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# TERMINATION FOR DEFAULT AND FOR CONVENIENCE OF THE GOVERNMENT

EDWIN P. JAMES\*

It would be most inappropriate to discuss government contracts without covering an item that is a living possibility with every contract—termination. Although terminations do not of themselves automatically result in a dispute case, they are of such a complex and controversial nature that appeals by contractors to the Armed Services Board of Contract Appeals and to other tribunals are frequently made. Therefore, although this article will deal basically with regulations covering the two major types of termination—for default and for convenience of the government—it will also make frequent reference to appeal cases in other categories.

First, we need to distinguish between the two major types of terminations which are handled in entirely different ways. Termination for default is generally the exercise of a contractual right of the government or prime contractor to terminate the contract in whole or in part by reason of the contractor's failure, actual or anticipatory, to perform its obligations under the contract.<sup>1</sup> Termination for the convenience of the government, on the other hand, is a contractual right to terminate the contract in whole or in part due to requirements no longer existing for the products being procured, to a lack of funds, to advances in the state of the art rendering obsolete the product covered by the contract or for any other reason the contracting officer determines is in the best interest of the government.

Before describing in detail the two types of termination, it is of interest to note the *Klein* case,<sup>2</sup> which was an action against the United States for alleged wrongful termination for default of a military supply contract. The court allowed damages of \$233,295.32 on the grounds that evidence indicated the contractor was not in default. It further ruled that, since the contractor was not in default, the termination could not become one for convenience as that would only apply under the terms of the contract if the contractor's default were excusable. As a result of this decision, the government gave strong consideration to combining the default and convenience termination clauses to avoid any such future court actions. However, it was finally determined to remedy the situation, from the government's viewpoint,

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<sup>1</sup> ASPR, 32 C.F.R. § 8.601(a) (1961).

<sup>2</sup> *Klein v. United States*, 285 F.2d 778 (Ct. Cl. 1961).

by revising the default clauses<sup>8</sup> to indicate that if the contractor were not in default or if the default were excusable, the termination would automatically become one for convenience.

#### TERMINATION FOR DEFAULT

Under termination for default, a contractor may not recover its costs on undelivered work and must repay any progress or advance payments applicable to such work. Furthermore, the contractor is liable to the government for any excess costs for supplies and services procured similar to those terminated and for any other damages. The government may elect to take all or any part of the completed supplies and manufacturing materials involved for which the contractor is paid.

It is obvious from the above that termination for default is a harsh penalty indeed, so that all contractors should take every step possible to avoid such a situation. It will prove advantageous to the contractor to have completely documented files when dealing in government work (including telephone conversations), as these files may prove invaluable in contesting a termination for default. Frequently, too, it can be proved by the contractor that its failure to perform arose out of causes beyond its control and without its fault or negligence, so that a termination for default should rather be a termination for convenience, in which case he may recover allowable costs plus a reasonable profit and not be subject to repurchase excess costs.

Most terminations for default are predicated upon the contractor's failure to make timely deliveries, but they may also be for failure to perform services required within the time specified in the contract, failure to perform any other provision of the contract or failure to make progress so as to endanger performance of the contract. Normally the contracting officer will notify the contractor by letter of the possibility of such termination, at which time the contractor should make every effort to remedy the situation or to present his case as to why he is not at fault. If the contracting officer still determines that termination for default is proper, he will immediately issue a notice of termination where timely deliveries are in question. If any other failure of the contractor is in question, the contractor is given written notice specifying such failure and providing a period of ten days (or such longer period as may be authorized) in which to cure such failure, with the formal notice of termination following at the expiration of the ten day period if negotiations so dictate.

Every contractor has a right to appeal a default termination as specified in the Disputes Clause. Since this is such a controversial area, appeal cases are not unusual, and are quite frequently won by the

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<sup>8</sup> ASPR, 32 C.F.R. §§ 8.707, 709, 710 (Supp. 1963).

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contractor. The following brief examples are furnished covering the outcome of some recent dispute cases under a termination for default.

