounts, and other factors. The contractor is liable to the FAA for any excess costs incurred in acquiring supplies and services similar to those terminated for default, and any other damages, whether or not repurchase is made.

c. Contract Clause Cost Reimbursement Contracts Terminated for Default

Contract Clause 3.10.6-3 Termination (Cost Reimbursement) and Alternates provides the CO authority to terminate cost reimbursement contracts for default.

**4 Definitions**

- a. 'Claim,' as used in this part, means the same as the language in Resolution of Protests and Disputes.
- b. 'Continued portion of the contract,' as used in this part, means the portion of a partially terminated contract that the contractor must continue to perform.
- c. 'Effective date of termination' means the date on which the notice of termination requires the contractor to stop performance under the contract. If the termination notice is received by the contractor subsequent to the date fixed for termination, then the effective date of termination means the date the notice is received.

d. 'Other work,' as used in this part, means any current or scheduled work of the contractor, whether Government or commercial, other than work related to the terminated contract.

e. 'Partial termination' means the termination of a part but not all, of the work that has not been completed and accepted under a contract.

f. 'Settlement agreement,' as used in this part, means a written agreement in the form of an amendment to a contract settling all or a severable portion of a settlement proposal.

g. 'Settlement proposal,' as used in this part, means a proposal for effecting settlement of a contract terminated in whole or in part, submitted by a contractor or subcontractor in the form, and supported by the data, required by this part. A settlement proposal is included within the generic meaning of the word 'claim' under false claims acts (see 18 U.S.C. 287 and 31 U.S.C. 3729).

h. 'Show cause' refers to a notice which the CO is required to issue prior to terminating a contract. The purpose of a show cause notice is to permit the contractor to present its defense against termination.

i. 'Terminated portion of the contract' means the portion of a terminated contract that relates to work or end items not completed and accepted before the effective date of termination that the contractor is not to continue to perform. For construction contracts that have been completely terminated for convenience, it means the entire contract, notwithstanding the completion of, and payment for, individual items of work before termination.

j. 'Termination inventory' means any property purchased, supplied, manufactured, furnished, or otherwise acquired for the performance of a contract subsequently terminated and properly allocable to the terminated portion of the contract. It includes FAA-furnished property. It does not include any facilities, material, special test equipment, or special tooling that are subject to a separate contract or to a special contract requirement governing their use or disposition.

k. 'Unsettled contract change' means any contract change or contract term for which a definitive modification is required but has not been executed.

## **B Clauses**

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## **C Forms**

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