

# The Government Contractor's Guide to Termination for Convenience

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The Trump administration, as part of its efforts to reshape the federal government, began terminating federal contracts for the convenience of the government almost immediately after coming back to town. These contract terminations show no signs of slowing in the near term. Accordingly, government contractors need to know their rights and obligations so that they can be best positioned if one or more of their contracts are terminated. This article provides a user-friendly guide for government contractors on these important rights and obligations.

## General

“Termination for convenience means the exercise of the Government’s right to completely or partially terminate performance of work under a contract when it is in the Government’s interest” (Federal Acquisition Regulation (FAR) 2.101). The right to terminate for convenience is made a part of almost all government contracts by inclusion of the standard Termination for the Convenience of the Government clauses in [FAR 52.249-1](#) through [-5](#). The Termination for Convenience clause in commercial item contracts issued under FAR Part 12 can be found in paragraph (l) of FAR 52.212-4. For government contracts that do not contain a termination for convenience clause, such a clause nonetheless is generally read into the contract by operation of law under the “*Christian Doctrine*.” See *G.L. Christian & Assoc. v. United States*, 312 F.2d 418 (Ct. Cl. 1963).

## Procedures

Once a government contract has been terminated for the convenience of the government, a series of duties for both the prime contractor and the contracting officer are triggered under FAR 49.104 and FAR 49.105, respectively. These duties are discussed in turn below.

- **Duties of Prime Contractor**

FAR 49.104 (Duties of Prime Contractor After Receipt of Notice of Termination) states that, “[a]fter receipt of the notice of termination, the contractor shall comply with the notice and the termination clause of the contract, except as otherwise directed by the TCO [Termination Contracting Officer].”

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FAR 49.104 states that “the notice and clause applicable to convenience terminations” generally require that the contractor:

1. Stop work immediately on the terminated portion of the contract and stop placing subcontracts thereunder;
2. Terminate all subcontracts related to the terminated portion of the prime contract;
3. Immediately advise the TCO of any special circumstances precluding the stoppage of work;
4. Perform the continued portion of the contract and submit promptly any request for an equitable adjustment of price for the continued portion, supported by evidence of any increase in the cost, if the termination is partial;
5. Take necessary or directed action to protect and preserve property in the contractor’s possession in which the government has or may acquire an interest and, as directed by the TCO, deliver the property to the government;
6. Promptly notify the TCO in writing of any legal proceedings growing out of any subcontract or other commitment related to the terminated portion of the contract;
7. Settle outstanding liabilities and proposals arising out of termination of subcontracts, obtaining any approvals or ratifications required by the TCO;
8. Promptly submit the contractor’s own settlement proposal, supported by appropriate schedules; and
9. Dispose of termination inventory, as directed or authorized by the TCO.

Accordingly, government contractors who have had a contract terminated for convenience need to be mindful of the duties that the FAR imposes upon them and should adequately document their compliance with these duties.

- **Duties of Contracting Officer**

FAR 49.105 (Duties of Termination Contracting Officer After Issuance of Notice of Termination), in turn, states that “[c]onsistent with the termination clause and the notice of termination, the TCO shall”:

1. Direct “the action required of the prime contractor;”
2. Examine the prime contractor’s termination settlement proposal and, when appropriate, the settlement proposals of subcontractors;
3. Promptly negotiate settlement with the contractor and enter into a settlement agreement; and
4. Promptly settle the contractor’s settlement proposal “by determination for the elements that cannot be agreed on, if unable to negotiate a complete settlement” (see FAR 49.105(a)).

Next, FAR 49.105(b) states that, “[t]o expedite settlement, the TCO may request specially qualified personnel to”:

1. Assist in dealings with the contractor;
2. Advise on legal and contractual matters;
3. Conduct accounting reviews and advise and assist on accounting matters; and
4. Perform the following functions regarding termination inventory (see FAR subpart 45.6): verify its existence; determine qualitative and quantitative allocability; make recommendations concerning serviceability; undertake necessary screening and redistribution; and assist the contractor “in accomplishing other disposition.”

