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Sequestration Mechanics Under The BCA

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Last summer's debt ceiling crisis produced a compromise bill—the Budget Control Act of 2011 (BCA)—that includes an enforcement mechanism, sequestration,[2] similar to the doomsday device in *Dr. Strangelove*. Like its fictional counterpart, sequestration was never supposed to be used. It was supposed to encourage political leaders to negotiate with one another to avoid a calamitous outcome. Instead, despite the best intentions of its creators (or perhaps because of their misjudgment), it appears increasingly likely that the sequestration mechanism will actually be used. And although the effects may not be as apocalyptic as those in *Dr. Strangelove*, sequestration could have pronounced and unpredictable adverse consequences on multiple parties, including Government contractors.

Sequestration may pose a serious threat to both the broader U.S. economy and the defense industry in particular. The Congressional Budget Office, for instance, has estimated that the impact of sequestration and other mandatory budget cuts could result in the economy contracting by 1.3 percent during the first half of next year.[3] Regarding cuts to the defense budget, the secretary of defense, Leon Panetta, stated that sequestration would be "disastrous for our national defense," and he called on political leaders to "de-trigger sequestration."[4]

Furthermore, Panetta stated that the Department of Defense is not preparing for sequestration, despite his own prediction that it "could very well threaten the programs critical to our nation's security."[5] Deputy Secretary of Defense Ashton Carter recently testified before Congress in even more emphatic fashion: "We don't want to begin taking actions now [in preparation for sequestration, and] tear ourselves to pieces to prepare for something that's really stupid."[6] Remarkably, the threat of hundreds of billions of dollars in sudden budget cuts, to be implemented in a manner that remains unclear, has certainly caused alarm, but has not prompted much in the way of preparation.

This article describes the process by which the BCA will reduce Government spending, how those reductions will be spread out over the two broad categories of discretionary spending (essentially, defense and non-defense spending), and potential areas of uncertainty as to how these budget cuts will actually be implemented.

Those areas of uncertainty can be broadly identified as follows:

- *The timing of the mandatory cuts*. The fiscal year starts several months before the mandatory budget cuts are scheduled to take place. It is unclear how sequestration will affect those contracts that are executed at the beginning of the fiscal year. Government agencies may choose to reduce their funding of contracts as the next fiscal year begins in anticipation of the looming threat of sequestration.
- *The calculation of the size of the uniform cuts*. Under sequestration, every "program, project, and activity" must be reduced by a uniform percentage in FY 2013. Below the line of programs, projects and activities, agencies may have discretion in how to implement the fund-

ing reductions triggered by sequestration. Absent implementing guidance from the Office of Management and Budget, it is unclear at what level of specificity the uniform cuts will occur.

- *The effects of the exemption of military personnel funding from these mandatory cuts*. The president has statutory authority to exempt military personnel funding from sequestration. Now that President Obama has exercised this authority, a smaller percentage of the defense budget will be subject to the sequestration requirement. This creates even more pressure on Government contractors whose chief focus is on the production of weapon systems and other defense-related equipment.

The Budget Control Act of 2011

In the summer of 2011, as the Federal Government faced the threat of shutdown and potential furloughs, Congress reached an uncomfortable compromise in order to pass the BCA. In exchange for an increase in the debt ceiling of $2.1 trillion (or $2.4 trillion if a balanced budget constitutional amendment had been submitted to the states), Congress created two mechanisms to reduce the federal budget deficit.7 The first, the Joint Select Committee on Deficit Reduction (Supercommittee), was supposed to reduce the deficit by $1.5 trillion between fiscal years 2012 and 2021.8 The second was sequestration.

Last November, the Supercommittee, composed of six Republicans and six Democrats, failed to reach an agreement on how to best to reduce the deficit.[9] The Supercommittee's failure increased the likelihood that the second budget control mechanism, sequestration, will actually be used.

Sequestration is a process implementing mandatory budget cuts intended to reduce the federal deficit.[10] It also is intended to result in across-the-board uniform cuts that affect almost all categories of the federal budget.[11] Under the BCA, automatic sequestration will occur only in FY 2013; however, every year thereafter until FY 2021, OMB is required to reduce spending caps to control discretionary spending with limits set by the BCA. The general process established by the BCA is as follows:

- First, discretionary spending caps are revised, and the scope of the national defense budget is considerably reduced.[12]
- Second, the BCA provides a calculation of funding reductions from both the revised security and nonsecurity budgets (the former consists almost entirely of DOD's budget, while the latter consists of all other discretionary spending). A uniform percentage by which each category is reduced is also calculated.[13]
- Third, the BCA establishes two different processes to reduce the federal deficit. Mandatory budget cuts for FY 2013 take place on Jan. 2, 2013. For FYs 2014–2021, OMB must further lower discretionary spending caps by the amount identified by the BCA calculation in step two.[14]

Under current law, automatic budget cuts are scheduled to occur on Jan. 2, 2013.[15] The details of how the mandatory budget cuts or reductions in discretionary spending are to be implemented will be discussed step-by-step below, after first reviewing predecessors to the BCA.