### *Termination for Default Upheld*

The government terminated for default for non-delivery of 1,782 wire rope terminals, and demanded refund of \$14,457.67 paid as the purchase price on an additional 2,685 terminals which were rejected under a warranty and later terminated, together with an assessment of \$6,461.03 in excess costs on the repurchase of the terminated items.

The Armed Services Board of Contract Appeals (ASBCA) ruled that the contract was properly terminated for default where the contractor, even though in disagreement with the government's interpretation of manufacturing and testing procedures, failed to maintain deliveries. Even if the contractor's interpretation were correct, it was still obligated to perform and to seek its relief in additional compensation under the Changes Article. The Board did, however, sustain that portion of the appeal protesting assessment of reprourement costs after rejection under the Warranty Clause of the contract on the grounds that the Warranty Clause provided only for collection or withholding of sums equivalent to the purchase price, and not for excess costs of reprourement.<sup>4</sup>

### *Termination for Default Overruled*

The contractor refused to perform further services after the government had failed to make the monthly payment for services rendered within the time required by the contract. The government then terminated for default for refusal to perform and withheld payments due as a set-off against excess costs incurred upon repurchase. The ASBCA sustained the contractor's appeal, finding the government had breached a material condition of the contract by failing to meet its obligation to make payment within the time required by the contract.<sup>5</sup>

### Termination for Default Changed to Termination for Convenience

The contract was terminated for default when certain pre-production samples submitted by the contractor were rejected by the government for failure to pass hydraulic pressure tests. The contractor contended that its samples had been built to meet the pressure requirement of the contract, using static rather than dynamic testing. The ASBCA found that the specifications could reasonably be read to call only for a static performance test and that the contractor was therefore entitled to the benefit of its interpretation of the government-authored specifications. The Board sustained the appeal and remanded

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<sup>4</sup> Granary Brothers, A.S.B.C.A. No. 7779 (1963).

<sup>5</sup> U.S. Services Corp., A.S.B.C.A. Nos. 8291 and 8433 (1963).

the matter for consideration of the termination as one for the convenience of the government.<sup>6</sup>

#### Termination for Convenience of the Government

Termination for convenience of the government is of far greater frequency than termination for default. Contractors dealing with the government should be prepared at all times for such an occurrence—files should be well documented, accounting systems should be compatible with termination to insure maximum recovery and a termination co-ordinator should be available to monitor the claim in the various company divisions affected, including the proper handling of termination inventory and preparation of the necessary forms. Before accepting a government contract or subcontract, the termination clause should be scrutinized closely and rejected if not appropriate.

A recent decision of the United States Court of Claims<sup>7</sup> in effect rules that even though a contract contains no express termination clause, in event of termination it would be treated as though the standard termination clause had been included. Involved was a claim for over \$5,000,000, representing damages and anticipated profits arising out of termination for the government's convenience of a housing construction contract. The court reasoned (1) that ASPR 8-703 (Termination Clause for Fixed-Price Construction Contract) required inclusion of such a clause; (2) that the Armed Services Procurement Regulations have "statutory authority" since they are issued under the Armed Services Procurement Act of 1947; (3) that this gives them the "full force and effect of law"; (4) notwithstanding the fact that ASPR 8-703 was not complied with, the contract would be treated as though the standard termination clause had been included and (5) while the applicability of the termination clause in ASPR 8-703 is limited to procurements which obligate appropriated funds and such funds are not immediately expended in Capehart Act military construction contracts, appropriated funds are ultimately obligated by the use of appropriations for quarters allowances for payment of obligations of mortgagor corporations acquired by the government.

In a rehearing of *Christian*<sup>8</sup> the United States Court of Claims adhered to its original decision and further pointed out (1) that old ASPR 8-101 (applicability of Section VIII) in effect at the time of the contract did not controvert the mandatory requirement of ASPR 8-703 that future contracts are to include the new clause; (2) that ASPR 8-703 did apply to housing contracts under the Capehart Act and (3) that there was no showing that the mandatory requirement of ASPR

<sup>6</sup> Brook Labs Co., Inc., A.S.B.C.A. No. 7764 (1962).