Moreover, FAR 49.105(c) states that the TCO “should promptly hold a conference with the contractor

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to develop a definite program for effecting the settlement.” In addition, the FAR states that, “[w]hen appropriate in the judgment of the TCO, after consulting with the contractor, principal subcontractors should be requested to attend.”

FAR 49.105(c) goes on to state that “[t]opics that should be discussed at the conference and documented include”:

1. General principles relating to the settlement of any settlement proposal, including obligations of the contractor under the termination clause of the contract;
2. Extent of the termination, point at which work is stopped, and status of any plans, drawings, and information that would have been delivered had the contract been completed;
3. Status of any continuing work;
4. Obligation of the contractor to terminate subcontracts and general principles to be followed in settling subcontractor settlement proposals;
5. Names of subcontractors involved and the dates termination notices were issued to them;
6. Contractor personnel handling review and settlement of subcontractor settlement proposals and the methods being used;
7. Arrangements for transfer of title and delivery to the government of any material required by the government;
8. General “principles and procedures to be followed in the protection, preservation, and disposition of the contractors and subcontractors’ termination inventories, including the preparation of termination inventory schedules;”
9. Contractor accounting practices and preparation of SF 1439 (Schedule of Accounting Information (FAR 49.602-3);
10. Accounting review of settlement proposals;
11. Any requirement for interim financing in the nature of partial payments;
12. Tentative “time schedule for negotiation of the settlement, including submission by the contractor and subcontractors of settlement proposals, termination inventory schedules, and accounting information schedules (see [FAR] 49.206-3 and [FAR] 49.303-2)”;
13. Actions taken by the contractor to minimize impact upon employees affected adversely by the termination (see paragraph (g) of the letter notice in FAR 49.601-2); and
14. The “[o]bligation of the contractor to furnish accurate, complete, and current cost or pricing data, and to certify to that effect in accordance with [FAR] 15.403-4(a)(1) when the amount of a termination settlement agreement, or a partial termination settlement agreement plus the estimate to complete the continued portion of the contract exceeds the threshold in [FAR] 15.403-4.”

Although the duties set forth under FAR 49.105 are generally directed to the contracting officer, contractors should keep an eye on these obligations and do their best to make sure that the contracting officer is adhering to them.

## **Termination Settlement Proposals**

In exchange for the government retaining the right to terminate most federal contracts for the convenience of the government, the FAR allows contractors to submit a convenience termination settlement proposal in which the terminated contractor may seek recovery of certain costs. FAR 49.201(a) states that such a settlement “should compensate the contractor fairly for the work done and the preparations made for the terminated portions of the contract, including a reasonable allowance for profit.”

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There are two basic approaches to convenience termination settlement proposals: the “inventory basis” and the “total cost” basis. The submission requirements under these two approaches are discussed in turn below. In addition, we discuss unique convenience termination rules for commercial item contracts under FAR 12.403, as well as the general timing requirements for submitting convenience termination settlement proposals.

- **Inventory Basis**

FAR 49.206-2(a) states that “[u]se of the inventory basis for settlement proposals is preferred.” Under the inventory basis, “the contractor may propose only costs allocable to the terminated portion of the contract, and the settlement proposal must itemize separately” the following: (1) “[m]etals, raw materials, purchased parts, work in process, finished parts, components, dies, jigs, fixtures, and tooling, at purchase or manufacturing cost;” (2) charges such as engineering costs, initial costs, and general administrative costs; (3) costs of settlements with subcontractors; (4) settlement expenses; and (5) other “proper charges.”

FAR 49.206-2(a) additionally states that “[a]n allowance for profit ([FAR] 49.202) or adjustment for loss ([FAR] 49.203(b)) must be made to complete the gross settlement proposal.” In addition, “[a]ll unliquidated advance and progress payments and all disposal and other credits known when the proposal is submitted must then be deducted.”

