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E-ALERT | Government Contracts

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THE GOVERNMENT CONTRACTS UPDATE

Covington & Burling LLP's Government Contracts practice delivers an update on major news, notes, and trends relevant to government contractors.

SEQUESTRATION GOES INTO EFFECT

On March 1, 2013, President Obama issued a sequestration order canceling $85 billion from the federal budget for the remaining months of fiscal year 2013. The much-discussed statutory deadline passed without an agreement between Congress and the White House to avert the budget cuts. And as of today, no deal to reverse the sequestration order appears in sight. The Office of Management and Budget's (OMB) March 1 report to Congress detailing the cuts can be found here. OMB calculates that sequestration will reduce non-exempt defense discretionary funding by 7.8% and non-exempt nondefense discretionary funding by 5.0% over the course of the fiscal year. As OMB notes, because there are only seven months remaining in fiscal year 2013, the effective percentage reductions will be approximately 13% for non-exempt defense discretionary funding and 9% for non-exempt nondefense funding.

The longer sequestration continues, the more disruptive it will be to contractors. While sequestration's impact on particular programs and contracts remains unclear, here are a few of the many developments that we are following:

DoD Discontinues Policy of Accelerating Payments to Prime Contractors

To save funds, the Department of Defense (DoD) has discontinued its practice of accelerating payments to prime contractors. *See* 77 Fed. Reg. 63,298. The practice, first announced in October 2012, was intended to promote prompt payment to small business subcontractors by paying prime contractors as soon as practicable, with the goal of making payment to prime contractors within 15 days. *Id*. Still, DoD says that it will continue its preexisting policy of paying *small business* prime contractors as quickly as possible. And it is unclear what effect this discontinuance will have on a December 2012 proposed FAR rule to speed payments to small business subcontractors. *See* 77 Fed. Reg. 75,089. That proposed rule would add a new clause to the FAR requiring that prime contractors, upon receipt of accelerated payments from the government, make accelerated payments to small business subcontractors to the maximum extent practicable.

Contractors Serving DoD Face Considerable Uncertainty

Sequestration is having an immediate impact on DoD, which faces a nearly $50 billion cut in spending. For example, Admiral Jonathan Greenert, Chief of Naval Operations, told the House Appropriations Committee that the Navy will cancel 70% of ship maintenance in private shipyards and all aircraft maintenance scheduled in the last two quarters of the fiscal year. Similarly, Assistant Secretary of the Army for Acquisition, Logistics, and Technology Heidi Shyu told the House Armed Services Committee's Subcommittee on Tactical Air and Land Forces that Army procurement funds

will be reduced by $3 billion and research program funds by $1 billion, applied equally across some 400 Army programs. She also said the Army anticipates a large number of contract changes relating to procurement quantities or schedule. The drop in research funding alone will result in schedule extensions ranging from 6 weeks to 18 months, and the termination of up to 150 contractors.

For a discussion of DoD's implementation of sequestration measures and the impact on the contracting community, see here for a letter sent by Under Secretary of Defense for Acquisition, Technology and Logistics Frank Kendall to the National Defense Industrial Association. Ultimately, contractors highly dependent on DoD contracts are at great risk as DoD postpones or reduces the size of new contracts to accommodate its cuts. Further, contractors with existing DoD contracts should be prepared for a variety of potential cost-cutting measures, including contract modifications, delays, changes, and terminations. These contractors should be proactive in protecting their rights—for example, by requesting equitable adjustments or filing claims.

Sequestration Likely to Delay Renewable Energy Projects

The outgoing Secretary of the Interior, Ken Salazar, recently warned that sequestration may put new energy-related initiatives on hold as the cuts affect the Department's leasing, permitting, and safety enforcement functions. Secretary Salazar warned of delays to recently authorized projects on public lands involving solar, wind, and geothermal energy production. He also noted that fossil energy projects could be affected, including 300 onshore oil and gas leases issued for public lands in western states. Secretary Salazar's public statements follow a warning from the outgoing Secretary of Energy, Steven Chu, in testimony before Congress last month, that sequestration "would decelerate the nation's transition into a clean energy economy, and could weaken efforts to become more energy independent and energy secure."

Treasury Department Announces Cuts to Renewable Energy Grant Program

The Treasury Department announced that awards issued between March 1, 2013 and September 30, 2013 under the Section 1603 cash grant program for renewable energy projects will be reduced by 8.7%. This reduction applies regardless of when the application was received by the Department. The Section 1603 cash grant program was established by the American Recovery and Reinvestment Act of 2009. It reimburses eligible applicants for a portion of the expense of placing into service qualifying renewable energy projects. The grants had already been cut by 5% under the Taxpayer Relief Act of 2012. It is not clear that the Department has the authority to effect an automatic reduction in the cash grant available under this program.

