Acquisition Research Program:
Creating Synergy for Informed Change

DoD Contract Termination Liability: An Analysis of the Special Termination Cost Clause

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Overview

- Purpose of Research
- Termination Liability (TL) Requirements
- Special Termination Cost Requirements
- Observations and Findings
- Alternative Approaches to Funding TL
- Recommendations

Purpose of Research

- Review current policies, practices, and procedures for funding and managing contract termination liability within the DoD
- Propose alternative approaches to funding TL
- Provide recommendations for funding TL

Background

- Termination Liability (TL): The government's liability to the contractor for certain costs and damages resulting from a termination for convenience
  - Applies to incrementally funded contracts
- Regulations require that obligated funds are adequate and sufficient to cover TL expenses at any point during the contract period
  - Protects against possible Anti-Deficiency Act violations

Background

- Two exceptions:
  - Statutory Waiver (Congressional approval)
  - Special Termination Cost (STC) Clause
- STC Clause (DFARS)
  - Limits the amount of certain termination costs (per FAR 31) that the government is liable for in a Termination for Convenience
  - Requires agency head approval and Congressional notification

Observations and Findings

- Inconsistent approach to managing and budgeting for TL
- Diffused guidance between Financial Management Regulation (FMR) and the Federal Acquisition Regulation (FAR)
  - Differing interpretation of policy, guidance, procedures

Observations and Findings

- Insufficient database to conduct proper analysis
  - Number of contracts requiring TL
  - Total amount of TL funding
  - Number of contracts containing STC clauses
  - Total amount of funding managed at higher levels because of STC

Observations and Findings

- Lack of acceptability for STC clause
  - Not well received by Congress or OMB
    - Current environment of cost overruns and schedule delays
  - Not well received by acquisition Program Managers
    - Hesitant to approach higher headquarters

Alternative Approaches to Funding TL

- Impose a "tax" on all programs subject to TL
  - Use tax to fund TL insurance pool to cover TL costs
  - Advantages:
    - PM won't have to commit funds for TL
    - Less funds tied up at service level for TL and available for program execution
  - Disadvantages
    - All programs subject to TL must pay tax, regardless of termination risk
    - At-risk programs would have less funds for program execution

Alternative Approaches to Funding TL

- Fund TL at the major command or PEO level
  - TL funds managed at higher headquarters level
  - Advantages:
    - PM won't have to commit funds for TL
    - STC clauses would not be needed
  - Disadvantages
    - Congress not receptive (similar to STC)
    - Actual termination may have adverse affects on other programs

Alternative Approaches to Funding TL

- Increase the use of STC Clauses
  - Advantages:
    - More funds available for program execution
    - Elimination of uncertainty of fund availability
  - Disadvantages
    - Congress not receptive
    - OMB not receptive
    - STCs are administratively burdensome

Recommendations

- Remove ambiguity and improve consistency in the FMR and FAR
- Do not impose a tax system to provide TL
- Continue to use STC clauses for major programs having funding or longevity concerns

Summary

- Inconsistent TL regulations subject to misinterpretation
- Inconsistent practices and procedures in managing TL
- Given number of contracts, there is a very small probability of a termination for convenience
- Program managers are satisfied with current practices and procedures for managing TL
- Lack of Congressional support for STC clauses
- Recommend improving regulations pertaining to TL and consider use of STC in major acquisition programs