

## 31.205-42 Termination costs.

Contract terminations generally give rise to the incurrence of *costs* or the need for special treatment of *costs* that would not have arisen had the contract not been terminated. The following cost principles peculiar to termination situations are to be used in conjunction with the other cost principles in [subpart 31.2](#):

(a) *Common items*. The *costs* of items reasonably usable on the contractor's other work *shall* not be allowable unless the contractor submits evidence that the items could not be retained at cost without sustaining a loss. The *contracting officer should* consider the contractor's plans and orders for current and planned production when determining if items can reasonably be used on other work of the contractor. Contemporaneous purchases of *common items* by the contractor *shall* be regarded as evidence that such items are reasonably usable on the contractor's other work. Any acceptance of *common items* as allocable to the *terminated portion of the contract should* be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

(b) *Costs continuing after termination*. Despite all reasonable efforts by the contractor, *costs* which cannot be discontinued immediately after the *effective date of termination* are generally allowable. However, any *costs* continuing after the effective date of the termination due to the negligent or willful failure of the contractor to discontinue the *costs shall* be unallowable.

(c) *Initial costs*. Initial *costs*, including starting load and preparatory *costs*, are allowable as follows:

(1) Starting load *costs* not fully absorbed because of termination are nonrecurring labor, material, and related overhead *costs* incurred in the early part of production and result from factors such as-

(i) Excessive spoilage due to inexperienced labor;

(ii) Idle time and subnormal production due to testing and changing production methods;

(iii) Training; and

(iv) Lack of familiarity or experience with the product, materials, or manufacturing processes.

(2) Preparatory *costs* incurred in preparing to perform the terminated contract include such *costs* as those incurred for initial plant rearrangement and alterations, management and personnel organization, and production planning. They do not include special machinery and equipment and starting load *costs*.

(3) When initial *costs* are included in the settlement *proposal* as a direct charge, such *costs shall* not also be included in overhead. Initial *costs* attributable to only one contract *shall* not be allocated to other contracts.

(4) If initial *costs* are claimed and have not been segregated on the contractor's books, they *shall* be segregated for settlement purposes from cost reports and schedules reflecting that high unit cost incurred during the early stages of the contract.

(5) If the settlement *proposal* is on the inventory basis, initial *costs should* normally be allocated on the basis of total end items called for by the contract immediately before termination; however, if the contract includes end items of a diverse nature, some other equitable basis *may* be used, such as

machine or labor hours.

(d) *Loss of useful value.* Loss of useful value of *special tooling*, and special machinery and equipment is generally allowable, provided-

(1) The *special tooling*, or special machinery and equipment is not reasonably capable of use in the other work of the contractor;

(2) The Government's interest is protected by transfer of title or by other means deemed appropriate by the *contracting officer*; and

(3) The loss of useful value for any one terminated contract is limited to that portion of the *acquisition* cost which bears the same ratio to the total *acquisition* cost as the *terminated portion of the contract* bears to the entire terminated contract and other Government contracts for which the *special tooling*, or special machinery and equipment was acquired.

(e) *Rental under unexpired leases.* Rental costs under unexpired leases, less the *residual value* of such leases, are generally allowable when shown to have been reasonably necessary for the performance of the terminated contract, if-

(1) The amount of rental claimed does not exceed the reasonable use value of the property leased for the period of the contract and such further period as *may* be reasonable; and

(2) The contractor makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease.

(f) *Alterations of leased property.* The cost of alterations and reasonable restorations required by the lease *may* be allowed when the alterations were necessary for performing the contract.

(g) Settlement expenses.

(1) Settlement expenses, including the following, are generally allowable:

(i) Accounting, legal, clerical, and similar costs reasonably necessary for-

(A) The preparation and presentation, including supporting data, of settlement *claims* to the *contracting officer*; and

(B) The termination and settlement of subcontracts.

(ii) Reasonable costs for the storage, transportation, protection, and disposition of property acquired or produced for the contract.

(iii) *Indirect costs* related to salary and wages incurred as settlement expenses in (i) and (ii); normally, such *indirect costs* shall be limited to payroll taxes, fringe benefits, occupancy costs, and immediate supervision costs.

(2) If settlement expenses are significant, a cost account or work order shall be established to separately identify and accumulate them.

(h) *Subcontractor claims.* Subcontractor *claims*, including the allocable portion of the *claims* common to the contract and to other work of the contractor, are generally allowable. An appropriate share of the contractor's indirect expense *may* be allocated to the amount of settlements with

subcontractors; provided, that the amount allocated is reasonably proportionate to the relative benefits received and is otherwise consistent with [31.201-4](#) and [31.203\(d\)](#). The indirect expense so allocated *shall* exclude the same and similar *costs* claimed directly or indirectly as settlement expenses.

**Parent topic:** [31.205 Selected costs](#).