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Sequestration: A Tale Of Unrequited Patriotism

Law360, New York (November 05, 2012, 4:35 PM ET) -- Sequestration is slated to start Jan. 2, 2013. Under the terms of the Budget Control Act of 2011, the Office of Management and Budget must trim $1.2 trillion evenly from the budgets of civilian agencies and the U.S. Department of Defense from 2013 through 2021, an annual reduction of $109 billion.

In a report issued on Sept. 14, the OMB started that process, providing initial estimates of what, exactly, would be sequestered from discretionary programs (i.e. nonentitlements) in the 2013 budget, including approximately $54 billion spread across the civilian agencies and $54 billion from the DOD budget, which includes a cut in funds for "overseas contingency operations," i.e., war spending. The same requirement will continue for the next nine years. However, after 2013, the Appropriations Committees will be allowed to determine how it will apply the cuts to live within the Budget Control Act's mandatory reduced spending caps.

The issue of sequestration is especially critical as we approach the first quarter of fiscal year 2013, because it will affect contracts awarded on or after Oct. 1, 2012, and contracts awarded before that date that were not fully funded with FY 2012 or earlier year appropriations.

No one can predict with certainty what will transpire on Jan. 2. However, if past is prologue — and it usually is — it is highly likely that government procurement offices will lean on contractors to save the country from the consequences of political mismanagement. An all too familiar pattern that we anticipate is the one in which the government:

- tells you it has no money;
- stresses the importance of the at-risk contract to our nation's security;
- emphasizes the company's patriotic duty; and
- offers assurances that the government will "take care of" the company later.

There are a variety of legal terms that describe this empty promise. Bunk, poppycock and drivel are three that come immediately to mind. All too often, contractors in the past have succumbed to this siren song and lived to regret it. What makes the scenario even more problematic in relation to sequestration, however, is that the money that the agencies do not have today is not going to materialize like the proverbial manna from heaven at any time in the future.

Unless and until Congress solves the budget problem, the sequestration cuts are here for the next decade. Working without coverage under these circumstances — in a financially unstable environment, free of reliable assurances of future payments and possibly devoid of remedies for performance that will be characterized as voluntary — can be ruinous.

The prosecution of claims against the government for sequestration is not likely to be successful. Sequestration will be characterized by the government as a "sovereign act," for which contractors will have no contractual recourse other than excusable delay. As a result, contractors are forced to "play defense" as the impacts of sequestration spool out into the market. How do they do that? There is no "one size fits all" defensive game plan, but we have some suggestions:

1. Review your contract portfolio to determine how your contracts are funded, which ones are not at risk of sequestration and which are.

2. Get every dollar to which you are entitled — now.

- Invoice immediately for all dollars to which you are entitled, including all fees that you have earned.

- Evaluate, prepare and submit whatever valid claims you may have.

- Submit claims for Prompt Payment Interest, if applicable to your payments, when the only basis for nonpayment is the unavailability of funds.

- Exercise your rights under the "limitation of funds" and "limitation of cost" clauses of your cost reimbursable contracts — stop work when you reach the ceilings.

- Be sure to include the costs of mass severance in the event of termination in your calculation of the costs incurred and to be incurred against the LOC and LOF ceilings. Contractors who do not will find that those costs are not reimbursable if they exceed the contract ceilings. See, e.g., Allied Signal Aerospace Co., ASBCA No. 46890, 95-1 BCA ¶ 27,462.

3. In a fixed price environment, consider the following:

- Will the government have the money to pay for the last 10 percent of your performance?

- Will it have the money to pay any back-ended fee?

- Can the government properly invoke the changes clause to reduce quantities? The conventional wisdom — and the terms of the changes clause itself — is that it cannot do so, that such reductions must be undertaken pursuant to a partial termination for convenience. That entitles you to termination costs, but will the government have the money to pay them?

- Can you, in the face of lack of government resources to pay what it owes, demand reasonable assurances of payment, like a commercial seller can? And who in the government can provide those reasonable assurances? Who is authorized to provide such assurances? Let us not forget in this regard Federal Crop Insurance Corp. v. Merrill, 332 U.S. 380 (1947).

- If the government cannot provide assurances of its performance, can you stop work?
    - Which disputes clause do you have? The standard clause, which has the narrower requirement to continue work pending the resolution of a dispute? Or the ALT I version, which includes the broader work mandate?
    - Is a government funding shortfall a dispute within the meaning of the clause or simply a fact that is not in dispute? In other words, does the disputes clause's "continue to work" mandate even apply?
    - Is a government "direction" to continue work in the face of a funding shortfall a violation of the Ant-Deficiency Act?

The bottom line is this — the government is likely to jawbone you into "doing the right thing for the country." The right thing here is exercise your rights. Maybe, just maybe, if the contracting community actually stands on its rights it will communicate a clear message to Congress — like Howard Beale in "Network" — that "I'm as mad as hell, and I'm not going to take this anymore," and require the Congress to solve its own mess without riding on the backs of contractors.

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