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**DoD Contract Termination Liability: An Analysis of Special
Termination Cost Clause (STCC)**

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by

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DoD Contract Termination Liability: An Analysis of Special Termination Cost Clause (STCC)

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Abstract

The specific purpose of the research was to review current policies, practices, and procedures for funding and managing Contract Termination Liability within the Department of Defense (DoD). The research proposes alternative approaches for improving the DoD's ability to manage Contract Termination Liability and discusses the resulting effect of each alternative on defense acquisition practices. First, we provide a brief review of regulatory and policy guidance on Contract Termination Liability as reflected in the *Federal Acquisition Regulation (FAR)* and the *Financial Management Regulations (FMR)*. We then discuss the current practices and procedures for funding and managing Contract Termination Liability. Next, we present program management challenges and observations and findings based on our research of current Contract Termination Liability policies and real-world practices. A discussion of alternative approaches to funding Contract Termination Liability is then presented, including the use of Special Termination Cost Clauses (STCC). Finally, this research concludes with a summary and recommendations on how the DoD could improve the policies and practices for managing Contract Termination Liability.

A copy of the complete report is available at the following website: www.acquisitionresearch.org:
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Executive Summary

This research paper explores the Department of Defense (DoD) policies and practices for managing Contract Termination Liability. The specific purpose of the research was to review current policies, practices, and procedures for funding and managing Contract Termination Liability within the DoD. Alternative approaches for improving the DoD's ability to manage Contract Termination Liability are proposed and the resulting effect of each alternative on defense acquisition practices is discussed. Recommendations on how the DoD could improve the policies and practices for managing Contract Termination Liability are provided.

This research found that the regulations and policies pertaining to the management and funding of Contract Termination Liability are inconsistent and subject to interpretation. Program managers, finance and budget managers, and contracting officers have differing interpretations of the requirement for funding Contract Termination Liability. Furthermore, the practices and procedures used in defense acquisition program offices reflect this inconsistency.

A review of current practices and procedures for funding and managing Contract Termination Liability and historical data of past contract terminations found that the probability of a contract termination for convenience is very small, and program managers' approaches to managing Contract Termination Liability reflects this probability. The normal procedure for handling the potential liability associated with a contract terminated for convenience is to "budget" for the liability. Then, in coordination with the contractor, the required amount of funding is tracked on a regular basis. In this case, budgeting for Termination Liability does not mean obligating funds specifically for that purpose.

Interviews with various acquisition program offices indicate that program managers are generally satisfied with the current method for managing Contract Termination Liability because the procedure they currently use allows them to keep all of the funding appropriated for their program. Furthermore, program managers are not in favor of a "tax" that would negate the requirement to budget for Contract Termination Liability. A tax would deprive them of funds that they currently have at their disposal. Additionally, if all programs were taxed, there is a general concern that the pooled funds would likely be lost—either the Military Departments (or DoD) would use them to solve other problems if they were not required to cover a liability, or Congress would look upon the funds that had been set aside as a "slush fund," making them tempting for other uses.

Interviews also indicated that support for increased use of STCCs is not evident, either at the program level or the OMB or Congressional level. Congress has expressed its concern through report language. OMB correspondence has indicated that support for more than one STCC per service is unlikely. However, it should be noted that those programs that have significant funding problems and/or are concerned about the possibilities of termination do support additional use of STCCs. In fact, these programs would prefer to have a STCC that covers more cost elements than the standard STCC.

Finally, this research concluded with the following recommendations for the DoD's management of Contract Termination Liability: 1. Remove the ambiguity and improve the consistency in the regulations pertaining to the management of Contract Termination Liability; 2. Refrain from imposing a tax system to provide funding for potential Contract Termination Liability, and 3. Continue to use STCCs for the larger programs with funding or longevity concerns.



Regulatory and Policy Guidance

This section of the research report focuses on the regulatory and policy guidance on Termination Liability and the Special Termination Cost Clause (STCC). The regulatory and policy guidance covering Termination Liability (and, specifically, Special Termination Cost Clauses (STCC)) is found in the DoD *Financial Management Regulation (FMR)* and the *Defense Federal Acquisition Regulation Supplement (DFARS)*. In addition, the Air Force *Financial Management Regulation* is also discussed as an example of Agency-specific guidance on contingent liability.