<sup>7</sup> G. L. Christian & Associates v. United States, 312 F.2d 418 (Ct. Cl. 1963).

<sup>8</sup> G. L. Christian & Associates v. United States, 32 U.S.L. Week 2050 (Ct. Cl. July 12, 1963).

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8-703 was deliberately waived by a military official empowered to do so.

This has implications reaching far beyond the termination question, as it could be interpreted to mean that a contractor cannot rely on a signed contract as embodying the full agreement between himself and the government.

### **Initial Action Required**

The termination for convenience notice may be preceded by a stop work order. Whether it is an official termination or only a stop work order, the contractor should immediately take steps to stop all work and to notify subcontractors or suppliers to do likewise. In the event a stop work order is converted later to a termination, as is frequently the case, a contractor is entitled to costs and profit related to the stop work order as well as to the termination. Normally the notice of termination will be in telegraphic form and will be followed by a letter, but sometimes a letter notice only is used. The effective date of termination is the date of receipt of the telegram or letter. It is imperative that a contractor immediately stop work as any costs incurred after the effective date of termination (with the exception of settlement expense) will not be allowable.

### **Inventory Action**

Of prime concern when a termination occurs is the inventory related to the terminated contract. Such inventory should immediately be segregated and moved to a termination area. A complete listing of all inventory involved should be made. The next step is to screen this inventory for possible diversion to other contracts or work which will remove it from the termination claim. If common or off-the-shelf items exceed known requirements, however, such items may be included in the termination claim as a contractor is not required to suffer a loss in diverting inventory. Also, if the inventory diverted bears a higher cost than had been anticipated on the contract to which it is being diverted, the excess cost may be claimed under the termination. Diversion of inventory under terminated cost-reimbursement contracts requires the prior approval of the contracting officer.

### **Contracting Officer Meeting**

At the earliest possible date a preliminary conference should be held with the contracting officer or his designated representatives to discuss the problems and handling of the termination. He should be advised of finished items on hand for possible delivery to the government and elimination from the termination. In some instances the items terminated may be at such a high stage of completion that the govern-

ment may decide to reinstate them. In the event of a partial termination, clarification should be obtained by contract item as to what is or is not terminated. An estimate of the claim should be made at this time.

#### No Cost Settlement

If work has barely begun or if all items can be satisfactorily diverted, it is possible that the contractor will be able to sign a release of liability and effect a no-cost settlement. Many larger firms waive their claim if the dollar amount is nominal, thereby avoiding the red tape and added costs of going through the official termination procedure.

#### Fixed Price v. Cost Reimbursement Contracts

There is a considerable difference in the handling of termination claims between fixed-price and cost reimbursement contracts. Under a fixed-price termination, all costs (including subcontractor claims) and profit are included in the claim. On a cost reimbursement termination, a contractor may elect to continue to voucher costs in the normal fashion, with his claim simply being a proposed adjustment to his fee (which can be submitted by letter), or he may elect to discontinue vouchering and include costs not vouchered to date in his claim along with an appropriate fee adjustment. In both cases inventory schedules must be submitted as well as a Schedule of Accounting Information, DD Form 546, where appropriate. The Regulations place a six-month limit on vouchering out under a completely terminated contract.<sup>9</sup> First, let us examine the steps required in preparation of a termination claim under a fixed-price contract the price of which may be firm or redeterminable.

#### Short Form

If a claim is less than \$2,500, and many are, it is advisable for a contractor to use DD Form 831, Settlement Proposal, and DD Form 832, Inventory Schedule E. These forms have been streamlined by the government for ease of preparation, and the ceiling for their use has in recent years been raised from \$1,000 to \$2,500. Less detail is required and consequently faster settlements are affected.

