

Impending Defense Budget Cuts May Affect Contract Orders and Government Dealings

Aerospace & Defense Group Newsletter

Last October, in response to the passage of the Budget Control Act of 2011 (BCA) that imposes discretionary spending caps from Fiscal Years 2012 through 2021¹, the Center for New American Security² released a report that outlines the ends, ways, and means of U.S. defense strategy under various budget constraints. Titled, *Hard Choices: Responsible Defense in an Age of Austerity*, the report outlines four best possible scenarios to cut military force structure, end strength, procurement, and overhead to reach four different levels of savings that are consistent with the cuts that Congress could make over the next decade under the BCA.

The report proposes a vision of U.S. military strategy that is affordable. In that vision, the Center suggests that the country should continue pursuit of a global engagement strategy, but with re-prioritized force structures and missions. The proposed strategy clearly cannot require the current force levels, existing bureaucracy, infrastructure, or expenses.

Given the likely defense budget cuts, the question for contractors becomes how (and which) programs will the cuts come from and what are the effects on existing contracts and future work prospects. While too many variables prevent us from definitively stating all of the effects, some things may be reasonably anticipated in the near term:

1. Contract Terminations May Occur.

Wherever possible, the U.S. Government will attempt to terminate contracts for default, rather than for convenience, as a money-saving expedient. Unlike contractors' litigation costs, the Government's litigation costs are considered sunk costs (a cost that has already been incurred and cannot be reversed), and they are inconsequential to it.

2. Reduction in Task Orders under IDIQ Contracts.

The Government may reduce the number of task orders under IDIQ contracts. Historical ordering experience and Government-provided look-ahead projections will be rendered even more meaningless than otherwise indicated by experience.

3. Quantity Reductions in Orders.

Quantities under existing IDIQ orders may be reduced. This would apply to both outstanding orders under IDIQ contracts and those under fixed-quantity contracts. Contractors should price those changes realistically and prudently. They should think about costs associated with the lost overhead absorption value of the facilities and labor used in the changed work, all of which are real and compensable under current contract law. Contractors should also resist the siren song of promises of future work that are not backed-up by committed funds.

4. Increase in IDIQ Protests and Disputes.

As available opportunities begin to dry up, look for contractors to file more protests and disputes, as the Government will seek to avoid any degree of additional costs associated with order changes.

Contractors should

- Be vigilant concerning their contractual rights, yet easy for the government to work with,
- Administer every contracts and Task Order professionally and *very* carefully,
- Be sure that all personnel having face-to-face dealings with government personnel are aware of the specific contracting authority of everyone with whom they are working,

- Document every interaction with government personnel, and
- Establish and maintain ongoing and strong professional relationships with lawyers and accountants familiar with Federal Contracting.

However things eventually shake-out, the fact is that the impending budget sequestration is bringing in a “new day” for defense contractors that best not be ignored!

¹ The Center for New American Security projects that under the Budget Control Act of 2011, cuts to defense would fall “almost entirely on the [Department of Defense’s] base budget, which totaled \$530 billion in FY 2011.” Lieutenant General David W. Barno, Nora Bensahel, and Travis Sharp, *Hard Choices: Responsible Defense in an Age of Austerity*, CTR. FOR A NEW AM. SECURITY, 6 (October 2011), http://www.cnas.org/files/documents/publications/CNAS_HardChoices_BarnoBensahelSharp_o.pdf.

² The Center for a New American Security (CNAS) is a nonprofit, nonpartisan organization whose mission is to develop strong, pragmatic, and principled national security and defense policies. It leads efforts to inform and prepare present and future national security leaders.

CONTACTS

J. William Eshelman

Partner, Butzel Long Tighe Patton

Phone: 202.454.2830

Email: weshelman@butzeltp.com

Mr. Eshelman is a Partner at Butzel Long Tighe Patton. He is also on the Faculty Council, and Lead Faculty/Area Chair, Law & Ethics, for The School of Business at The University of Phoenix Online.

Jeremy R. Cnudde

Senior Attorney, Butzel Long

Phone: 248.258.2922

Email: cnudde@butzel.com

Mr. Cnudde is a Senior Attorney practicing in Butzel Long’s Bloomfield Hills and Detroit offices. He concentrates his practice on corporate transactions and federal and state tax planning and tax appeals litigation. Mr. Cnudde also represents a variety of Aerospace and Defense companies in business and commercial matters.