**CONTRACT TERMINATIONS**

**Basic Definitions**

Contract Termination can be defined simply as “ending ones obligations under a contract.” The government is able to terminate its obligations through special clauses called “termination clauses”. The government may terminate or end a contract at any time whether it is for the convenience of the government or due to fault by the contractor. The procedures for terminating a contract vary depending on whether the contract is being terminated for the government’s convenience or due to the contractor’s fault. The procedures also vary depending on whether the contract being terminated is a *commercial* or *noncommercial*contract. When the government terminates a contract for its convenience, whether the contract is commercial or noncommercial, it is called “Termination for Convenience.”

When a *noncommercial* contract is terminated due to contractor fault, it is called “Termination for Default” and the termination of a *commercial* contract due to contractor fault is called “Termination for Cause.”

**TERMINATION FOR CONVENIENCE**

Termination for Convenience (“T4C”) is the government’s unilateral contractual right to partially or completely terminate a contract without being required to pay damages, despite full contractor compliance with its contractual obligations.

Termination for Convenience is defined in the FAR as the exercise of the government’s right to completely or partially terminate performance of work under a contract when it is in the government’s interest.

The government’s right to terminate for convenience is one of the most unique provisions of government contracting, with no counterpart in common law contracting. The government does not need any particular reason to terminate a contract for convenience, other than it is in its best interest do so.

Government termination clauses allow contracting officers to terminate contracts for convenience and to enter into settlement agreements. There are four basic types of termination for convenience clauses used by the government. These are the long and short form clauses at FAR [52.249-1](http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/52_246.htm#P1663_241447) and [FAR 52.249-2](http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/52_246.htm#P1672_242545) for fixed price contracts less than the simplified acquisition threshold (SAT) and over the SAT (respectively), and the Termination for Convenience clause for cost-reimbursement contracts at FAR[52.249-6](http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/52_246.htm#P1828_277044). FAR clause [52.212-4](http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/52_000.htm#P1749_245556) is used for commercial items.

Notwithstanding the government’s wide latitude in terminating contracts for convenience, the contracting officer is permitted to do so only when the contracting officer has determined that it is in the government’s interest. Before executing a termination for convenience, the contracting officer must consider the alternatives in consultation with the customer, legal, and other interested parties.

Due to the impact on both the government and the contractor, government policy favors a no-cost settlement in lieu of termination. When the price of the undelivered balance of the contract is less than $5,000, government policy requires that the contract be permitted to run to completion rather than be terminated.

**Written Notice**
A written notice must be issued to the contractor by the contracting officer prior to terminating a contract for convenience. The notice must include the following:

1. That the contract is being terminated for the convenience of the Government under the contract clause authorizing the termination;
2. The effective date of termination;
3. The extent of termination;
4. Any special instructions; and
5. The steps the contractor should take to minimize the impact on personnel if the termination, together with all other outstanding terminations, will result in a significant reduction in the contractor’s work.

After the contracting officer issues a notice of termination, a **Termination Contracting Officer (TCO)**may be appointed to handle the termination. The TCO will be responsible for negotiating any settlement with the contractor, including a no-cost settlement if appropriate.

**Settlement**
When the contracting officer terminates a contract for convenience, the government is liable to the contractor for the contractor’s incurred costs and profit on all work performed. The contracting officer is required to effect a no-cost settlement in lieu of termination when:

1. It is known that the contractor will accept a no cost settlement,
2. Government property was not furnished, and
3. There are no outstanding payments, debts due the government, or other contractor obligations.

**Profit**
The contractor is allowed profit on preparations made and work done for the terminated portion of the contract but not on settlement expenses. *Anticipatory profits and consequential damages are not allowed*. When determining the overall rate of profit allowed, the effort expended by the prime contractor in settling subcontracts can be considered. Various other factors which may be considered when negotiating or determining profit are listed in the FAR.

Profit is not allowed if it appears the contractor would have incurred a loss had the entire contract been completed. Accordingly, an adjustment for that loss is required in the amount of the settlement.

**Settlement by Determination**
A *unilateral settlement determination* should be issued when:

* The government and contractor cannot reach a bilateral agreement on all elements of outstanding cost; or
* The contractor has not submitted a settlement proposal within the period stipulated in the termination clause.

The [**Standard Form 30**](http://www.acquisition.gov/far/current/html/FormsStandard9.html)is used to settle a termination for convenience by determination when (i) the contractor has lost its right of appeal because it failed to submit a timely settlement; or (ii) to confirm the determination when the contractor does not appeal the government’s decision.

**Reinstatement of terminated contracts**
With written consent of the contractor, the terminated portion of a contract may be reinstated in whole or in part by amending the notice of termination if it has been determined in writing that:

1. Circumstances clearly indicate a requirement for the terminated items; and
2. Reinstatement is advantageous to the government.

