

CLIENT ALERT

Shutdown Suspicions? Crowell & Moring Identifies the Questions You Should Be Asking

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As the press reports about delays in the appropriations process have multiplied in recent days, we have received a number of calls from clients about the contractual issues that might arise if there is a government shutdown after March 4. Although the issues that might arise in connection with a shutdown will likely be specific to the circumstances of individual contracts, there are several broad issues that all contractors should be considering. Based on our experience with the issues that arose during the last shutdown in the mid-nineties and on the standard provisions in most contracts, we recommend that contractors consider at least the following:

- **Where Is the Money?** For incrementally funded contracts, a "shutdown" situation is likely similar to those experienced at the end of any fiscal year when there is a "gap" between appropriations. Contractors will need to consider the implications of the various standard clauses (Limitation of Costs, Limitation of Funds, Limitation of Government Obligations) that may affect the government's obligation to pay costs in excess of the amounts obligated to their contracts. Of particular concern will be the standard provisions in those clauses that may limit the government's liability for termination costs in the event that the contracts are eventually terminated without new funding. As is the case when there is a gap in funding, contractors will need to decide whether to continue to perform or to take the actions authorized under the various relevant clauses when funding is insufficient to pay for anticipated costs. But for contracts that are fully funded or that have incremental funding sufficient to cover all anticipated costs, including termination costs, a shutdown would not normally create any additional risk.
- **Delay and Disruption.** During the last federal shutdown, due to the unavailability of appropriated funds, the principal contractual issues reported related to the disruption and delay caused by the inability of contractors to gain access to closed government facilities or to obtain timely direction and support from the government. For example, a contractor that performs services in a federal facility may find that the facility is closed, so the contractor's employees do not have access to their workplace. In that situation, contractors will need to decide whether to (1) continue to pay the employees for idle time caused by the shutdown, (2) force the employees to take vacation or other paid leave for the duration of the shutdown, or (3) furlough or lay off the employees. In connection with those decisions, contractors need to consider not only their contractual requirements, but also the applicability and requirements of federal, state, and local labor and employment laws (including the federal WARN Act and state analogs), the terms of their employment contracts and collective bargaining agreements, the impact that their decisions may have on employee relations, and other relevant factors. In a situation in which the duration of the shutdown is unclear, those decisions can be even more difficult, involving a variety of competing and largely unattractive options.
- **Remedy.** Contract type and the availability of a remedy from the government for the consequences of a shutdown will also be important in the decision-making process. For contractors with cost-reimbursement contracts, the reasonable costs of coping with a shutdown should be recoverable, although there may be issues about the allocability and

allowability of specific items of cost. On fixed-price contracts, any recovery from the government will likely depend on whether the contractor is entitled to an equitable adjustment. And, on T&M contracts, there are likely to be contract-specific issues about whether the contractor is entitled to be paid under the contract for idle time or would need to make a claim for an equitable adjustment. Again, every situation should be assessed separately, based on specific facts. But, in general, contractors should take steps to ensure that any increased costs associated with the shutdown are collected in a way that will support an equitable adjustment claim, if the contractor ultimately decides that a claim is warranted.

- **Don't Ask, Don't Tell?** Contractors should also weigh whether it is prudent to seek direction from the government in advance of a shutdown. Indeed, by asking, a contractor might prompt direction from the government that puts the contractor in a situation worse than attempting to gauge the uncertainty.
- **Mission Creep.** Some contractors may actually be approached by their government customer seeking to off-load, at least temporarily, work that cannot be performed by the government during the shutdown period. If the contract funding is available, the government may want to increase the scope of the contract in order to ensure that certain work is not disrupted or delayed. Contractors should ensure that any increases in scope and associated cost or price adjustments are appropriately reflected in a contract modification.
- **Timing of Payment.** There may be delays in payment. As noted above, the government's ultimate legal liability for payments due on contracts that are already funded at the time of the shutdown are unlikely to be at issue, but if the government employees who process contractor invoices and make contractor payments are not at work, there will obviously be no payments made. For large contractors with substantial bills that may involve payments of millions of dollars on a daily basis, the consequences of even a short delay in payment could be economically significant, although probably not an existential threat to the company. For contractors without readily available cash or credit lines, the consequences of more than a brief delay in payment could be catastrophic. Again, each situation needs to be evaluated based on the circumstances of the contractor and the consequences of delay in payment. Suspension of performance for non-payment may be justified legally, but for contractors performing in war zones or under other circumstances where suspension of performance would have significant collateral consequences, decisions to suspend performance, even if legally justified, may be exceptionally difficult.

When the Government was last forced to shut down because of delays in the appropriations process, the shutdown was relatively short, and the consequences were relatively modest. Although, there were claims and there was some litigation, the impact on industry was not substantial. However, in some cases -- both then and today -- even a very brief shutdown could have material economic consequences for individual contractors. A shutdown that lasts more than a few days might have devastating effects, particularly on service contractors that perform in government facilities. Even if it seems improbable that a shutdown will occur or that it will last long if it does occur, it would be prudent for all contractors to assess the likely impact of a shutdown on their specific operations and to make contingent plans for dealing with the consequences of a shutdown.

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