Termination Liability

The DoD *Financial Management Regulation (FMR)* defines Termination Liability as:

The amount of prepayments that cover payments required by the contract, and any damages and costs that may accrue from the cancellation of such contract. Funds prepaid for Termination Liability will convert to cover actual expenditures in the event that the contract not be terminated prior to performance completion. Termination Liability may not apply to articles/services provided under other authorities of the Foreign Assistance Act or AECA. (DoD, 2006c, Vol. 15)

The *Financial Management Regulation (FMR)* categorizes Contingent Liabilities (CLs) as probable, possible, or remote (DoD, 2006c). The terms probable, reasonably possible, and remote identify three areas within that range as follows:

1. Probable: The future event or events are likely to occur.
2. Reasonably possible: The chance of the future event or events occurring is more than remote but less than likely.
3. Remote: The chance of the future event or events occurring is slight.

Probable CLs must be covered by a commitment of funds. Probable CLs are most likely to become actual liabilities. Commitments are not required for possible CLs and should not be established for remote CLs (DoD, 2006c, Vol. 4, Ch. 13, pp. 241-242).

The budgeting for Contingent Liabilities is discussed in the following excerpts taken from the DoD *Financial Management Regulation*:

Special Provisions for Determining the Amounts of Commitments

Contingent Liabilities Remaining Under Outstanding Contracts. There are contingent liabilities for price or quantity increases or other variables that cannot be recorded as valid obligations in the cases of (1) outstanding fixed-price contracts containing escalation, price redetermination, or incentive clauses, or (2) contracts authorizing variations in quantities to be delivered, or (3) contracts where allowable interest may become payable by the US Government on contractor claims supported by written appeals pursuant to the “Disputes” clause contained in the contract (see subparagraph 080202.D, below). Amounts to cover these contingent liabilities should be carried as outstanding commitments pending determination of actual obligations. The amounts of such contingent liabilities, however, need not be recorded at the maximum or



ceiling prices under the contracts. Rather, amounts should be committed that are estimated conservatively to be sufficient to cover the additional obligations that probably will materialize, based upon judgment and experience. In determining the amount to be committed, allowances may be made for the possibility of downward price revisions and quantity underruns. Each contingent liability shall be supported by sufficient detail to facilitate audit. (DoD, 2006c, Vol. 3, Ch. 8, para. 080202)

Budgeting for Termination Liability on Incrementally Funded RDT&E Contracts

The legal requirements of the *Anti-deficiency Act* and the long-standing policy of not committing a successor Congress to a course of action both make it necessary that the unliquidated obligation for an incrementally funded, multiple-year contract be sufficient at all times to cover the cost of terminating that contract for the convenience of the Government.

Budgeting to cover Termination Liability will not increase the total amount budgeted for the program. It will require that the distribution of funds by fiscal year be shifted more towards the earlier years of the contract than if funds had been budgeted only to cover the actual bill to be paid each year. The distribution of funds by fiscal year shall be such that, if a contract is terminated at any point during the fiscal year, all termination costs can be financed from the unliquidated obligation on the contract without recourse to reprogramming of funds, supplemental appropriations, or awaiting the appropriation of funds for the succeeding fiscal year's funding increment. All programs shall adhere to this policy with the following two exceptions, both of which are to be used rarely.

- a. Special Termination Cost Clause (STCC). DoD *FAR* Parts 249.50170 and 252.249-7000 permit the use of STCC in fixed-price incentive contracts and incrementally funded cost reimbursement contracts. If contracts containing an STCC are terminated before completion, the special termination charges are covered by the unobligated balance of the applicable appropriation, subject to any congressional approval required for reprogramming. The extent to which the STCC can be used is limited to the ability of the Service or Agency to cover expected termination costs from unobligated balances. A recordable obligation under the STCC arises when the contract is actually terminated. If a proposed STCC would require an above-threshold reprogramming action when a program is terminated, the approval to use the STCC shall be obtained from the USD (Comptroller) before the contract or contract modification is awarded. All STCCs, regardless of dollar amount, require prior notification of the House and Senate Appropriations Committees.
- b. Statutory Waivers. The Department is not required to budget for, or obligate funds sufficient to cover, Termination Liability in connection with an incrementally funded RDT&E contract if Congress has expressly exempted the program or contract from that requirement. When this situation arises, however, the budget exhibits for the program shall clearly indicate the value of the unfunded Termination Liability by year for the current year, budget year, and the outyears covered by the FYDP. (DoD, 2006c, Vol. 2A, Ch. 1, para. 010214)