FAR 49.206-2(a) goes on to state that the “inventory basis is also appropriate for use under the following circumstances.”

1. The “partial termination of a construction or related professional services contract;”
2. The “partial or complete termination of supply orders under any terminated construction contract;” and
3. The “complete termination of a unit-price (as distinguished from a lump-sum) professional services contract.”

- **Total Cost Basis**

Concerning the “total cost” basis of settlement, FAR 49.206-2(b) states: “When use of the inventory basis is not practicable or will unduly delay settlement, the total-cost basis (SF-1436) may be used if approved in advance by the TCO as in the following examples”:

1. If production has not commenced and the accumulated costs represent planning and preproduction or get ready expenses;
2. If, under the contractor’s accounting system, unit costs for work in process and finished products cannot readily be established;
3. If the contract does not specify unit prices; and
4. If the termination is complete and involves a letter contract.

Accordingly, contractors seeking to use the “total cost” basis should confirm in writing with the TCO in advance that the “total cost” basis is acceptable.

“When the total-cost basis is used under a complete termination, the contractor must itemize all costs incurred under the contract up to the effective date of termination.” FAR 49.206-2(b)(2). Further, “[t]he costs of settlements with subcontractors and applicable settlement expenses must also be added,” “[a]n allowance for profit ([FAR] 49.202) or adjustment for loss ([FAR] 49.203(c)) must be

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made,” and “[t]he contract price for all end items delivered or to be delivered and accepted must be deducted.” “All unliquidated advance and progress payments and disposal and other credits known when the proposal is submitted must also be deducted.”

With respect to the use of the total-cost basis under a partial termination, the FAR states that the “settlement proposal shall not be submitted until completion of the continued portion of the contract.” FAR 49.206-2(b)(3). The FAR also states that the settlement proposal “must be prepared as in [FAR 49.206-2(b)(2)], except that all costs incurred to the date of completion of the continued portion of the contract must be included.”

If, however, “a construction contract or a lump-sum professional services contract is completely terminated, the contractor shall”:

1. Use the total cost basis of settlement;
2. Omit line 10 “Deduct-Finished Product Invoiced or to be Invoiced” from Section II of Standard Form-1436 Settlement Proposal (Total Cost Basis); and
3. “Reduce the gross amount of the settlement by the total of all progress and other payments” (see FAR 49.206-2(b)(4)).

FAR 49.602, in turn, outlines the standard forms used to prepare settlement proposals under both the inventory and total cost basis.

Generally speaking, a convenience termination settlement proposal should seek costs that would otherwise be allowable under FAR Part 31 (see e.g., FAR 52.249-2(i)). FAR 31.205-42 (Termination Costs) sets out specific cost principles applicable to certain unique termination situations. Notably, “settlement expenses,” including the costs incurred in the preparation and presentation of convenience termination settlement proposals, may be allowable costs (see FAR 31.205-42(g)). Finally, in instances in which the prime contract allows for partial payments, “a prime contractor may request [partial payments] on the form prescribed in [FAR] 49.602-4 at any time after submission of interim or final settlement proposals,” and “[t]he Government will process applications for partial payments promptly” (see FAR 49.112-1(a)).

#### • **Commercial Item Terminations**

Unique termination for convenience procedures apply to commercial item contracts covered by FAR Part 12. Specifically, FAR 12.403(d) provides that, when the contracting officer terminates a contract for commercial items for the government’s convenience, the contractor shall be paid:

1. The “percentage of the contract price reflecting the percentage of the work performed prior to the notice of the termination for fixed-price or fixed-price with economic price adjustment contracts;” or
2. An “amount for direct labor hours (as defined in the Schedule of the contract) determined by multiplying the number of direct labor hours expended before the effective date of termination by the hourly rate(s) in the Schedule;” and
3. Any “charges the contractor can demonstrate directly resulted from the termination.”

FAR 12.403(d) goes on to state that the “contractor may demonstrate such charges using its standard record keeping system and is not required to comply with the cost accounting standards or the contract cost principles in [FAR] part 31.” Importantly, the government “does not have any right to audit the contractor’s records solely because of the termination for convenience.”

