

Legal Alerts

Sequestration & Austerity May Increase Government's Use of Terminations for Convenience - Be Prepared!

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Sequestration and budget cuts in Washington may result in increased use of "termination for the convenience of the Government" clauses in contracts by federal agencies. All contractors, subcontractors and suppliers to all federal agencies, at all tiers, could be deeply affected. All should be aware of basic principles governing their rights and remedies in the event of a termination for convenience, and should make sure they are prepared to deal with the consequences.

A. What is "Termination for Convenience?"

All federal contracts contain standard "termination for convenience" clauses (see FAR §§ 52.249-1 through 52.249-7), and such clauses are "read in" to all government contracts whether they contain them or not. Generally, these allow the government to terminate all, or part, of the contract when it is in the Government's interests to do so. In a post-sequestration environment, or any significant budgetary retrenchment, agencies may resort to total or partial terminations for convenience, especially for contracts with extended performance periods. Typically, "T for C" clauses are "flowed down" to lower tier subcontractors and suppliers. So, even if you don't hold a government contract, but supply goods or services to someone who does, you may be affected.

B. What Can You Do in a "T for C?"

A true termination for convenience is not regarded as a breach by the Government, which would entitle the contractor to full "benefit of the bargain" damages. Rather, applicable federal procurement laws and the FAR afford contractors more limited remedies.

For fixed-price contracts, the contractor is allowed "fair compensation," in the event of a termination for convenience. As a general rule, a T for C converts the terminated portion of a fixed-price contract into a cost-reimbursement type of contract, so costs are determined under FAR Part 31 Cost Principles and Procedures, elements of which include:

- Certain allowable costs (with "allowability" determined by complex FAR Part 31 cost principles), such as:
 - Costs of settling subcontractor claims;

- Rental cost under unexpired leases;
- Reasonable settlement expenses (including time of in-house personnel and reasonable attorneys' and accountants' fees); and
- Certain "continuing after termination" costs.
- A reasonable profit for work performed and on preparations to perform.

Termination for convenience of contracts for "commercial" items and services are governed by a different formula, set out in Part 12 of the FAR. For commercial item contracts, the contractor may recover according to a modified price-based formula, including:

- the percentage of the contract price corresponding to the percentage of the work performed prior to termination; and
- charges the contractor can demonstrate resulted directly from the termination.

A subcontractor's rights on termination for convenience of the prime contract turns largely on what the subcontract says. It behooves both contractors and subcontractor/suppliers to pay very close and careful attention to termination clauses to make sure they protect the party's interests in the event the Government terminates for convenience the prime contract.

Subcontractors and suppliers generally have no right to proceed directly against the Government. Typically, the prime contractor will try to settle the subcontractor's claim, and recover the costs of the settlement from the Government as part of the contractor's recoverable costs. It may also be possible for the prime contractor to "sponsor" and pursue the subcontractor's claim under a "pass through" claim agreement negotiated between the contractor and subcontractor.

C. Preparation and Planning Are Paramount

When facing a termination for convenience situation, a company must grapple with a host of strategic decisions and thorny legal, financial and business issues. To navigate this maze and to prepare and present termination for convenience claims, most companies should not try to go it alone. Having at your side counsel and accountants familiar with the regulations and sufficiently experienced to help develop and implement an integrated strategy for managing a termination for convenience is critical. As Government budgets grow ever tighter, to be prepared, it makes sense to ensure that your subcontract and supply agreements and cost accounting systems are in proper shape to minimize the harm caused by a Government termination for convenience.

Contact Us

Attorneys at GSB are available to assist you through all phases of Government contracting. Please contact Ben Lambiotte at 202-298-2525, John Knab at 202-298-2536, and Julia Holden-Davis at 907-258-2400, for legal advice tailored to your individual circumstances.

Government Contracts Alert by Garvey Schubert Barer.

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