Termination Liability is considered a contingent liability since adequate funds must be committed to cover the liabilities resulting from the termination of contracts, including any potential or Contingent Liabilities (Gill, 2003).

The DoD *FMR* explains Contingent Liabilities as follows:



Contingent Liability—The term has two meanings. As a budgetary term, it represents variables that cannot be recorded as valid obligations. Such variables include (1) outstanding fixed-price contracts containing escalation, price redetermination, or incentive clauses, or (2) contracts authorizing variations on quantities to be delivered, or (3) contracts where allowable interest may become payable by the US Government on contractor claims supported by written appeals pursuant to the "DISPUTES" clause contained in the contract. As a proprietary accounting term, it represents an obligation, relating to a past transaction or other event or condition that may arise in consequence, as a future event now deemed possible but not probable. When the liability is determined to be possible, but not probable, the potential liability is disclosed as a footnote to the financial statements. When the potential liability becomes probable, it is recorded in the accounts as a current liability or a reduction of an asset. The budget definition is the preferred usage. (DoD, 2006c, Vol. 15)

Thus, according to DoD *FMR*, Volume 2A, Chapter 1, "all termination costs can be financed from the unliquidated obligation on the contract without recourse to reprogramming of funds, supplemental appropriations, or awaiting the appropriation of funds for the succeeding fiscal year's funding increment" (2006c). The two exemptions to this are a Special termination Cost Clause (STCC) and a Statutory Waiver.

In addition, Volume 3, Chapter 8, Section 080512 of the DoD *FMR* states that in the case of termination of a contract, the contract shall be decreased to an amount that is sufficient to meet the settlement costs under the termination.

The Air Force Material Command (AFMC) *Financial Management Reference System* (2005, February) provided more detailed guidance on funding termination costs. The AFMC *FMRS* states the following concerning funding termination costs:

The funded activity should commit the estimated funds to cover the expected contingent liability (CL). This estimated CL amount is in excess of the contract awarded amount recorded as an obligation. The financial manager must record commitments for CLs against the applicable FY and appropriation cited on the contract. Normally, funds for CLs are maintained locally. Funds are committed for a contingent liability at the time of contract award, based on the amount provided by the contracting officer [...]. Commitments are not recorded for STCC or contingent termination liabilities. Obligations are recorded when the action to terminate is taken. (AFMC, 2005, February)

The AFMC *FMRS* further states that funds are committed for all "probable" CLs (funding for "possible" or "remote" CLs is not necessary) as defined in a matrix. "The CL Matrix is used to identify, categorize according to probability, and track CLs throughout the life of a contract [...] must be reported to SAF/FM semi-annually" (AFMC, 2005, February).

As indicated above, the DoD *FMR* refers to two exceptions to the policy of budgeting for Termination Liability. These include the Special Termination Cost Clause (STCC) and the Statutory Waiver. These will be discussed below.

Special Termination Cost Clause (STCC)

Regulatory and policy guidance related to the use of Special Termination Cost Clauses is found in the DoD *FMR* (Section: "Budgeting for Termination Liability on Incrementally Funded RDT&E Contracts," p. 3) and the DoD *FAR*.



Although the *Federal Acquisition Regulation (FAR)* Part 49 provides guidance on contract terminations, the *Defense FAR Supplement (DFARS)* provides the guidance and prescribes the clause specifically for Special Termination Costs. The *DFARS* guidance at 249.501-70 states the following:

249.501-70 Special Termination Costs.