#### Inventory v. Total Cost Basis

On claims over \$2,500, a decision must be made whether to submit on the inventory or total cost basis. Normally the inventory basis (DD Form 540) is used, where inventory cost is the basis for applying markups and arriving at a total claim. However, it may be advisable to submit on a total cost basis (material, labor and overhead) under the following circumstances: (1) Where the nature of the accounting sys-

<sup>9</sup> ASPR, 32 C.F.R. §§ 8.402, 403, 404 (Supp. 1963).

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tem or the nature of the contract does not lend itself to precise inventory pricing by part; (2) Where one is performing under a letter contract; (3) Where substantial engineering and development work has been performed and (4) Early in the life of a contract where a substantial portion of the costs relates to production planning, starting-load, etc. Use of the total cost basis (DD Form 541) requires prior approval of the contracting officer. Under both bases, inventory schedules must be prepared. However, under the inventory basis the total inventory cost must tie out to your claim whereas under the total cost basis the inventory is valued only for disposal purposes and its costs are intermingled under material, labor and overhead categories. Various inventory schedules<sup>10</sup> are available to cover different types of inventory. These should be prepared in great detail to facilitate property disposition.

### Cost Reimbursement Type Claim

Normally it is preferable for a contractor under a cost reimbursement type termination to continue to voucher out costs and to propose a fee adjustment as a settlement proposal. This may be done by letter. The fee adjustment is based on the percentage of contract completion. The extent and difficulty of the work, but not necessarily the costs incurred, are taken into consideration. If a contractor elects to stop vouchering costs and to include costs not billed in a settlement proposal along with fixed fee adjustment, DD Form 547 must be prepared. Vouchering out of costs usually results in faster payment and in less disruption to the contractor's accounting system. As with a fixed-price termination, no costs are normally allowable after the effective date of termination, except settlement expense and subcontractor claims paid. However, at the time of termination frequently there is a backlog of unbilled costs. Settlement expense and subcontractor claims should be listed on separate vouchers.

Unresolved overrun situations or change of scope can complicate settlement of a cost reimbursement termination, affecting both unbilled costs and a determination of the proper per cent of completion. It is advisable to resolve the overrun or change of scope before attempting to complete the termination claim, although this is not always possible.

An example of an appeal in this area is a 1961 dispute case<sup>11</sup> where the government refused to allow a termination claim of \$273,455 on the grounds it was in excess of the funds that had been allotted to the cost-plus-fixed-fee contract involved. The Board ruled that the contractor was entitled to additional funds for overrun costs when it had been notified in writing by the contracting officer that the additional

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<sup>10</sup> DD Forms 542, 543, 544 and 545.

<sup>11</sup> Republic Aviation Corp., A.S.B.C.A. No. 5729 (1961).

funds would be forthcoming during the course of the execution of the contract.

Inventory schedules must be submitted under a cost reimbursement termination just as on a fixed-price termination. However, the estimated cost of such inventory does not form the basis for a claim, since such cost has been or will be billed in the normal voucher fashion or included under the material-labor-overhead category on the DD Form 547 Settlement Proposal. The chief purpose of inventory schedules under a cost reimbursement termination is to provide the basis for inventory disposition.

#### Partial Payments

A method of relief frequently overlooked by contractors under a fixed-price termination or under a cost reimbursement termination where costs are not vouchered out is the application for partial payment. This device enables a contractor to recover a substantial portion of his costs in advance of final settlement of the claim, which may take months to negotiate.

With every sizable claim a contractor should submit a DD Form 548, Application for Partial Payment. By listing his costs on this form in the same general manner as on the Settlement Proposal form, he may obtain an advance for the following items:

- (1) one hundred per cent of the contract price for undelivered completed items,
- (2) one hundred per cent of the amount of approved subcontractor claims paid,
- (3) ninety per cent of the direct cost of termination inventory,
- (4) a reasonable amount (not to exceed ninety per cent) of other allowable costs and
- (5) one hundred per cent of partial payments made to his subcontractors.

No partial payment may cover profit. Also, if it can be proved that the contractor would have suffered a loss had the entire contract been completed, no partial payments may be allowed on the pro rata share of the loss incurred to date. Partial payments have to be adjusted, of course, for any progress payments received on the contract prior to its termination or for any property disposal credits.

