



# CHES

CONSULTING LLC

*When the right move matters*

# Contract Changes and Terminations

## GOVERNMENT CONTRACT REGULATORY COMPLIANCE

### Contract Changes

When a government contractor identifies a change to a contract that will result in or has resulted in increased costs, the contractor may decide to submit a Request for Equitable Adjustment (“REA”) in order to recover those costs. The preparation of the REA requires the contractor to conduct investigations and cost determinations with respect to changed work, associated delay and disruption impacts, and related profit/fee considerations. The REA pricing can be based on the discrete cost impact of specific, individual changes, as well as on delay and disruption involving issues such as unabsorbed and extended overhead, idle labor and equipment, and loss of efficiency.

Some examples of situations where an REA is appropriate include:

- **Changes in Scope including both Directed and Constructive Changes**
- **Delay**
- **Disruption**
- **Dispute over Contract Interpretations**
- **Defect in Contract Specifications**

When preparing an REA, discrete costing pricing approaches are commonly used. Additionally, depending on the circumstances, pricing for the contract change can be based on a number of other approaches, including total cost, modified total cost, and jury verdict pricing.

### Stop-Work Orders

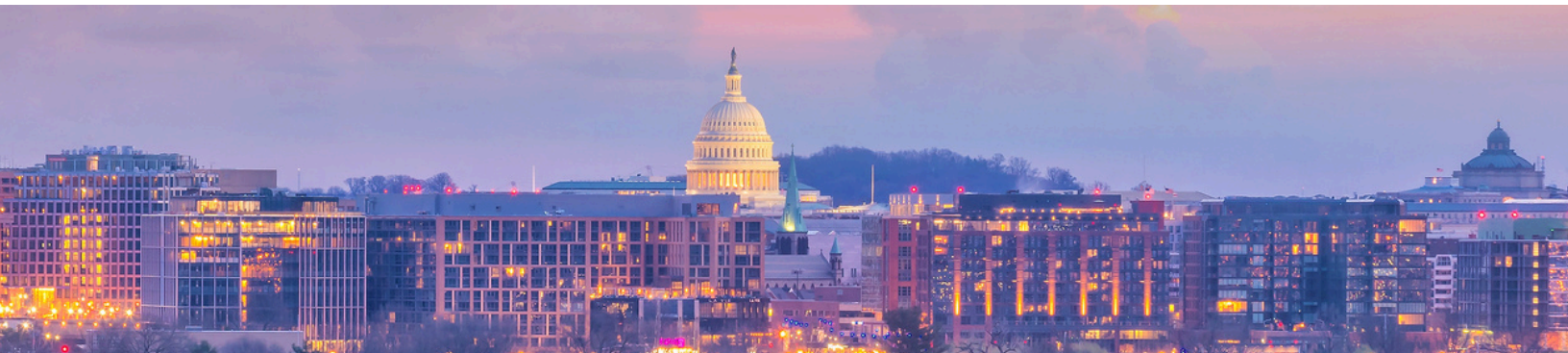
If work stoppage is deemed appropriate, government contracting officers may issue stop-work notices. In some instances, stop-work orders are received and a termination notice is subsequently issued (although stop-work orders can also be extended or canceled). Under a stop-work order, a contractor is generally entitled to recover unavoidable and reasonable contract costs incurred during the stop-work period, potentially including unabsorbed overhead.

## **Terminations**

Contracts are terminated on a regular basis. The Federal Government (the “Government”) has unilateral rights to terminate a government contract at any time. Examples of high profile terminations include the Air Force’s Tanker program and NAVAIR’s Presidential Helicopter program. Contractors are entitled to fair compensation in accordance with regulatory provisions and prompt settlement for the impact of contract terminations. However, they must be prepared for close scrutiny of, and aggressive challenges to, their proposals. There are two general types of government contract terminations: terminations for convenience and terminations for default.

### **Terminations for Convenience**

The Government may cancel part or all of a contract to accommodate current needs and protect the government’s interest when, for example, a product becomes obsolete or a service is no longer needed. When this happens, it is called a termination for convenience.