- (a) The clause at 252.249-7000, Special Termination Costs, may be used in an incrementally funded contract when its use is approved by the agency head.
- (b) The clause is authorized when—
 - (1) The contract term is two years or more;
 - (2) The contract is estimated to require—
 - (i) Total RDT&E financing in excess of \$25 million; or
 - (ii) Total production investment in excess of \$100 million; and
 - (3) Adequate funds are available to cover the contingent reserve liability for special termination costs.
- (c) The contractor and the contracting officer must agree upon an amount that represents their best estimate of the total special termination costs to which the contractor would be entitled in the event of termination of the contract. Insert this amount in paragraph I of the clause.
- (d) (1) Consider substituting an alternate paragraph I for paragraph I of the basic clause when—
 - (i) The contract covers an unusually long performance period; or
 - (ii) The contractor's cost risk associated with contingent special termination costs is expected to fluctuate extensively over the period of the contract.
- (2) The alternate paragraph I should provide for periodic negotiation and adjustment of the amount reserved for special termination costs. Occasions for periodic adjustment may include—
 - (i) The Government's incremental assignment of funds to the contract;
 - (ii) The time when certain performance milestones are accomplished by the contractor; or
 - (iii) Other specific time periods agreed upon by the contracting officer and the contractor.



A review of the *DFARS* clause reveals that the clause may be used on incrementally funded contracts when: the contract term is two years or longer and is estimated to require in excess of \$25 million of Research, Development, Test, and Evaluation (RDT&E) funds or a total of over \$100 million of production investment.

Incrementally funded contracts are those contracts in which funds are incrementally obligated throughout the period of performance. Typically, cost reimbursement RDT&E contracts are incrementally funded and require the use of the Limitation of Funds Clause at *FAR* 52.232-22. This clause requires the contractor to notify the Contracting Officer in writing whenever it has reason to believe the cost it expects to incur in the next 60 days, when added to all costs previously incurred, will exceed 75% of the total amount allotted on the contract (DoD, 2006b, 52.232-22).

Another requirement of the Special Termination Cost Clause (STCC) is that there will be adequate funds available to cover the contingent reserve liability for special termination costs.

In addition, the clause states that the contractor and the contracting officer must agree upon an amount that represents their best estimate of the total special termination costs to which the contractor would be entitled in the event of termination of the contract. These special termination costs are identified within the *DFARS* in the actual Special Termination Costs clause as follows:

252.249-7000 Special Termination Costs.

As prescribed in 249.501-70, use the following clause:

SPECIAL TERMINATION COSTS (DEC 1991)

(a) *Definition*. "Special termination costs," as used in this clause, means only costs in the following categories as defined in Part 31 of the *Federal Acquisition Regulation (FAR)*—

- (1) Severance pay, as provided in *FAR* 31.205-6(g);
- (2) Reasonable costs continuing after termination, as provided in *FAR* 31.205-42(b);
- (3) Settlement of expenses, as provided in *FAR* 31.205-42(g);
- (4) Costs of return of field service personnel from sites, as provided in *FAR* 31.205-35 and *FAR* 31.205-46i; and
- (5) Costs in paragraphs (a)(1), (2), (3), and (4) of this clause to which subcontractors may be entitled in the event of termination.

(b) Notwithstanding the Limitation of Cost/Limitation of Funds clause of this contract, the Contractor shall not include in its estimate of costs incurred or to be incurred, any amount for special termination costs to which the Contractor may be entitled in the event this contract is terminated for the convenience of the Government.



- (c) The Contractor agrees to perform this contract in such a manner that the Contractor's claim for special termination costs will not exceed \$_____. The Government shall have no obligation to pay the Contractor any amount for the special termination costs in excess of this amount.
- (d) In the event of termination for the convenience of the Government, this clause shall not be construed as affecting the allowability of special termination costs in any manner other than limiting the maximum amount of the costs payable by the Government.
- (e) This clause shall remain in full force and effect until this contract is fully funded. (End of clause)(DoD, 2006a, 252.249-7000)

Thus, the Special Termination Cost Clause limits the amount of special termination (as agreed between the government and the contractor) costs that the Government is liable for in a Termination for Convenience. It should be noted that the STC clause does not apply to the regular termination costs as outlined in FAR 31.205-42.

