

Contractors Brace For Shutdown's Delays And Costs

By Dietrich Knauth

Law360, New York (October 01, 2013, 12:14 AM ET) -- With Congress unable to pass new appropriations to keep the government from shutting down, federal contractors must brace for unpredictable disruptions and increased costs under their contracts and begin keeping detailed records to prepare for the inevitable wave of legal disputes over those costs.

The lapse in appropriations, caused by disagreement over a Republican measure that would tie new appropriations to a one-year delay in the implementation of President Obama's 2009 health care law, will shut down most nonessential government services and place large numbers of government workers on immediate unpaid leave.

Without 2014 funding authority, the government will generally be unable to sign new contracts, make payments on existing contracts that are not fully funded or exercise new options years for existing contracts, according to experts. And many already-funded contracts will suffer severe disruption.

The extent of the disruption will be unpredictable, depending on many factors, including the type of work, the type of contract, and the extent to which contractors can access the government employees and resources on which their contracts rely. Contractors should determine how their contracts are funded, get as much information as they can about how the shutdown will affect them, make backup plans for interrupted cash flow, and consider how government furloughs will affect their work, experts say.

Many contractors will suffer increased costs as they shut down operations, work with decreased supervision, and manage the uncertainty surrounding subcontracting and purchasing decisions. Contractors should be prepared to document claims for any additional costs related to the shutdown and explain any decisions such as continuing to pay salaries, travel costs or hotel costs to workers on idled contracts, according to Daniel Graham, a partner in Wily Rein LLP's government contracts group.

"All that should be documented, and if it's not documented properly, then it becomes much harder for the contractor to recover those costs in a claim," Graham said. "There are a lot of ways to lose money on a project, and the contractor always bears the burden of showing that it is facing additional costs as a result of something the government did."

Shutdowns can carry significant costs for the government, as well, including the cost of contingency planning, contract premiums related to uncertainty and delays, and user fees and other charges it fails to collect. Contracting delays, adjustments and cancellations all lead to increased government costs in the long run, according to Dismas Locaria, a partner at Venable LLP.

"Some things just don't stop on a dime. There could be a wind-down period where the government isn't really getting value, but the contractor will still need to be paid," Locaria said. "At the end of the day, the

government could get a lot less value for the contracts that it has to terminate or stop."

The Office of Management and Budget estimated that the 1996 government shutdown cost taxpayers \$1.4 billion, and the costs could rise faster in the current environment, in which contractors are increasingly integrated within the federal workforce.

"The difference between now and then is the sheer number of government contractors on-site. That complicates everything to a significant extent," said Angela Styles, a former administrator of the Office of Federal Procurement Policy and current head of Crowell & Moring LLP's government contracts group. "It's easy if you're building a building somewhere or you're building a plane somewhere — you just keep doing what you're doing. But if you're working on IT, or on federal buildings, you're going to need access to those locations."

This shutdown could go harder on contractors than previous appropriations lapses, because budget cuts have already placed contract spending under scrutiny for fraud and waste, Locaria said. With the administrative headaches that furloughs can cause added to existing tensions between the government and its contractors, Locaria predicts even more blame-trading in the near future.

"There's a heavy dose of skepticism between the federal government and contractors these days," Locaria said. "There could be plenty of cases where a 'stop work' order is not issued, but where a contractor reports in and can't get to work. Those are areas where it could get particularly litigious."

Having suffered through previous shutdown threats in recent years, contractors have gotten better at preparing for funding lapses. But an inherent uncertainty in the shutdown process means no plan can cover all the possibilities, experts say.

"It's kind of like *deja vu* all over again," Graham said. "Most contractors have thought very hard about their dependencies and where they are indirectly vulnerable, but you may not fully appreciate how dependent you are on some resource that will not be available, until it's no longer there. Nobody can predict and identify all of those potential dependencies in advance, so there are going to be surprises."

Though federal agencies have prepared shutdown guidance, government officials are likely scrambling to make decisions about which federal employees are essential and can keep coming to work, according to Styles. Whether an employee's work is exempt from furloughs for national security or public welfare reasons is a subjective decision, and contract management will take a backseat until these questions have been answered, she says.

Communication with the government will be a paramount concern as contractors prepare for cost increases and disruptions. But the shutdown will not make collaboration easy, Graham said.

"If the government shuts down, there are going to be fewer contracting officers to provide information and direction," Graham said. "There may be facilities that have their hours reduced or are entirely shut down. If a contractor works at those facilities, having a fully funded contract won't help them open the doors in the morning and get to their desk to work," Graham said.

The Department of Defense, which spends more on contracts than any other agency, has railed against the the shutdown, which Deputy Defense Secretary Ash Carter characterized as "stupid" and "extremely disruptive and unfortunate" during a Monday speech. DOD Comptroller Robert Hale said that about half of the department's 800,000 civilian employees would be sent home Tuesday, including contracting officers, auditors and inspectors.

The DOD has told contractors to continue working on already-funded contracts unless they hear otherwise from their contracting officers. Because the government is allowed to enter new contracts for national security reasons or to protect the safety of people and property, the DOD will enter into some new contracts, although the contractors would have to risk a delay in payment, according to Frank Kendall, undersecretary of defense for acquisition, technology and logistics.

Federal furloughs will affect contractors in other important ways. A contractor who has been suspended or debarred, for example, may be unable to work with government officials to get off the blacklist, and companies pursuing bid protests will be unable to resolve their disputes quickly, Styles said. And at locations where contractors and federal employees work side by side, contractors might also be asked to perform significant additional work to cover for furloughed and absent government employees, Styles said.

The effects of the shutdown will depend to some extent on how long it lasts. The DOD, for example, has said that more than a week of furloughs in its payroll department would risk delayed payment to U.S. troops who are exempted from the shutdown, and the Department of Veterans Affairs has said it would run out of money to pay pensions and disability compensation to more than 3.6 million veterans if the shutdown lasts into late October.

But even a short shutdown will have long-lasting impacts, Locaria says.

"Everything is going to be impacted in terms of timing. Things are going to take a good bit of time to get done during a shutdown, because you're going to have whole groups of employees who are out of work," Locaria said. "Even if this is only for a couple of days or a week or two, you're going to feel the impact of this for a lot longer than that."

Unfortunately for the government and its contractors, the shutdown drama is not the end of the story. Sequestration, the across-the-board budget cuts that kicked in as a result of the congressional deficit showdown in 2011, remains in effect, and some in Congress see another fight brewing over the debt ceiling.

If the ceiling is not raised when it reaches the end of its borrowing authority Oct. 17, the government would be unable to pay the bills it has accrued, impacting everything from Social Security payments and contract debts to the trust that companies and governments place in the United States as a borrower.

"Increased costs on federal contracts will probably be the least of our concerns at that point," Graham said.

--Editing by Kat Laskowski and Philip Shea.