Government Shutdown:
A Contractor’s Guide

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With the impending end of the current continuing resolution and swirling political winds, there is talk of a possible federal government shutdown. What does this mean for contractors?

Background

Federal agencies require funds to operate and to pay contractors. At present, federal agencies are operating under a continuing resolution that provides funding through Friday, March 4, 2011. Roughly 15 years ago, the federal government shut down for three weeks, from December 16, 1995 to January 6, 1996. Many government employees were instructed not to report for work, but were later paid. Many contractors laid off employees. The shutdown was difficult and costly, but brief.

The national economy is less healthy today than in 1995. The federal government is more dependent on contractors for services, particularly in the information technology field, where there has been a substantial increase in government spending since the mid-1990s. Because of the way the work is performed and contractors are compensated, a shutdown may have a disproportionate adverse impact on services contractors. Even if contract performance continues, contractors should expect payments to be delayed as a result of government furloughs.

Since the shutdown of the mid-1990s, individual contracts obviously have been the subject of funding problems or concerns, but there has not been a broad shutdown of government operations. What will happen if that changes? And what, if anything, can a contractor reasonably do to prepare for the worst?
Antideficiency Act

The U.S. Constitution provides that “No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law.” Art. I, § 9, cl. 7. Pursuant to the Antideficiency Act, agencies may not: (i) make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation; or (ii) involve the government either in a contract or obligation for the payment of money before an appropriation is made, unless authorized by law. 31 U.S.C. § 1341.

Agencies may not accept “voluntary services,” except in “emergencies involving human life and protection of property.” See 31 U.S.C. § 1342. The term “emergencies involving the safety of human life or the protection of property” does not include “ongoing, regular functions of government the suspension of which would not imminently threaten the safety of human life or the protection of property.” Id. The underlying concern regarding voluntary services is that an agency might “augment” its appropriations through accepting services for which it should be paying. There are penalties for violating the Antideficiency Act. See, e.g., 31 U.S.C. § 1350.

In the event of a shutdown, the Government will not be able to award new contracts or task or delivery orders or to exercise options that are dependent on the funding that has not been appropriated. Existing contracts (e.g., cost-reimbursement contracts) may be funded incrementally, in which case there may not be funds available to permit performance in the event of a shutdown.

To the extent dependent on annual appropriations that have not been obligated, agency personnel may be unavailable to administer contracts, inspect work or approve designs, or perform numerous other tasks relevant to government contracts. A variety of contracts thus may be adversely affected by a shutdown.

It is critical to note that a shutdown will not affect all government contracts. Some contracts are fully funded or are for services and supplies that may be deemed essential and permitted to continue. OMB Circular No. A-11 provides some guidance to agencies regarding operations in the event of a shutdown. Specifically, Section 124 of the Circular addresses agency operations in the absence of appropriations. See also CRS Report 7-5700, Shutdown of the Federal Government: Causes, Processes and Effects, Sept. 27, 2010, by Clinton T. Brass.
Circular No. A-11 provides that in the absence of appropriations: (i) federal officers may not incur any obligations that cannot lawfully be funded from prior appropriations unless such obligations are otherwise authorized by law; and (ii) federal officers may incur obligations as necessary for orderly termination of an agency’s functions, but funds may not be disbursed. *Id.*, Section 124.1(b). In the absence of appropriations, agencies must “limit obligations to those needed to maintain the minimum level of essential activities necessary to protect life and property.” *Id.*, Section 124.3. Agencies must maintain shutdown plans that enable identification of the employees who may continue to work in the event of a shutdown. *Id.*, Section 124.2.

Nearly three decades ago, and reiterated prior to the 1995 shutdown, the Attorney General concluded that certain activities funded by annual appropriations may continue despite a lapse in funding because the lawful continuation of other activities (e.g., Social Security benefits paid under indefinite appropriations) implies that these functions should continue as well. Similarly, contracting for the materials necessary for performance of emergency services should be permitted to enable such services to be provided. *See* August 16, 1995 Memorandum by Walter Dellinger to Alice Rivlin, Director of Office of Management and Budget (“OMB”) regarding “Government Operations in the Event of a Lapse in Appropriations,” at 4.

A 1981 OMB memorandum explained that activities which may continue in the absence of appropriations are “those which may be found under applicable statutes to:

1. Provide for the national security, including the conduct of foreign relations essential to the national security or the safety of life and property;

2. Provide for benefit payments and the performance of contract obligations under no-year or multi-year or other funds remaining available for those purposes; [and].

3. Conduct essential activities to the extent that they protect life and property.

*See* http://main.opm.gov/furlough/furlough.asp#Appendix%20A-4. Examples under category 3 above may include “[m]edical care of inpatients and emergency outpatient care”; “[a]ctivities essential to ensure continued public health and safety, including safe use of food and drugs and safe use of hazardous materials; and “[a]ir traffic control and other transportation safety functions and the protection of transport property,” among others. *See id.*
Based on the foregoing, a variety of contractors may (and must) continue to perform despite any shutdown. For example, any contractors working on a fixed-price contract for which funds already have been obligated or paid to the contractor must continue to perform. In addition, contractors must continue to perform contracts that are covered by multi-year funding. Other contracts will be deemed “essential,” and require continued performance notwithstanding a shutdown.