#### Costs

In settling a termination claim, nothing is more vital or controversial than the various elements of cost included in the settlement proposal. For all contracts dated after June 30, 1960, the revised ASPR section XV cost principles are used as a guide in negotiations. Prior

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to that date the more lenient section VIII applied. In addition to the broad cost principles applicable to all procurement actions, section XV contains a special paragraph covering costs peculiar to termination. The following costs are generally allowable: initial costs (starting load and preparatory); loss of useful value of special tooling, special machinery and equipment; rental costs under unexpired leases; settlement expenses and subcontractor claims. Generally unallowable are the costs of common (off-the-shelf) items, unless a loss would be sustained, and costs (other than settlement expense) continuing after termination.

A recent ASBCA case<sup>12</sup> involved an appeal from a unilateral determination by the contracting officer wherein various cost elements were disallowed. The Board made the following findings:

1. *Engineering Labor.* Allowable since the object of the contract was engineering development work and the amount of the labor was not unreasonable for the work performed.

2. *Indirect Factory Costs—Method of Allocation.* Allowable since there was no evidence that the contractor's method of allocating the costs on a job cost basis, rather than a yearly basis, was improper.

3. *Interest on Loans.* Allowable since the loans were in fact necessary for the performance of the contract and were made for that purpose.

4. *Settlement Expenses.* Sustained to the extent they actually related to the termination in areas of legal and accounting expense, president's salary and storage.

### Profit

Another very controversial area in the settlement of a termination claim is profit. The factors to be considered in negotiating profit under ASPR<sup>13</sup> are as follows:

- (1) Extent and difficulty of the work done by the contractor . . . ;
- (2) Engineering work, production scheduling, planning, technical study and supervision, and other necessary services;
- (3) Efficiency of the contractor . . . ;
- (4) Amount and source of capital employed, and extent of risk assumed . . . ;
- (5) Inventive and developmental contributions, and cooperation with the Government and other contractors in supplying technical assistance;
- (6) Character of the business . . . ;
- (7) The rate of profit which the contractor would have earned had the contract been completed;
- (8) Character, extent, and difficulty of subcontracting, including

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<sup>12</sup> Q.V.S. Inc., A.S.B.C.A. No. 7513 (1963).

<sup>13</sup> ASPR, 32 C.F.R. § 8.303 (1961).

selection, placement, and management of subcontracts, settlement of terminated subcontracts, and engineering, technical assistance, and other services rendered but the profit shall not be measured by the amount of the contractor's payments to subcontractors for settlement of their termination claims; and

- (9) The rate of profit both parties contemplated at the time the contract was negotiated.<sup>14</sup>

In a settlement by determination (which occurs in the event of the failure of the contractor and the contracting officer to agree), a profit of two per cent of material, eight per cent of other costs, but overall not to exceed six per cent of all costs is allowed. No profit may be allowed on settlement expense.

Industry feels that in three areas above changes should be made. First, now that settlement expense is included in the revised section XV along with all other costs, why should it alone be penalized with a disallowal of profit when it is a necessary cost of doing business caused by a termination generated by the government? Naturally, if settlement expense is excessive and unreasonable, it, as well as any profit thereon, should be disallowed. The ASPR Termination Subcommittee is presently giving consideration to amending section VIII to remove this inequity.

Second, although the paragraph quoted above from section VIII goes into great detail about the allowance of profit on subcontracting effort, in practice no profit is usually allowed on subcontractor claims. This is due to two primary factors: (a) section VIII will not allow profit as a percentage of the settlement with the subcontractor; and (b) subcontractor claims appear below the profit line on the settlement proposal forms. The framers of section VIII maintain that it is their intent that contractors be given an allowance for subcontracting effort but the government people in the field take a different view. There are many arguments on both sides, but industry feels strongly that it is being unduly penalized in the event of a termination by the non-allowance of any profit on subcontractors' claims when, had the contract not been terminated, full profit would have been allowed. An excellent example is where the work terminated is being performed entirely by subcontractors who have claims, for example, totaling \$100,000, yet a contractor is allowed no profit whatsoever because the government exercised its right to terminate. On this item also the ASPR Termination Subcommittee is considering revising section VIII to put more teeth into the present wording.

