

## Cliff Notes: The Long, Slow Trudge Toward Sequestration

*Law360, New York (December 17, 2012, 12:33 PM ET)* -- From a budgetary perspective, 2012 has been, in a word, unique. As discussed below, no legislation of any true budgetary import has been enacted into law in over a year, yet more news stories and scholarship on federal budgetary matters seem to have been produced in the past year than at any time in recent memory.

This attention is due in large part to one word: sequestration. A concept once understood by only the wonkiest of policy and appropriations wonks, sequestration — or more appropriately, the looming possibility of sequestration — has garnered unprecedented interest from federal contractors, business leaders and executive branch agencies. This article provides a brief retrospective of the developments in 2012 relating to sequestration, and a short overview of what contractors can expect in the weeks ahead as the countdown to sequestration approaches zero.

To properly understand the budgetary developments that occurred this year, a brief history of events and practices leading up to 2012 is necessary. A fair starting point is 1985, when Congress passed the 1985 Balanced Budget Act (“BBA”). Prior to 1985, the United States’ budgets were not developed with an eye toward their deficit impact. But as the budget process began to produce significant deficit estimates in the early 1980s, Congress passed the BBA with the goal of eliminating the deficit by requiring that budgets stay below fixed deficit targets.

These targets would be enforced through the sequestration process, by which the Office of Management and Budget director would apply automatic, across-the-board budget cuts necessary to keep the estimated deficit within allowable limits. The process was then revised in 1990 by imposing limits on discretionary spending (i.e., spending funded through the annual appropriations acts, such as the annual Defense Appropriations Act) and a “pay-as-you-go” requirement for direct spending (i.e., spending outside of annual appropriations, such as Medicare funding). Sequestration remained as the mechanism for enforcing these discretionary and direct spending limits.

Since the enactment of these regimes, five separate sequesters have been ordered. Three (fiscal years 1986, 1988 and 1990) were quickly resolved through revisions to the sequestration process, changes to the deficit targets and/or budget agreements. In fiscal year 1991, however, two sequesters were ordered, producing budget reductions of just over \$4.55 billion (as reduced by subsequent law). No sequester has been implemented since.

Fast-forward to summer 2011, when Congress and the White House stalemated over the need to lift the U.S. debt ceiling — a statutorily established limit on the dollar value of U.S. public debt. Notably, raising the debt ceiling would not allow the government to bypass the limits and restrictions on discretionary and direct spending and to accrue new debt, but rather, would authorize the government to honor the debts that have already been accrued or authorized through the discretionary and direct spending process.

The product of these negotiations, resolved just days before the United States would have defaulted on

its debt, was the 2011 Budget Control Act (“BCA”). In relevant part, the BCA established a special congressional “supercommittee” to develop legislation that would produce \$1.2 trillion in deficit reduction by 2020. The supercommittee was to provide its legislation by Nov. 23, 2011, which Congress was then required to pass by Jan. 15, 2012. If the committee and Congress were to not meet these deadlines, then \$1.2 trillion in automatic, indiscriminate, across-the-board sequestration cuts would begin on Jan. 2, 2013. Annually, these cuts would reduce discretionary spending by roughly \$109 billion per year through 2021, split evenly between defense and nondefense programs.

As most readers are well aware, these deadlines have come and gone without legislative movement, and the specter of sequestration has thus hung over every budgetary action in 2012 — and in fact, has prevented any true budgetary action from occurring in 2012. Barring a last-minute deal on sequestration, only one appropriations measure will have been enacted into law in 2012: a continuing resolution that served only to extend (with minor deviations) the existing Consolidated Appropriations Act for fiscal year 2012 into the second quarter of fiscal year 2013. As a mere continuing resolution, this legislation simply continued the status quo and provided no true budgetary developments.

The most significant budgetary developments have instead come in the form of executive branch testimony and guidance. Three instances in particular stand out. First, in August 2012, senior officials from the OMB and the U.S. Department of Defense testified before the House Armed Services Committee, presenting grave warnings of sequestration’s impact on U.S. military readiness and advising Congress of how sequestration would be implemented if it were to occur.

Second, in September 2012, the OMB released guidance — mandated under the Sequestration Transparency Act of 2012 — identifying the specific percentage cuts (and corresponding dollar-figure cuts) that would be made to specific program accounts across the government in the event of sequestration. And third, earlier this month, the OMB released guidance directing executive branch agencies to begin preparing for sequestration. In response, numerous agencies have begun disclosing their plans to furlough employees, shutter offices, and terminate or curtail contracts should sequestration occur.

In light of these dour plans and predictions, the president and congressional leaders seemed to approach the post-election Congressional session with a shared conviction that a deal should be reached and sequestration prevented. But sequestration is only one of four major budgetary issues with hard statutory deadlines on the near horizon. These other matters include the sunset of the tax cuts enacted under President Bush (a.k.a., the “Bush tax cuts”) and extended by President Obama, the need in early 2013 to again increase the U.S. debt ceiling, and the expiration of the continuing resolution in early 2013 and ensuing need for follow-on appropriations acts. (Also looming is the need for direct spending reform, with entitlement programs such as Medicare and Social Security commonly identified as potential targets).

Whether sequestration can be prevented likely turns on how the sunset of the Bush tax cuts, the looming need for fiscal year 2013 appropriations, and changes to direct spending are, or are not, addressed. This is because any revenue to be gained (or lost) through any changes in the tax code, coupled with any spending decreases (or increases) through changes to direct spending and discretionary spending (to be first reflected in fiscal year 2013 appropriations) will likely be determinative factors in whether sufficient deficit reductions are achieved so to justify delaying or cancelling sequestration.

Despite dire predictions regarding the potential impact of sequestration, most observers agree that it cannot simply be “undone” without some corresponding deficit reduction plan that would achieve similar savings; otherwise, the \$1.2 trillion now projected as savings from sequestration will return to the U.S. balance sheets as debt, likely producing significant negative consequences for the U.S. credit rating, bond rates, and so on.

Given the scope of the task at hand, perhaps it is unsurprising that, as of this drafting, no such deal has been reached. Barring a last-minute deal of some magnitude, 2012 seems poised to conclude much the same way it began — with the hard decisions not yet made and the consequences for these decisions (or lack thereof) still looming. The key difference, however, is that those consequences are now on our doorstep.

Thus, the overall budgetary cuts that are likely to occur in the coming weeks — whether as a result of sequestration or an alternative deficit reduction plan — are likely to be severe. The only likely difference is that the cuts through sequestration are made with a broadsword, whereas the cuts through an alternative deficit reduction plan would (presumably) be made with a scalpel; a similar total level of budgetary resources will likely fall away, just with more precision for particular projects, programs, or activities.

So just how will this 2013 budgetary environment impact the contracting community? First, and most obviously, federal agencies’ reduced resources will likely translate into fewer contracting opportunities. Second, agencies are likely to increase their use of lowest-priced, technically acceptable evaluations, thereby salvaging what resources they have, and their use of indefinite-delivery/indefinite-quantity contract vehicles, thereby giving agencies maximum flexibility to place awards (or not) as their budgetary fates crystallize. Third, based on their response to the OMB’s December 2012 guidance, it appears that at least some agencies are poised to begin terminating or downscoping their contracts. It is difficult to predict the scale and scope of these impacts with any degree of certainty.

Indeed, each passing news cycle presents a new twist on the status of sequestration negotiations, and each potential compromise has its own cascading consequences for the contracting community. But in any event, it seems clear that the year ahead will present a uniquely challenging environment for federal government contractors.

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