**Stop Work and Stopping Work**

Most government contracts should include FAR 52.242-15, which permits the agency to issue a “stop-work order.” This clause generally is inserted in “solicitation and contracts for supplies, services, or research and development.” FAR 42.1305(b)(1). Contractors should verify that the clause is in their contracts. The order is supposed to be approved at a level above the contracting officer (“CO”). FAR 42.1303(b). The FAR encourages use of a supplemental agreement between the parties rather than use of the order. See id.

If a shutdown would prevent a contractor from performing its work (e.g., necessary funding cannot be obligated to the contracts or contractor personnel cannot access the government facilities where work is to be performed, etc.), the contracting officer should issue a written stop-work orders to the contractor prior to or at least as soon as the shutdown happens. See FAR 52.242-15(a).

A stop-work order should include: (1) a description of the work to be suspended; (2) instructions concerning the contractor’s issuance of further orders for materials or services; (3) guidance to the contractor on action to be taken on any subcontracts; and (4) other suggestions to the contractor for minimizing costs. FAR 42.1303(c). A stop-work order may last up to 90 days, unless the parties agree to extend it. If the order is cancelled and the contractor resumes work, the contractor may receive an equitable adjustment in the contract schedule or the contract price. See FAR 52.242-15(b)(1). Contractors are directed to submit such requests within 30 days after the end of the work stoppage. See FAR 52.242-15(b)(2).

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Practical Problems and Planning Ahead

The following are five basic suggestions to follow while navigating the (potentially) choppy waters of any (hopefully brief) shutdown.

First, communication with COs is critical in advance of any shutdown. Contractors should seek a meeting with their COs as soon as possible to address a plan of action. COs are responsible for administering contracts and giving direction to contractors. Ask for direction. Do it in writing. Direction from the CO (e.g., to prepare to cease operations) offers reasonable protection for a contractor in the event of any later dispute. Ask questions. Particularly for services contracts, when will the funding run out? Will the work covered by the contract be deemed “essential”? May a contractor reasonably rely on an email to that effect from anyone other than a CO?

In light of the burdens that COs will face, it may be prudent to approach COs with some preliminary analysis (to the extent feasible) regarding whether your contract would be impacted by a shutdown and, if so, a plan of action to implement an orderly shutdown. Where the CO agrees that performance of a particular contract may continue, such information would be beneficial in terms of planning a course of action for other contracts as well as communicating with employees.

At a minimum, communications with COs regarding how a shutdown should be implemented may improve customer relations and reduce the prospect of subsequent disputes regarding costs. Contractors must be mindful, however, that COs and other agency personnel may be burdened with their own concerns about their ability to weather the shutdown while waiting for pay that may be delayed considerably.

Second, internal communications with employees are critical. Shutdowns raise a variety of challenges for contractors in terms of employee morale. For example, to avoid recourse to layoffs, a contractor might need to make a decision regarding reassignment of personnel if it has not heard from the CO as a shutdown becomes imminent. For example, if a contractor has a contract for information technology services to be performed in a government facility, should the contractor direct its employees to report to work if the contractor has not yet heard from the contracting officer? At a minimum, and particularly if the shutdown occurs over a weekend (e.g., early March 2011) and contractor personnel ordinarily report to work at a government facility, the contractor needs an effective means (e.g., BlackBerry service) to contact all affected company personnel before they report to the site.
Third, reach out to your team. To mitigate costs, contractors affected by the shutdown will need to contact their subcontractors and vendors to alert them to the shutdown and to defer deliveries or performance where possible. Hopefully, the subcontract or supply agreement will include a stop-work or similar clause. Contractors also should inquire about the impact of deferring delivery on the subcontractor or vendor’s ability to make deliveries at a later date if inventory is reallocated to other contracts. Regardless of whether the contractor later pursues an increase in price, it may need to negotiate an appropriate extension to the schedule when the stop-work order is lifted. To better manage expectations, it would be advisable to give the CO advance notice of any slippage by a supplier that may be beyond a day-for-day slip.

Fourth, explore alternatives in advance. Can employees be assigned to other projects? If so, will it be possible to reassign them to the government contract when the shutdown ends? Is there a reasonable basis to anticipate that the contractor may recover for any delay or increased costs resulting from the reassignment?

Finally, as with any contracts matter, document your work. Unabsorbed overhead and other costs may be recoverable. Establish billing codes to track the costs of your shutdown and restart efforts. Although contractors may elect not to pursue equitable adjustments for increased costs (e.g., under the Stop-Work or Changes clauses) arising out of a shutdown, they should document all activities taken to implement a shutdown as well as the associated actions for restarting. Adequate documentation of the precise steps and timing – including any advice or concurrence by agency contracting officials – will better enable the contractor to present a request for equitable adjustment that is targeted to the precise impact of the shutdown rather than reliant on a “total cost” method of claiming costs. This activity will have the further benefit of enabling the contractor to show that it implemented any shutdown as efficiently as possible under the circumstances.

In sum, any shutdown will not last forever, and may be over relatively quickly. Take the lessons learned from this round and build your best practices for the next time.