Agency Approval for STCC

As stated in the *DFARS* clause, the use of the STC clause is subject to approval of the agency head. A review of the various agency *FAR* supplements provides some perspective on how this approval is obtained.

The Air Force *FAR* supplement at *AFFARS* 5349.501-70 provides additional and specific policy related to the use of the Special Termination Cost Clause. *AFFARS* 5349.501-70 specifically states the following:

5349.501-70 Special termination costs.

- (a) Contracting officers shall refer to Volume 2A, Chapter 1, Section 010213, paragraph C.2 of DoD 7000.14-R, DoD *Financial Management Regulation*, for Congressional notification and additional approval requirements for Special Termination Cost Clauses (STCCs). Because STCCs require special notification to Congress and entail a long approval process over which the Air Force has little control, the contracting officer should allow SAF/AQCK sufficient time to process requests to use *DFARS* 252.249-7000, Special Termination Costs (i.e., not less than 90 days prior to contract award). The request shall include the following:
 - (i) A detailed breakdown of applicable cost categories in the clause at *DFARS* 252.249-7000 (a)(1) through (5), which includes the reasons for the anticipated incurrence of the costs in each category;
 - (ii) Information on the financial and program need for the clause, including an assessment of the contractor's financial position and the impact of a failure to receive authority to use the clause; and
 - (iii) Clear evidence that only costs that arise directly from a termination would be compensated under the clause. Costs that would be incurred by the Government, regardless of whether a termination occurs, shall not be covered by an STCC.



- (b) The contracting officer shall obtain SAF/FM approval prior to authorizing any increase in the Government's maximum liability under the clause. (Air Force, 2006, 5349.501-70)

The *AFFARS* is the only agency-level *FAR* guidance that gives more specific instruction on the coordination and review process, as well as on the Congressional notification requirement for the use of STCCs. This guidance also identifies the requirement for referencing the DoD *Financial Management Regulations (FMR)* for specific notification and approval requirements.

Statutory Waiver

The second exception to the Termination Liability funding policy is the Statutory Waiver. This exception is explained in the *FMR* as follows:

Statutory Waivers. If a program is exempted by Public Law from the requirement to budget for Termination Liability, the fiscal year increments may be budgeted on a pay-as-you-go basis, providing only sufficient funds to cover the disbursements expected to be made in that fiscal year. When this situation arises, however, the budget exhibits for the program shall clearly indicate the value of the unfunded Termination Liability by year for the current year, budget year, and the outyears covered by the FYDP. (DoD, 2006c)

As can be seen from the above discussion, the regulatory and policy guidance pertaining to the funding of Termination Liability and the use of STCCs is found in two different functionally oriented regulations—the *Financial Management Regulation (FMR)* and the *Federal Acquisition Regulation (FAR)*. This regulatory guidance on budgeting for Contract Termination Liability from two different functional areas of DoD acquisition increases the potential for different interpretations or even misinterpretation of the DoD policy. These differences in policy interpretation are reflected in the practices and procedures used by the various DoD services.

Observations and Findings

The researchers conducted interviews with various DoD program management offices and analyzed samples of DoD contracts related to the management of Termination Liability. Based on these reviews, interviews, and analyses, the research team identified the following observations and findings:

1. Inconsistent Approach

There is an inconsistent approach among the various military and DoD agencies to managing Termination Liability funds on contracts. Although all program offices that were interviewed in this research manage Termination Liability based on the funds obligated on contract, the procedures used for ensuring the obligated funds are adequate and sufficient to cover Termination Liability expense at any point during the contract period of performance varied. Some program offices maintained close coordination with their contractors to monitor and ensure sufficient obligated funds to cover estimated Termination Liability expenses throughout the contract period, while other program offices depended solely on the contractor to monitor the obligated funds to ensure sufficient coverage for Termination Liability. Some program offices conducted periodical “budget drills” to determine if the amount of obligated funds at any given time would be sufficient to cover the estimated Termination Liability at that



point in time. Some program offices used the Contractor Funds Status Report (CFSR) as an aid in monitoring the estimated Termination Liability expenses.