### **Terminations for Default**

If the contractor fails to perform adequately in accordance with the contract, the Government may terminate for default. A key aspect related to fixed-price contracts is that the default clause limits the Government’s liability for unaccepted work, and may subject the contractor to actual (or liquidated) damages and the excess cost of re-procurement.

Default terminations become part of the contractor’s past performance record, and may impede the contractor’s ability to obtain future contracts. Because the Government is not liable for work not accepted, terminations for default may have a greater adverse impact on supply contracts than on service and construction contracts. If a contractor attempts and succeeds in appealing the termination for default, it becomes a termination for convenience.

### **Termination Settlement Proposal Requirements**

When contracts are terminated for convenience, a contractor is required to submit a termination settlement proposal accompanied by specific government standard forms. The Federal Acquisition Regulation (“FAR”) sets forth guidance regarding the form of submission and timing of various deliverables to the government. Guidance is also found in the Uniform Administrative Requirements of 2 CFR 200 for terminated awards subject to those regulations. Preparation of timely and accurate termination settlement proposals is often challenging, especially for a company that does not have sufficient resources or the necessary experience in-house. Compiling underlying financial data and other contract information can be time-consuming, and regulatory requirements, which frequently are subject to interpretation, can be confusing. Proper preparation not only requires completion of the requisite forms, but also entails the use of estimates and judgment to determine the allowability of various costs incurred as a result of the termination.

# THE CHESS CONSULTING ADVANTAGE

Our professionals work closely with each client to establish an understanding of the various aspects of the contract changes or the terminated contracts, and assist them in addressing pricing issues, including those requiring special attention due to limitation of funds or other complexities. Clients rely on our experience to help ensure that the REA or termination settlement proposal is prepared in a manner consistent with FAR guidance. We have extensive experience helping contractors and their legal counsel identify and price constructive change order claims, prepare termination settlement proposals, and assist in efforts related to converting default terminations to terminations for convenience. Our assistance includes, but is not limited to:

- Reviewing/preparing the REA or termination proposal and the corresponding requisite government standard forms;
- Determining the allowability/recoverability of costs including incremental costs incurred as the result of contract termination or contract change;
- Preparing Basis of Estimates (“BOEs”) to support key elements of the REA or termination settlement proposal;
- Ensuring that allowable costs are properly captured and supported by adequate documentation; and
- Facilitating discussions between DCAA auditors and the client during audits of REA's, or other matters.

We have been assisting clients with REAs and terminations for many years. Our work includes reviewing the client’s cost structure, identifying potential costs related to the REA or termination, and then assisting the client in crafting the proposal along with BOEs to support the costs identified.

## Notable Client Engagements

- A large international aerospace and defense contractor. The company was terminated from a multi-billion dollar government contract to provide aircraft to the U.S. military. We began working with the company on the initial evaluation of its claim, first advising the company on the relevant regulations and how they affected the allowability of potential termination costs. Then we assisted the company in preparation of its termination settlement proposal and BOEs in support of its claimed costs. After submission of the termination settlement proposal, we helped the company address any questions or concerns regarding the proposal from the government.
- A publicly traded aerospace, defense, information, and services contractor. The company identified a change in circumstances related to a large services contract in Afghanistan and decided to submit an REA to the government. We began working with the company by reviewing the current contract, actual costs incurred, and estimated costs to completion on the contract, as well as the relevant government regulations. We identified potential increased costs to the contractor as a result of the change in circumstances and assisted the company in the preparation of an REA, along with BOEs, to support the costs. After submission, we supported the company in addressing any government questions.

### SERVICE LINE CONTACTS:

**James Check**, *Managing Director*  
**Marc Schwartz**, *Senior Manager*

**CHESS**  
CONSULTING LLC

11710 Plaza America Drive, Suite 820, Reston, Virginia 20190  
(703) 796-2850 | [www.ChessConsultingLLC.com](http://www.ChessConsultingLLC.com)

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