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How Sequestration May Impact Government Construction Contracts [Ober|Kaler]

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Pursuant to the Budget Control Act of 2011, sequestration is the process by which automatic across-the-board spending cuts are being imposed on government programs. Because Congress was unable to reach an agreement by its March 1, 2013 deadline to avoid these spending cuts, sequestration has become a reality, and government construction contractors need to consider how their existing contracts may be affected.

The most important thing for a government contractor to figure out is how its contract is being funded and the status of the funding for any work yet to be performed.

For existing fully funded contracts, if the funds have already been obligated and the project is expected to stay within its budget, then sequestration will likely not have a direct impact. The Anti-Deficiency Act, 31 U.S.C. §1341 *et seq*., prevents an agency from incurring obligations in excess of its available funds. As a result, the funding for a contract awarded prior to 2013 should already be obligated.

Sequestration, however, will likely have a large impact on incrementally funded contracts. Incrementally funded contracts are contracts for which an agency has permission to obligate only the current year's cost at the time of the contract award. The future funds are obligated annually in the subsequent years for work occurring in each fiscal year. As a result of the spending cuts, an agency may not have the funds to pay contractors for future phases of work. Sequestration could have a particularly large impact on construction contracts involving non-severable work. Agencies may choose to terminate a contract for convenience as an alternative to stop a project when the funds ultimately run out. Many government contracts have an Availability of Funds clause which limits the government's liability to pay up to the amount funded. A contractor must be careful to meet the notice provisions required by these clauses when it considers stopping work. Depending on the clause's language, the contractor may be entitled to additional compensation if it has no choice but to stop work due to lack of funding, including pursuing claims for delay damages.

Contractors also need to consider how sequestration will affect options under existing contracts. A contract option must be financed with funds for the fiscal year in which it is exercised. As a result, contract options exercised prior to 2013 should not be impacted by sequestration. For contract options scheduled for exercise after the start of sequestration, however, the necessary funds may not be available because of the 2013 sequestration spending cuts. Contractors that choose to perform work in anticipation of an option being exercised run the risk of not being compensated for their work. Agencies may also try to renegotiate options with contractors. It is important to learn if the agency has funding for option work that has been allocated to a particular contract before starting the work.

It is also important to consider how sequestration may affect contract modifications and claims. A modification or change order may not be issued unless there are funds appropriated and available to pay. A contractor should ask the agency to provide funding information before the extra work is performed in order to avoid being a “volunteer” who has no right to payment. In a similar fashion, funds to pay claims may be tougher to find. A contractor may end up having to take the claim through the disputes process to obtain payment from the Judgment Fund which is unaffected by sequestration.

Federal construction programs will be cut by several billion under the mandatory spending cuts that took place on March 1, 2013. The OMB Report to the Congress on Joint Committee Sequestration for Fiscal Year 2013 published on March 1, 2013 provides more detailed information about program-by-program spending cuts. There are a variety of ways that agencies may choose to deal with these reductions. Agencies may take unilateral action to reduce or return obligated funds that have not yet been spent if they do not consider the project critical. Specifically, agencies may reduce or "claw back" funds by relying on the "changes clause" (FAR 52.243) in government contracts or agencies may terminate all or part of a contract for convenience. Agencies may also choose to 'de-scope' contract performance through deductive change orders.

Conclusion

Government construction contractors need to look carefully at the funding status of their projects. Hard decisions may need to be made about stopping work when future funding is not in place. Will there be more public private partnerships as a result? No one has a crystal ball, but we may see PPPs as the path to the future.