RECENT CASES

Federal Circuit Holds That Failure to Notify Government of Assignment Does Not Render CDA Claim Invalid (*Northrop Grumman Computing Sys., Inc. v. United States*, 2011-5124, 2012-5044 (Fed. Cir. Feb. 19, 2013))

The Federal Circuit reversed a Court of Federal Claims (COFC) decision, which had held that a written claim letter is not a valid claim under the Contract Disputes Act (CDA) if the contractor has assigned its rights to payment under the contract to a third party and fails to disclose that fact in the claim letter. Northrop Grumman had assigned its right to all payments under a delivery order to another entity, which in turn had assigned its rights to a third entity. Northrop Grumman later submitted a written CDA claim letter alleging a breach of contract, but without mentioning the two private financing assignments. The COFC held that the claim letter did not provide "adequate notice" of the

claim because it failed to alert the contracting officer to the potential application of the Anti-Assignment Act, the *Severin* doctrine, and other issues associated with "pass-through" claims.

The Federal Circuit agreed with the COFC that Northrop Grumman's failure to notify the government of its assignment voided the assignment as against the United States under the Anti-Assignment Act. But it held that Northrop Grumman's breach of contract claim was still valid under the CDA. The claim was unaffected by the failed assignment, and therefore Northrop Grumman was the proper party to assert it. Further, Northrop Grumman's claim satisfied the requirements for a valid claim under the CDA: it was a (1) written demand, (2) seeking, as a matter of right, (3) the payment of money in a sum certain. The claim thus was valid despite the failure to disclose the assignments.

In addition to clarifying the prerequisites for a valid CDA claim, this decision highlights the importance of notifying the government of an assignment so that the assignee may pursue a claim for non-payment, if necessary. Assignees may also want to obtain some guarantee that the assignor will pursue the claim if the requisite notice is, for some reason, not given.

Federal Circuit Holds That Disputes Involving Interpretation of a Schedule Contract Must Be Filed With the GSA Contracting Officer (*Sharp Elecs. Corp. v. McHugh*, No. 2012-1299 (Fed. Cir. Feb. 22, 2013))

Sharp Electronics Corp. held a multiple-award schedule contract with the General Services Administration (GSA) that allowed agencies to lease or purchase office equipment and supplies from Sharp. Under that schedule contract, the Army issued a delivery order providing for the lease of copier equipment. Sharp viewed the Army's failure to exercise a third option year as a premature cancellation entitling it to termination fees. The company filed a formal claim with the Army Contracting Officer (CO), citing the schedule contract's termination fee provisions. The Army CO did not respond. Sharp then appealed the deemed denial of its claim to the Armed Services Board of Contract Appeals (ASBCA), which held that it lacked jurisdiction.

The Federal Circuit agreed. The court concluded that FAR 8.406-6 (which calls for an ordering activity contracting officer to "refer" disputes concerning interpretation of the schedule contract to the schedule contracting officer) creates a bright-line rule that all cases requiring interpretation of a schedule contract must be resolved by the GSA CO, even if those cases also involve disputes over order interpretation or performance. The authority of the ordering CO, by contrast, is limited to deciding disputes about order interpretation or performance that do not involve interpretation of the schedule contract. Such a bright-line rule was necessary, the court reasoned, for a clear, predictable allocation of jurisdiction between agency contracting officers and GSA. Because Sharp's entitlement to termination fees partly involved the interpretation of provisions in the company's schedule contract, the court ruled that the dispute had to be decided by the GSA CO. Still, the decision does not specifically address who has authority to decide a dispute arising under a schedule contract administered by an agency, such as the Department of Veterans Affairs, under authority delegated by the GSA.

OTHER NOTEWORTHY ITEMS

House Bill Would Require Contractors To Certify That They Do Not Have Seriously Delinquent Tax Debts

Reps. Jason Chaffetz (R-Utah) and Jackie Speier (D-Cal.) have proposed legislation that would prohibit awarding a contract in excess of the simplified acquisition threshold unless the contractor certifies that it has no seriously delinquent tax debts (defined as an outstanding tax debt for which a

notice of lien has been filed in public records). The Contracting and Tax Accountability Act of 2013 (H.R. 882) codifies a 2008 revision to the FAR requiring contractors to certify that they do not have a delinquent tax debt to the federal government exceeding $3,000. *See* FAR 52.209-5(a)(1)(i)(D). The bill also provides a means for verifying the contractor's certification, by requiring the contractor in its bid or proposal to authorize the Secretary of the Treasury to disclose to the contracting agency information describing whether the contractor has a seriously delinquent tax debt. In addition, agencies will be required to consider a certification that a contractor has a seriously delinquent tax debt to be definitive proof that the contractor is not a responsible source under 41 U.S.C. § 113, and the agency will be required to propose such contractors for debarment unless it makes a written finding of urgent and compelling circumstances justifying a waiver.

Currently, under FAR 9.406-2(b)(1)(v), a debarring official may, but is not obligated to, suspend or debar a contractor on the basis of delinquent federal tax debt exceeding $3,000. If the Chaffetz-Speier proposal were to become law, agencies would have no choice but to propose a contractor for debarment (absent urgent and compelling circumstances), even on the basis of a truthful certification.

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