Third, industry feels that the profit formula applicable when there is a failure to agree on cost or profit is extremely unfair and unwar-

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<sup>14</sup> ASPR, 32 C.F.R. § 8.303(b) (1961).

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ranted. Why should termination be penalized in this area when no other pricing actions are? The formula was originally devised to expedite settlement of the huge backlog of termination claims at the close of World War II and has no place in the present economy. This is particularly true in view of the recent inclusion in ASPR of the new weighted guidelines approach to profit, which is intended to reverse the trend of the past five years of steadily dwindling defense contractor profits. The failure to agree, incidentally, does not mean the Disputes Article has been invoked. It simply means that in the thinking of the contracting officer there is not a meeting of the minds, thus he may immediately turn to the profit formula or at least threaten its use.

The futility of appeal in the areas of profit on subcontractor work and the profit formula is well illustrated in the *Douglas* case.<sup>15</sup> In this instance the contractor and the contracting officer could not reach an agreement on the amount of profit to be allowed on the termination claim. As a result, the contracting officer applied the profit formula, determining a profit of \$3,946.12 related to the contractor's own costs of \$89,141.00 and allowing no profit related to subcontractors' claims of \$358,090. The contractor, who had proposed profit of \$44,000, appealed to the ASBCA. The Board ruled that under the terms of the contract the profit formula must be applied in event of failure to agree. Its decision further stated that, since the materials covered by the subcontractors' claims were not processed by the contractor, they did not represent a fair index of the work done by him.<sup>16</sup> The Board, of course, also referenced the fact that a contractor's profit shall not be measured by the amount of subcontractors' claims.<sup>17</sup>

The new weighted guidelines approach to profit, mandatory after January 1, 1964 for negotiated procurement, will have an impact on future termination settlements. Under this concept, different ranges of profit rates are applied to various cost elements. Also added are profit rates for risk, performance and other factors. The regulations<sup>18</sup> now state that other methods for establishing profit objectives may be used for termination settlements provided such methods accomplish the intent of the weighted guidelines to (1) insure consideration of the relative value of the appropriate profit factors and (2) provide a basis for documentation of this objective. If a future contract, on which the original profit rate was determined by the weighted guidelines method, is terminated, a contractor may find it to be to its advantage to use that basis in computing its termination claim. Profit factors (7) and (9), *supra*, should be employed.

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<sup>15</sup> *Douglas Aircraft Co., Inc.*, A.S.B.C.A. No. 5921 (1962).

<sup>16</sup> This appears to be contra to ASPR, 32 C.F.R. § 8.303(b)(8) (1961).

<sup>17</sup> This does not mean that the contractor should get no profit from the effort of the subcontractors.

<sup>18</sup> ASPR, 32 C.F.R. § 3.808-2, 28 Fed. Reg. 2097 (1963).

### Loss Contract

The termination regulations<sup>19</sup> state that no profit shall be allowed in settling a claim if it *appears* that the contractor would have incurred a loss had the *entire* contract been completed. The theory is sound enough—a contractor should not avoid a loss on a termination when he would not have had the contract been completed. However, to prove that a loss would have existed at completion of the entire contract is another matter. Involved is proper computation of an estimate to complete. Unless the evidence is definite that a loss would have been incurred, the contractor must fight back on this subject and attempt to disprove the government's contention. The question of whether a contract is in a loss position is usually settled in negotiations. However, occasionally a dispute case arises, two examples of which are: (1) Where the ASBCA overruled the loss adjustment on the basis no such provision was contained in the contract;<sup>20</sup> and (2) Where the ASBCA sustained the loss adjustment by deciding the contractor could not reduce the percentage of its loss by being paid in full for certain repair costs.<sup>21</sup>

### Disposition of Termination Inventory

An essential part of the final settlement of every termination claim is disposition of the termination inventory involved. Disposition may be effected in any one of the following ways: (1) By diversion to other work of the contractor; (2) By return of parts to suppliers; (3) By government acquisition for utilization by the Department of Defense, the General Services Administration, and other government agencies including donations to the Department of Health, Education & Welfare; (4) By sale based on competitive bids; (5) By a salvage offer by the contractor; (6) By transfer to another defense contractor; (7) By a scrap offer by the contractor or (8) By destruction or abandonment.

