A Primer on a Federal Contractor's Rights When a Contract is Terminated for Convenience

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The early days of the Trump Administration have seen a dramatic shift in federal spending priorities, impacting government contractors across a wide range of industries. There have been widespread terminations for convenience of federal contracts for a variety of reasons including budget-cutting exercises, and in response to President Trump's Executive Orders, such as Executive Order (EO) 14173, "*Ending Illegal Discrimination and Restoring Merit-Based Opportunity*", EO 14151, "*Ending Radical and Wasteful Government DEI Programs and Preferencing,*" and EO 14169, "*Reevaluating and Realigning United States Foreign Aid*." For example, the latter of these Executive Orders has, according to Secretary of State Marco Rubio, seen about 83% percent of U.S. foreign aid contracts cancelled. The question becomes what are a contractor's rights after receiving a termination for convenience notice. The following is a basic primer of a contractor's rights.

By way of background, nearly all federal contracts contain a "Termination for Convenience of the Government" clause. This clause, with no common law contracting analogue, allows the government to terminate—without any fault on the part of the contractor—all or part of any government contract, by written termination notice, when doing so is in the government's interest. Indeed, the right of the government to do so is so fundamental that the U.S. Court of Federal Claims has held that the clause is to be read into government contracts even where the procuring agency inadvertently omits it. See *G.L. Christian & Associates v. United States*, 312 F.2d 418 (Ct. Cl. 1963). It is through the operation of this clause that mass terminations have taken place at various agencies, with many more expected as the Department of Government Efficiency ("DOGE") engages in its systematic review of spending. Indeed, last Thursday, the Trump Administration issued an Executive Order attempting to

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essentially consolidate IT contracting (and procurement for other "common goods and services") under the U.S. General Services Administration. This will undoubtedly result in even more terminations.

This raises the question: when the government decides to terminate a contract, or a part of the contract, for convenience, what options are available for a contractor? As a threshold matter, because the government's discretion to terminate is nearly unfettered, it is contractually obligated, in most cases, to pay the terminated contractor incurred costs and specified continuing costs. But the contracting officer first must notify the contractor, in writing, prior to terminating a contract for convenience. Such notice is to include, among other things, which clause the contract is being terminated under, the effective date of the termination, the scope of the termination, and any steps that the contractor is required to take to minimize the termination's impact. At that point, the contractor is generally obligated to: (1) immediately stop work; (2) terminate any subcontracts; (3) complete inventory disposal schedules (SF 1428 Inventory Disposal Schedule) and turn in to contracting officer no later than 120 days from the effective date of termination; and (4) **submit a termination settlement proposal within a year after the contract has been terminated for convenience**.

That last step presumes the contractor decides to accept the termination and file a termination settlement proposal. The contractor does, however, have the option of challenging the termination as being made in bad faith or as an abuse of discretion.

The standards for a bad faith or abuse of discretion claim are extremely high and because the government, acting through a contracting officer, has broad discretion to terminate a contract in the government's interest, these claims are rarely successful. Specifically, to prove a bad faith claim, the contractor must prove with "well-nigh irrefragable proof" that the government had a specific intent to injure the contractor. *JKB Solutions & Servs, LLC v United States,* 18 F.4th 704, 709 (CA Fed, 2021). Actions that have risen to this level are when the contractor has proven that the government engaged in a "proven conspiracy to get rid of" the contractor or that the government was "motivated alone by malice" against the contractor. *V.I.C. Enters. v. VA,* 2009 CIVBCA LEXIS 145, *15. While this is a high threshold, if a contractor does succeed in demonstrating that the agency acted in bad faith, it can recover more significant damages such as anticipatory profits, which are not allowable in the context of a termination settlement. In any event, making a bad faith termination claim is not the most likely path forward for most contractors.

When the government terminates a contract for convenience and the contractor does not challenge the decision, the contractor is generally entitled, under a termination settlement, to the payment of costs associated with fulfilling the contract up to the effective termination date, profit on any work performed up to the effective date, and other categories of costs discussed below (including attorneys' fees). One important caveat is that the substance of a termination settlement proposal, and thus any recovery, is dependent upon the contract clause used, which itself depends upon the underlying contract type in question. The following clauses, contained in FAR Part 52, are the four primary termination for convenience clauses: (1) FAR 52.249-1 Termination for Convenience of the Government (Fixed-Price) (Short Form); (2) FAR 52.249-2 Termination for Convenience of the

Government (Fixed-Price); (3) FAR 52.249-6 Termination (Cost-Reimbursement); and (4) FAR 52.212-4 Contract Terms and Conditions—Commercial Products and Commercial Services. The last provision, which includes all terms applicable to FAR Part 12 commercial items contracts, contains the commercial items contract termination for convenience clause.

Taking the very frequently used FAR 52.249-2 as an example, a contractor terminated for convenience under a traditional fixed-price contract is expressly entitled to recover the following:

- Allowable costs incurred in performing the work;
- Reasonable profit for the work performed;
- Reasonable settlement expenses; and
- Certain post-termination costs.

This framework essentially converts a fixed-price contract into a cost-reimbursement contract, through its use of a cost-based formula to calculate recovery in the event the contractor is terminated. Notably, however, recovery of allowable costs incurred (and profit) under a fixed-price contract cannot exceed the total contract price.

A contractor submitting a termination settlement proposal under a fixed-price contract will also have to choose one of the two specified (at FAR 49.206-2) methods for submission of the termination settlement proposal: (1) inventory basis; or (2) total cost basis. In accordance with FAR Part 31, which sets out the principles for determining the allowability of contractor-incurred costs, the inventory basis is the government's preferred method for receipt of termination settlement proposals. The inventory basis is used when termination inventory is involved and is the subject of a contractor's request for reimbursement. On the other hand, when use of the inventory basis is not practicable, or will unduly delay settlement, the total cost basis may be used if approved in advance by the Termination Contracting Officer. If the total cost basis is used, the contractor must itemize all costs incurred under the contract up to the effective date of termination. Each methodology has its own required format, so contractors must evaluate this step at the outset as they formulate their termination settlement strategy.

One particular category of recoverable costs is worth highlighting here. FAR 31.205-42, Termination Costs, sets forth specific cost principles applicable to situations that are unique to the termination context. "Settlement Expenses" (at subsection (g)), provides for the allowability of a contractor's costs incurred in the preparation and presentation of convenience termination settlement proposals. These include not only items such as costs relating to the disposition of contract property and indirect costs related to salary and wages, but also "accounting, legal, clerical, and similar costs reasonably necessary for . . . (t)he preparation and presentation, including supporting data, of settlement claims to the contracting officer; and . . . (t)he termination and settlement of subcontracts." FAR 31.205-42(g)(1). In other words, a contractor is able to recover the legal or other consultant fees incurred in the process of submitting a termination proposal. This is potentially significant given the complexities in crafting and negotiating a termination settlement proposal and the likely need to involve outside

counsel and/or other experts.

This is by no means an exhaustive analysis of all the factors that a contractor must consider in confronting a termination for convenience; and, as mentioned above, the rules are different depending on the nature of the contractor's underlying contract. However, this primer should provide a starting point in considering the potential impact of a termination for convenience of a federal contract.

Members of Butzel's Aerospace and Defense practice have extensive experience advising contractors as to what their best options are when the federal government terminates a contract and have experience counseling contractors regarding, and litigating, claims, equitable adjustments, and terminations. Please reach out to the authors of this Client Alert or your Butzel attorney for further information.

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