

What would the effect of a potential government shutdown be on agencies and federal contractors?

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Summary: Negotiations between the White House, Senate Democrats and House Republicans continue around the clock, in advance of a Friday deadline for the latest continuing resolution ("CR") funding the operations of the federal government. If an accord is not reached on either a final spending plan for the remaining six months of the fiscal year - or another temporary CR - the federal government will shut down as of 12:01 a.m.(Saturday). At stake are two broad issues regarding the direction of fiscal and social policy for the final six months of Fiscal Year 2011: where should spending levels be set and what policy issues - in the form of "legislative riders" - should be included in any final deal. The Public Policy & Infrastructure Practice continues to monitor developments and offers this assessment of the likelihood of a shutdown and the effects it will have.

Both sides remain far apart on the amount to cut. Republicans and Democrats remain far apart on how much to cut. However, the debate goes beyond party label: House Republicans, led by Speaker John Boehner (R-OH-8), face pressure by their more conservative members, including those claiming the support of the "Tea Party," to enact cuts of \$61.3 billion from the President's Budget proposal for Fiscal Year 2011 ("FY 11"). In fact, the House of Representatives voted in favor of the \$61 billion in cuts in February, in an omnibus FY 11 spending bill sent to the Senate. This explains in part why the Speaker is now indicating that he is seeking \$40 billion in cuts, while Democrats had thought that \$33 billion in cuts was the goal of congressional negotiations. The \$61 billion figure should be considered a ceiling in the negotiations - even though Senate Democrats and the White House call it a non-starter. It remains to be seen whether Democrats and Republicans can agree on either a \$33 billion or \$40 billion spending cut, and whether Speaker Boehner would be able to sell either figure to his

members. This level of uncertainty increases the potential that a final agreement will not be reached in time by Friday, necessitating a shutdown.

A lot rides on riders. In addition, House Republicans have added a number of policy-related measures to the spending bill they sent to the Senate, known as legislative riders. They run the gamut from environmental measures affecting the management of federal land in the West to water quality in Florida to emissions standards for the cement industry. They also include language permitting the disposal of nuclear waste at the Yucca Mountain site in Nevada, strongly opposed by Majority Leader Reid. They also have language to bar federal and local financing for abortion services in Washington. Many of these are no-starters with Senate Democrats and President Obama. The question is how many remain in a final agreement, or whether they cause a shutdown independent of the issue of how much government spending to cut.

A discussion on how some federal agencies would be affected by cuts proposed by House Republicans. House Republicans have targeted their spending cuts to affect those federal policies they dislike the most, from those affecting the environment to the recently passed Dodd-Frank financial reform and health care laws. Cuts include:

- A cut of \$2.7 billion in funding for the Environmental Protection Agency ("EPA")
- A cut of \$5 billion in funding to the Department of Education
- A \$787 million cut in funding to the office of Energy Efficiency and Renewable Energy ("EERE"), which is responsible for funding renewable and alternative energy projects around the country
- A cut of \$1 billion in the National Institutes of Health ("NIH"); and a zeroing out of funding for two of President Obama's priorities: High Speed Rail and the Health Care Reform Act
- A cut to the two agencies most relevant to the implementation of Dodd-Frank: the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC"). The SEC gets its funding cut by \$188 million and the CFTC gets its funding cut by \$149 million. All of these cuts are objected to by the Senate Democratic Majority and the White House.

"Essential" vs. "Nonessential." How federal agencies would be affected by a shutdown.

The White House Office of Management and Budget ("OMB") has sent notice to federal agencies to update and share contingency plans if the government does shut down after midnight Friday. No other notice or instructions have been issued; however, the OMB does provide agencies with annual instructions on how to prepare for and operate during a budget gap, including most recently in Circular No. A-11: Preparation, Submission and Execution of the Budget, July 2010. The OMB does not use the terms "essential" and "nonessential," as used in news reports, but instead focuses on those employees "retained" during a shutdown versus those "released."

The Circular requires Agency heads to decide who to retain and who to release, with retained employees falling into two categories:

- "those engaged in military, law enforcement or direct provision of health care activities"
- those whose compensation is paid outside of federal appropriation (e.g., fees)

Note that retaining employees during a shutdown is not the same as paying them. That varies by the nature of the federal employment. For example, the Department of Defense has indicated that those stationed in Afghanistan and Iraq would remain at their posts. However, they would not be paid until a budget deal is reached. Any other military or civilian employees retained would have to pursue any back-pay concerns with Congress; there is no provision automatically allowing them for "back-pay" from a shutdown. The remainder of the federal workforce, estimated at 800,000 federal employees, would be released ("furloughed") with no payment.

This would affect operations of scores of federal agencies. The EPA, for example, has indicated that all activities related to air, land and water pollution permits would stop. All National Parks would close. The NIH would stop accepting new patients.

However, members of Congress would continue to get paid.

A shutdown's effects on government contracting and steps every federal contractor should take

A federal shutdown will mean different things to different contractors, but even those who don't stand to be severely or even marginally impacted in the short term would be well advised to take the time to consider the shutdown's potentially broader implications.

Perhaps the most obvious aspect of a shutdown is that its impact to current contracts will correlate most directly with the funding of those contracts. Even if the funding has been obligated to permit continued performance of a contract, however, logistical and other issues may arise during a shutdown to hinder that performance. Thus, even if it appears that contract performance should continue despite the shutdown, a contractor should verify with its contracting officer ("CO") whether and what kind of performance is expected, and should provide assurances that it is prepared to meet those expectations. While clarifying these performance expectations with the CO, a contractor should also determine how any contemplated change in or stop to work during the shutdown will impact the contractor's overall operations. A contractor should also communicate with its employees and subcontractors about performance expectations during the shutdown, and the expected impact to overall operations. These various communications - with the CO, employees, and subcontractors - should continue through the duration of the shutdown. The contractor should document these communications, as well as any work undertaken during the shutdown, the reasons for taking these measures, and how they support the contractor's performance expectations. Similarly, unless instructed otherwise, a contractor should assume that any type of reporting due during the shutdown period must still happen.

By taking these simple steps, federal contractors can ensure they are prepared to weather the shutdown and emerge on solid ground.

Federal grantees, and states that administer grant programs, would also be adversely impacted. While the extent of this impact is uncertain, it is likely that everything from grant payments to achievement of grant program purposes would be affected.

Summary: As P.T. Barnum once said, "You ain't seen nothing yet!"

Regardless of whether the federal government shuts down on Friday, the budget battles are expected to continue throughout this year and into next. House Budget Committee Chairman



Paul Ryan (R-WI-1) has proposed a budget for the upcoming fiscal year ("FY 12") that would cut spending further than measures currently under consideration - by more than \$5 trillion over 10 years - and reform the Medicare and Medicaid programs. If a budget for FY 12 is not put in place by October 1 of this year, there could be another government shutdown. And at some point soon, Congress has to vote on increasing the amount of funds the U.S. may borrow to finance the national debt, as we are coming close to the statutory \$14.3 trillion ceiling. If Congress and the President cannot agree on a new debt ceiling, the U.S. runs the risk of defaulting on its obligations. All of this makes for an interesting few months, and the Public Policy & Infrastructure Practice remains available to help clients navigate these complex and always changing times.

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