2. Diffused Guidance

The regulatory and policy guidance pertaining to Termination Liability are diffused between the Federal Management Regulation (*FMR*) and the *Federal Acquisition Regulation (FAR)*. The *FMR* is the main source of financial management policy and guidance used by DoD financial and budget managers, while the *FAR* is the main source for contract management policy and guidance used almost exclusively by DoD contracting officers. These two functionally based regulations lead to differing interpretations of policy, guidance, and procedures related to the management of Termination Liability by the financial-management and contract-management functional areas.

3. Insufficient Databases

There is no DoD-wide, Service-wide, Command-wide, or Center-wide database; yet, one is needed to conduct a proper analysis to determine the total number of contracts that require funding for Termination Liability, the total amount of Termination Liability funding on these contracts, the total number of contracts containing a Special Termination Cost (STC) clause, and the total amount of estimated Termination Liability expenses being managed at the Service levels because of these STC clauses. These databases would provide the data that would be considered a critical part of the business case needed to calculate the extent of the funding being budgeted for Termination Liability expenses.

4. Declining Acceptability of Special Termination Cost Clause

Because of the current acquisition climate of defense acquisition program cost overruns and schedule delays, the increased use of the current Special Termination Cost Clause (STCC) would not be well received by the Congress or the Office of Management and Budget (OMB). Furthermore, program managers are not necessarily receptive to requesting approval of a STCC from their higher headquarters.

Alternative Approaches to Funding Termination Liability

Our research identified the following alternative approaches to managing and funding contract termination Liability.

1. Impose a “Tax” on All Programs Subject to Termination Liability for the Purpose of Establishing an Insurance Fund to Cover Termination Liability.

The advantages of this alternative include the benefit for program managers of not having to commit funds to cover TL, thus allowing better use of funds for program execution. Additionally, since the required Termination Liability funds would be identified prior to any termination, any concerns for possible *Anti-deficiency Act* violations should subside. Finally, for the Military department, significantly fewer dollars would be tied up unproductively for TL and would be available for program execution.

The disadvantages of this option include the fact that those programs not at risk for termination would have to pay this TL tax, thus decreasing their amount of budget for executing



the program. For not-at-risk programs, this tax would make program management more difficult. The dollars associated with this tax would not be available until late in the fiscal year if they were not used to cover a termination; if they were used to cover a termination, the program would lose the money permanently—presenting a lose-lose proposition for the program manager. Finally, another disadvantage would be that at-risk programs would not have the funds required to pay for the tax available for program execution, thus, putting these programs at an increased disadvantage.

Some of the potential questions related to this alternative include the following:

- Who determines the “tax”? Those programs at greatest risk should logically be taxed more than those programs not at risk.
- Who determines the risk of a possible program termination?
- Would the insurance fund provide an attractive target for Congressional rescissions as well as Department reprogrammings?
- When and how would the unused portion of the funds be returned to the programs?

2. Allow Coverage of Termination Liability to be Assumed at the Major Command or PEO Level.

One advantage of this alternative is that program managers could use all of the funds appropriated for their programs for program execution. Additionally, the use of STCCs with the associated Congressional notification would not be required. Another advantage of this approach is that the uncertainty of fund availability (as opposed to the tax approach) would be eliminated. Finally, there would not be a pot of funds to be targeted by Congress or the Department.

The disadvantages of this option include the fact that this approach is similar to the STCC approach—which has not enjoyed strong support from the OMB or the Congress. Additionally, concerns regarding possible *Anti-deficiency Act* violations would likely increase. Finally, another disadvantage would include the fact that paying for a program’s termination costs would likely adversely impact other programs.

Some of the potential issues related to this alternative include the following:

- This approach would appear to the OMB and Congress as an attempt to forego budgeting for Termination Liability.
- A program termination late in the fiscal year could be difficult to fund. Above-threshold reprogramming requests are rarely certain or timely.