**TERMINATION FOR DEFAULT**

Termination for default (“T4D”) applies to noncommercial contracts only. It closely resembles a common law breach of contract in which one party fails to live up to its obligations. Termination for default is usually a difficult experience for both the contractor and Government who are likely to suffer significant economic and time losses. Therefore, the Government should only terminate a contract for default if it has clear grounds to do so. The Government is entitled to obtain various forms of damages from the contractor as relief, and may also charge the contractor whatever additional costs result from reprocuring the supply or service. When considering a potential termination (especially one based on default) the contracting officer should coordinate closely with the acquisition team including technical, financial, and customers or users and should consult with legal counsel before initiating a termination for default.

**Procedures**
When a default termination is being considered, the Contracting Officer shall decide which type of terminating action to take and shall consider the following factors:

1. The terms of the contract and applicable laws and regulations.
2. The specific failure of the contractor and the excuses for the failure.
3. The availability of the supplies or services from other sources.
4. The urgency of the need for the supplies or services and the period of time required to obtain them from other sources, as compared with the time delivery could be obtained from the delinquent contractor.
5. The degree of essentiality of the contractor in the Government acquisition program and the effect of a termination for default upon the contractor’s capability as a supplier under other contracts.
6. The effect of a termination for default on the ability of the contractor to liquidate guaranteed loans, progress payments, or advance payments.
7. Any other pertinent facts and circumstances.

Once the decision has been made to terminate for default, the contracting officer should, if practical, notify the contractor in writing of the possibility of the termination. The notice shall also call attention to the contractor’s contractual liabilities, and request the contractor to show cause why the contract should not be terminated for default. The notice may further state that failure of the contractor to present an explanation may be taken as an admission that no valid explanation exists. When appropriate, the notice may invite the contractor to discuss the matter at a conference. A format for a show cause notice is at [49.607](http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/49.htm#P867_163632).

When a termination for default appears imminent, the contracting officer shall provide a written notification to the surety. If the contractor is subsequently terminated for default, a copy of the notice of default shall be sent to the surety.

If the contractor is a small business firm, the contracting officer shall immediately provide a copy of any cure notice or show cause notice to the contracting office’s small business specialist and the Small Business Administration Regional Office nearest the contractor. The contracting officer should, whenever practicable, consult with the small business specialist before proceeding with a default termination.

The applicable default clause covers situations where the contractor has defaulted by failure to make delivery of the supplies or to perform the services within the specified time. ([FAR 52.249-8 thru FAR 52.249-10](http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/52_246.htm#P1935_298616)). In these situations, no notice of failure or of the possibility of termination for default is required to be sent to the contractor before the actual notice of termination. However, if the Government has taken any action that might be construed as a waiver of the contract delivery or performance date, the contracting officer shall send a notice to the contractor setting a new date for the contractor to make delivery or complete performance. This notice will reserve the Government’s rights under the Default clause.

If the termination is based on the contractor failing to perform other provisions of the contract (such as not furnishing a required performance bond) or fails to make progress as to endanger performance of the contract, the contracting officer shall give the contractor written notice specifying the failure and providing a period of 10 days (or longer period as necessary) in which to cure the failure. Upon expiration of the 10 days (or longer period), the contracting officer may issue a notice of termination for default ([FAR 49.607](http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/49.htm#P867_163632)) unless it is determined that the failure to perform has been cured.

**TERMINATION OF COMMERCIAL CONTRACTS**

The contracting Officer should exercise the Government’s right to terminate a contract for commercial items either for convenience or for cause only when such a termination would be in the best interests of the Government. The contracting officer should consult with counsel prior to termination for cause.

The clause at [FAR 52.212-4](http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/52_000.htm#P1554_215892) permits the Government to terminate a contract for commercial items either for the convenience of the Government or for cause. However, the paragraphs in 52.212-4 entitled “Termination for the Government’s Convenience” and “Termination for Cause” contain concepts which differ from those contained in the termination clauses prescribed in Part 49. Consequently, the requirements of Part 49 do not apply when terminating contracts for commercial items. However, Contracting officers may continue to use Part 49 as guidance to the extent that Part 49 does not conflict with [FAR 12.403](http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/12.htm#P174_30987) and the language of the termination paragraphs in 52.212-4.