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Finally, FAR 12.403(d) provides that the parties generally “should mutually agree upon the requirements of the termination proposal,” and that the parties “must balance” the government’s “need to obtain sufficient documentation to support payment to the contractor against the goal of having a simple and expeditious settlement.” Thus, unlike settlement proposals submitted under FAR Part 49, there is no standard form for submitting a settlement proposal under FAR Part 12.

- **Timing Requirements**

FAR 52.249-2 (Termination for Convenience of the Government (Fixed-Price)), which is the most common convenience termination clause, states in relevant part:

(c) The Contractor shall submit complete termination inventory schedules *no later than 120 days from the effective date of termination*, unless extended in writing by the Contracting Officer upon written request of the Contractor within this 120-day period.

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(e) After termination, the Contractor shall submit a final termination settlement proposal to the Contracting Officer in the form and with the certification prescribed by the Contracting Officer. The Contractor shall submit the proposal promptly, *but no later than 1 year from the effective date of termination*, unless extended in writing by the Contracting Officer upon written request of the Contractor within this 1-year period. However, if the Contracting Officer determines that the facts justify it, a termination settlement proposal may be received and acted on after 1 year or any extension. If the Contractor fails to submit the proposal within the time allowed, the Contracting Officer may determine, on the basis of information available, the amount, if any, due the Contractor because of the termination and shall pay the amount determined (*emphasis added*).

Notably, the timing requirements for submitting convenience termination settlement proposals are generally consistent across FAR clauses for traditional government contracts (see e.g., FAR 52.249-3 (Termination for Convenience of the Government (Dismantling, Demolition, or Removal of Improvements)) (containing similar timing requirements under subparagraphs (c) and (e)); FAR 52.249-5 (Termination for Convenience of the Government (Educational and Other Nonprofit Institutions)) (same). Generally, commercial item convenience termination submissions under FAR Part 12 do not contain similar timing requirements.

That said, each contract and set of facts should be analyzed on a case-by-case basis to ensure that the contractor is complying with applicable submission deadlines, and submission deadlines should be calculated conservatively regardless of which FAR clause applies.

Notably, the FAR does not impose a time limit by which the TCO must complete settlement negotiations with a terminated contractor. However, for small business concerns, the FAR dictates that auditors and the TCO “shall promptly schedule and complete audit reviews and negotiations, giving particular attention to the need for timely action on all settlements involving small business concerns” (see FAR 49.101(d)).

## **Claims and Appeal Rights**

In *Gardner Machinery Corp. v. United States*, 14 Cl. Ct. 286 (1988), the U.S. Claims Court — which is the predecessor to the U.S. Court of Federal Claims — distinguished settlement proposals from Contract Disputes Act (CDA) claims as follows:

[A] Settlement proposal is contemplated under the regulations as a request for opening negotiations. It is not contemplated by the regulations that settlement proposals be used for the submission of final demand, final decision requested CDA claims. That is not to say that CDA claims may not grow out of the settlement proposal process or be converted to a CDA claim. It simply means that at the point of impasse in the negotiation process, the contractor must submit or resubmit its written claim, now in dispute for a finite amount of money, to the contracting officer and request a final decision thereon.

While the foregoing summary may seem straightforward, the rules in this area can actually be quite tricky. Thus, it is important to seek guidance from experienced legal counsel when seeking to convert a convenience termination settlement proposal to a formal “claim” under the CDA.

Once a contracting offer issues a final decision on a contractor’s claim, a dissatisfied contractor may generally appeal that decision to the cognizant agency board of contract appeals within *90 days* of receipt of the decision or bring suit on the claim in the U.S. Court of Federal Claims within *12 months* (see 41 U.S.C. § 7104).

## Conclusion

In light of the recent uptick in federal contract terminations, contractors should be prepared to properly account for and timely submit recoverable costs in a convenience termination settlement proposal, as discussed in this guide.

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