3. Increase the Use of Special Termination Cost Clauses (STCC)

The advantages of this alternative include the benefit that program managers would be able to use all of the funds appropriated for their programs for program execution. The uncertainty of fund availability (as opposed to in the tax approach) would be eliminated for program managers.



The disadvantages of this option include the fact that Congress and the OMB have already exhibited a lack of enthusiasm for the increased use of STCCs. Additionally, the paperwork involved with STCCs is considered onerous by the programs that have completed it.

Recommendations

Based on the research findings, the following recommendations are provided.

1. Remove ambiguity and improve consistency in the regulations.

The current regulations pertaining to the management of contract termination lend themselves to differing and inconsistent interpretations among the Services and functional areas (program management, financial management, and contract management). If the “liberal” interpretation of current regulations is different from what is desired or is the intent of the agencies, these regulations should be revised to remove any ambiguity and to improve the consistency between the functional areas.

2. Do not impose a tax system to provide funding for potential Termination Liability.

The taxing of program offices for the purpose of generating a pool of funds to use for Termination Liability results in a lose-lose proposition for program offices and may result in more disadvantages than advantages. In addition, the potential issues related to this alternative would require additional research and analysis.

3. Continue to use STCCs for the larger programs with funding or longevity concerns.

For larger, major defense acquisition programs that have a lower probability of termination due to visibility, political ties, or urgency of need, the DoD should continue to support the use of STCCs to allow for greater use of program funds for program execution.

Summary and Conclusion

The purpose of this research was to explore current Department of Defense mechanisms for addressing Contract Termination Liability, review current practices and procedures for funding and managing Termination Liability, and propose alternative approaches to improve the DoD's ability to manage Termination Liability and its effect on defense acquisition programs. This research reviewed the regulatory and policy guidance on Contract Termination Liability. A review of current practices and procedures for funding and managing Termination Liability was conducted based on interviews and document reviews with the Air Force, Navy, and other various DoD agencies. Program management challenges and preliminary observations and findings were then presented. A discussion of alternative approaches to funding Termination Liability was discussed, including the use of Special Termination Cost Clauses (STCC). Finally, recommendations were presented.

The regulations and policies pertaining to the management and funding of Contract Termination Liability are inconsistent and subject to interpretation. Program managers, finance and budget managers, and contracting officers have differing interpretations of the requirement



for funding Termination Liability. Furthermore, the practices and procedures used in defense acquisition program offices reflect this inconsistency.

In addition, the probability that a government contract will be terminated for convenience is very small. Program managers and contractors are aware of the statistics, and their approach to Termination Liability reflects that knowledge. The normal procedure for handling the potential liability associated with a contract terminated for convenience is to “budget” for the liability. Then, in coordination with the contractor, the required amount of funding is tracked on a regular basis. In this case, budgeting for Termination Liability does not mean obligating funds specifically for that purpose.

Additionally, program managers are not in favor of a “tax” that would negate the requirement to budget for TL. For the most part, they are satisfied with the status quo because the procedure they currently use to handle TL allows them to keep all of the funding appropriated for their program. A tax would deprive them of funds they currently have at their disposal. In fact, a program that has funding problems could be put in jeopardy by having to relinquish funding to pay for a tax. Program managers feel as though the statistics support their current approach.

Furthermore, if all programs were taxed, there is a general concern that the pooled funds would likely be lost for good—either the military Departments (or DoD) would use them to solve other problems if they were not required to cover a liability, or Congress would look upon the funds that had been set aside as a “slush fund” and be tempted to use them elsewhere.

Also, support for increased use of STCCs is not evident, either at the program level or the OMB or Congressional level. Congress has expressed its concern regarding STCCs through report language. OMB correspondence has indicated that support for more than one STCC per service is unlikely. However, it should be noted that those programs that have significant funding problems and/or are concerned about the possibilities of termination do support additional use of STCCs. In fact, these programs would prefer to have a STCC that covers more cost elements than the standard STCC.

Finally, this research recommended that the Department of Defense: remove the ambiguity and improve the consistency in the regulations pertaining to the management of Termination Liability, not impose a tax system to provide funding for potential Termination Liability, and continue to use STCCs for the larger programs with funding or longevity concerns.

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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