Disposition of termination inventory has long been a problem in industry. Frequently contractors are required to retain such inventory for months before final disposition is resolved. As a result of industry pressure in this area, section VIII has gradually been revised to provide for more expeditious disposal of termination inventory with less red tape required and with more authority given to local cognizant government personnel. However, the problem has still not been entirely resolved in the screening area. In fact, the current trend in the government is to screen more rather than less in an effort to effect maximum utilization of termination inventory. The cost-cutting motives behind this approach are admirable providing the cost of disposition does not exceed the value of the item being disposed.

<sup>19</sup> ASPR, 32 C.F.R. § 8.304(a) (1961).

<sup>20</sup> Q.V.S. Inc., *supra* note 12.

<sup>21</sup> Power Generators, Inc., A.S.B.C.A. No. 7607 (1962).

### Storage

Upon expiration of the plant clearance period (ninety days), the contractor may request the government to remove the termination inventory or enter into a storage agreement.<sup>22</sup> Not later than fifteen days thereafter, the government shall either remove the inventory or agree to storage. Such storage costs are collectible as settlement expense. In actual practice contractors find that it is sometimes difficult to obtain storage agreements, but the contractor whose space is at a premium should leave no stone unturned in his efforts to obtain such an agreement.

### Subcontractor Claims

These claims, although handled separately from a contractor's own claim, nevertheless are an essential part of the over-all claim. When a termination strikes a prime contractor, the result is often a chain reaction down through several tiers of subcontractors. The government terminates the prime, he terminates the first tier subcontractor, the first tier terminates the second tier, and so on. Eventually all of these subcontractor claims come back up the chain and become embodied in the final total claim against the government.

The regulations<sup>23</sup> provide that a contractor may obtain authorization to settle subcontractor claims up to as high as \$25,000 without approval or ratification by the contracting officer. Once the authorization is granted, it is in effect, unless revoked by the government due to yearly reviews revealing that the contractor is not properly carrying out his duties, except that authorizations above \$10,000 are limited to a specific prime contract. Large contractors, who encounter numerous subcontractor claims, find it to their advantage to obtain this authority. Some contractors have only requested it up to \$2,500 or \$10,000, due to the varying volume of their subcontractor claims. If the volume of subcontractor termination claims is sufficient, a contractor should apply for the delegation of authority, as it expedites inventory disposition and final settlement.

In unusual cases the contracting officer may determine that it is in the best interest of the government to offer assistance to the prime contractor in the settlement of a particular subcontract. In the event a subcontractor obtains a final judgment against a prime contractor, the contracting officer will treat the amount of the judgment as a cost of settling with the subcontractor. The government may require the prime contractor to assign to the government all its right, title and interest under any subcontracts terminated by reason of termination of the prime contract. Normally, however, each subcontractor deals with the

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<sup>22</sup> ASPR, 32 C.F.R. § 8.511-2 (1961).

<sup>23</sup> ASPR, 32 C.F.R. § 8.208-4(e) (unpublished).

contractor above him under the theory of privity of contract; similarly, a prime contractor does not deal with subcontractors more than once removed in the various tiers affected by the termination.

#### Conclusion

Termination for default and for convenience of the government are facts of life in government procurement. Every contractor who accepts a government contract should be aware of their implications and should examine closely the clauses in his contract which relate to termination. Due to the complexity of products being developed in the aerospace age and to the very nature of government contracts, disagreements and disputes are bound to arise. A contractor should not be hesitant to appeal a contracting officer's decision which it believes to be unfair or unwarranted.