

ALERT

Implementing Sequestration: OMB Issues Memorandum Detailing Agencies' Responsibilities

March 4, 2013

With the President and Congress unable to come to an agreement on a long term budget solution, sequestration became a reality when the President signed an order canceling \$85 billion in budgetary resources across the federal Government late on Friday, March 1, 2013. On the eve of the President's Order, the Office of Management and Budget (OMB) issued new guidance in Memorandum M-13-05 to supplement its previous sequestration guidance (Memorandum M-13-03), as well as to address how agencies should carry out certain activities once sequestration takes effect. Like its prior guidance, this Memorandum provides important information for contractors along with internal guidance regarding agency operations that may also have an impact on contractors and others doing business with the federal Government.

Communications with Contractors

OMB suggests that agencies should, to the extent permitted by law, inform their various partners and stakeholders (including federal contractors) of the "elements of the agency's planning that have a direct impact on these groups." Agencies should be as specific as possible in communicating a level of detail that will permit federal contractors to understand the implications of the reduced budget authority and allow them to appropriately adjust their operations and plans. OMB's guidance may provide a useful opening for contractors to reach out to their agency customers and engage in a dialogue on how to address the effects of any funding constraints, with the goal of minimizing the disruption to both the agency and the contractor.

Authors

Kevin J. Maynard
Partner
202.719.3143
kmaynard@wiley.law
Kara M. Sacilotto
Partner
202.719.7107
ksacilotto@wiley.law

Practice Areas

Federal Contract Claims, Disputes, and
Terminations
Government Contracts

Agency Planning

Memorandum M-13-05 further directs agencies to continue planning to operate their activities with reduced budgetary resources. These planning efforts "should be done with sufficient detail and clarity to determine the specific actions that will be taken to operate under the lower level of budgetary resources required by sequestration." Recognizing that not all agencies will have these plans finalized by March 1, 2013, OMB stresses that agencies must "engage in intense and thorough planning activities . . . as soon as practicable." Important for contractors, this planning will now include the specific directive for agencies to identify those major contracts that agencies plan to cancel, re-scope or delay. Agencies are also advised that their plans should now include an identification of the total number of employees the agency plans to furlough, the timing and length of those furloughs and the manner in which the furloughs will be administered. Although furloughs might appear to be an internal matter only, it is important for contractors to know when their customer may be particularly short staffed as that short staffing may affect contractors' ability to perform their own functions.

Acquisition Approaches

OMB's Memorandum recognizes that, "[d]ue to the Government's large acquisition footprint, sequestration will inevitably affect agency contracting activities and require agencies to reduce contracting costs where appropriate." As a result, OMB instructs agencies to avoid entering into new contracts or exercising options unless doing so would support "high-priority initiatives" or "where failure to do so would expose the government to significantly greater costs in the future." Contractors therefore should expect delays or cancellations for new contracts. Furthermore, contractors would be well-advised to document justification for the "high-priority" nature of their contracts and, if they want options exercised, develop their communication plans for how the failure to exercise an option for their contract would result in significantly greater costs to the government in the future. On the other hand, there may be situations in which the exercise of an option is not in the best interests of either contracting party, especially in light of the focus on mission priorities.

In addition, OMB suggests that agencies consider "de-scoping or terminating for convenience contracts that are no longer affordable within the funds available for Fiscal Year 2013, should no other options exist to reduce contracting costs in these instances." As a result, contractors should continue to take steps to preserve their contractual rights in connection with any cuts to their particular contracts. In the alternative, it may prove beneficial in some instances for contractors to work with agencies to reduce the costs associated with their contracts in an effort to limit future de-scoping or termination.

The latest OMB Memorandum also reminds agencies that appropriate controls must be implemented to ensure that the use of contractors is not increased to offset the restrictions on hiring of agency personnel.

Notably, OMB's Memorandum continues to reflect the Administration's focus on contracting with small businesses to the extent possible as the nation continues its economic recovery. The Memorandum specifically instructs agencies to "take all appropriate steps to minimize . . . the impact on small business of reduced contracting activities." The practical effect of this initiative remains to be seen, as smaller contracts could in some ways be easier for agencies to de-scope or terminate than the complex contracts larger businesses perform. Nevertheless, small businesses should continue to remind their agency partners of the importance

the Administration has placed on minimizing the impact of sequestration on small businesses.

Decreased Financial Assistance

Recipients of grants, loans and other federal financial assistance should also be preparing for the effects of sequestration. As the OMB Memorandum makes clear, "sequestration will impact the funding of these activities." Agencies are instructed to "ensure that any new financial assistance obligations or funding increases . . . are consistent with the need to protect the agency's mission at the post-sequestration level," and recipients should expect delays in the award of new financial assistance obligations, reduced levels of funding for existing obligations and the renegotiation or reduction of current assistance. Again, given the direction for increased communication, now may be a good time for those receiving federal financial assistance to reach out to agencies to determine a path forward and how sequestration may affect their business. It also provides these entities with an opportunity to potentially work with the agency to mitigate those effects.

The impacts of sequestration will take time to ripple through the contracting community. Wiley Rein has previously written about the impacts of sequestration, see, e.g., March 1, 2013 alert and Winter 2013 and Summer 2012 *Government Contracts Issue Update* articles, and continues to monitor agency guidance on this issue and to assess the impact of sequestration on government contractors.