Termination for Cause closely resembles a common law breach of contract in which one party fails to live up to its obligations. (In noncommercial contracts, the applicable term is termination for default.) Termination for cause is usually a traumatic event for both parties. Both the contractor and Government are likely to suffer significant economic and time losses. Therefore, the Government should only terminate a contract for cause if it has clear grounds for doing so. The Government is entitled to obtain various forms of damages from the contractor as relief, and may also charge the contractor whatever additional costs result from reprocuring the supply or service. Remember that as a contracting professional you do not function in a vacuum; you are part of an acquisition team. When considering a potential termination, you should coordinate closely with your customer(s). Although a Contracting Officer has unilateral authority to terminate a contract, that authority should not be exercised independently of other members of the acquisition team. [FAR 12.403](http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/12.htm#P174_30987)

The Government has a contractual right to partially or completely terminate a contract because of a contractor's lack of performance or improper performance. Termination for cause applies only to commercial contracts. The Government may terminate all or portion of a commercial item contract for cause if the contractor fails to:

* Comply with contract terms and conditions; or
* Provide the Government, upon request, with adequate assurances of future performance.

After consulting with the customer and legal counsel, the Contracting Officer should consider several factors when determining whether or not to terminate a contract for cause:

* The terms of the contract and applicable law/regulations
* The specific failure of the contractor and the explanations for the failure
* The availability of the supplies and services from other sources
* The urgency of the need for the supplies or services.

**Notifying Parties of Termination for Cause**

*Cure Notice*
The Contracting Officer shall send a “cure notice” prior to terminating a contract for any reason other than late delivery, such as the contractor’s failure to perform some other provision of the contract or failure to make progress so as to endanger performance of the contract. The written notice should describe the failure and provide the contractor a period of 10 days by which to “cure” the failure. See format for a cure notice at [FAR 49.607.](http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/49.htm#P867_163632)

*Show Cause Notice*
The “show cause” notice is issued when there is not sufficient time remaining in the delivery schedule to cure the problem (typically 10 days) or the contractor failed to act on a cure notice already sent. The show cause notice advises the contractor of the consequences of a termination and asks the contractor to "show cause" why the contract should not be terminated. See format for a show cause notice at [FAR 49.607](http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/49.htm#P867_163632).

**Notice to Interested Parties**

As the Contracting Officer, you must inform interested parties who may be affected by the termination. When the contractor is a small business, you need to consult with your small business specialist before proceeding with the termination. Generally speaking, make the same distribution of the termination notice as was made of the contract. A copy should also be furnished to the contractor's surety, if any. In addition, you should notify the Defense Accounting and Finance Service (DFAS) to withhold further payments under the terminated contract, pending further advice.

**Conference with the Contractor and Amending the Termination for Cause Notice**

The Contracting Officer should conduct a conference only when it will facilitate the termination process. A meeting may also be scheduled with the contractor to discuss the pending termination. As a result of the meeting, the contract may be amended to correct minor mistakes in the notice; add supplemental data or instructions; or rescind the notice entirely if it is determined that the items terminated had been completed or shipped before the contractor's receipt of the notice. With the written agreement of the contractor the Contracting Officer may reinstate the terminated portion of a contract, in whole or part, by amending the notice of termination. If a reinstatement of a portion of the terminated contract is appropriate, the reinstatement must be based on a written determination that circumstances clearly indicate a requirement for the terminated items; and reinstatement is advantageous to the Government.

**Repurchasing the Items**

Termination guidelines for both commercial and non-commercial item contracts under simplified acquisition proceduresstate that the Government is not liable to the contractor for any amount. The contractor, however, is liable to the Government for any and all rights and remedies provided by law. When the supplies or services are still required after termination, the Government’s preferred remedy is to acquire the same or similar supplies/services from another source and charge the defaulted contractor with any excess reprocurement costs. The contracting officer should:

* Consider the "Repurchase Against Contractor' s Account" requirements of FAR [49.402-6](http://farsite.hill.af.mil/reghtml/regs/far2afmcfars/fardfars/far/49.htm#P481_88919);
* Mitigate or reduce damages to the Government by promptly reprocuring at a fair and reasonable price; and
* Compute excess reprocurement costs and incidental or consequential damages incurred because of the termination.

**Reaching Agreement on the Amount Due**

The contracting officer should strive to negotiate an agreement with the contractor on the amount of payment for supplies delivered/services rendered. In calculating the total amount owed to the contractor (if any) on a fixed-price termination, the following shoud be considered:

* The contract price for completed supplies that have been delivered and accepted.
* The price negotiated or set by the CO's final decision for manufacturing materials that have been delivered and accepted by the Government, and for any protection and preservation of the property.
* Any deductions necessary to protect the Government against loss because of outstanding liens or claims of former lien holders.

In the event an agreement cannot be reached, the Contracting Officer will issue a final decision. This is a unilateral decision, also referred to as a “unilateral determination.” If the contractor disagrees with the decision, the contractor can initiate dispute proceedings as long as the contractor's settlement proposal was provided to the Government in a timely manner.

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