Predecessors to the BCA

The BCA was not written on a blank slate; it was drafted as a modification to existing legislation, the Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA). The BBEDCA (popularly known as the Gramm-Rudman-Hollings Act) was envisioned as a way to enforce deficit reduction targets, although not necessarily to adhere to discretionary spending caps, as is the case with the BCA.[16] It mandated adherence to a series of budget deficit goals that gradually decrease over time as the deficit approached zero.[17]

The BBEDCA was passed as part of a compromise to raise the debt ceiling, which was raised from $1.8 trillion to $2 trillion. (The BCA was designed to raise the debt ceiling from $14.3 trillion to $16.4

trillion.) However, as one of its cosponsors, Sen. Phil Gramm (R-Texas), has said of the legislation, "It was never the objective of Gramm-Rudman to trigger the sequester; the objective of Gramm-Rudman was to have the threat of the sequester force compromise and action."[18] Despite being almost 30 years old, the budget sequestration mechanism has not often been tested, and not at all in recent history, making its current implementation and effects extremely difficult to predict.

Between FYs 1986 and 1991, there were three statutory budget sequestrations.[19] These were all tied to deficit reduction targets. The first one, in FY 1986, resulted in a sequestration of $11.7 billion with a uniform reduction of 4.9 percent applied to individual line items in the defense budget, except military personnel.[20] In subsequent years, Congress and the president enacted special legislation to eliminate mandatory budget cut requirements for years in which the Government missed deficit reduction targets.[21]

The vulnerability of Government contractors to these mandatory cuts remains an open question. Present legislation says nothing about an exemption for Government contracts, so we only have the three previous sequestrations as models. For instance, in their joint report to the U.S. Comptroller General regarding the FY 1986 sequester, CBO and OMB acknowledged that defense contracts could be terminated under certain circumstances to meet deficit requirements.[22] Still, they specifically exempted defense contracts from that year's sequestration process.[23] They stated,

> Existing contracts in defense programs can be terminated or modified to achieve outlay savings if such action would neither result in a net loss to the government *nor violate the legal obligations of the government*, and if the President notifies the Comptroller General and the Congress of proposed contract terminations and modifications by specified dates .... *No defense contract terminations or modifications are proposed for 1986 sequestration reductions.*[24]

Presently, it appears that both CBO and OMB acknowledge that the Government's contractual obligations preempt the necessity of achieving "outlay savings." Should the Government have preexisting legal obligations with certain Government contractors, it may choose to honor those commitments, even if appropriations are sequestered this coming January.

The Mechanics of Sequestration—Three Steps

The Downward Revision of Discretionary Spending Caps

The BCA presents some immediate short-term problems. First, once the sequestration process is triggered, existing discretionary spending limits for FYs 2013–2021 are reduced, in both the security and nonsecurity categories.[25]

Section 101 of the BCA establishes discretionary spending caps for the security and nonsecurity categories through FY 2021, and uses a broader definition for the security category.[26] For instance, under the conventional discretionary spending scheme, Congress set a cap of $686 billion to the "security category" for FY 2013.[27] This standard security category includes the budgets of a variety of agencies, including DOD, the departments of Homeland Security and Veterans Affairs, and the National Nuclear Security Administration, as well as those of most of the intelligence community and all accounts dealing with international affairs.[28]

Once the sequestration process is triggered, however, these categories are altered, and the scope of the revised security category is narrowed considerably. The new "revised security category" would only include discretionary appropriations in budget function 050—the national defense function.[29] The "revised nonsecurity category" would include all discretionary spending except the national defense function.[30] In other words, under sequestration, the budgets of the Department of State, parts of DHS, and parts of VA shift to the nonsecurity category. The revised security category, on the other hand, would consist almost exclusively of the budget of DOD.

The defense industry will lose more under the revised discretionary spending categories than it would have under the discretionary spending caps identified in BCA § 101.[31] Instead of having $54.5 billion cut from an appropriations budget of almost $700 billion for several agencies, that amount is instead

cut from a $546 billion appropriation, which is the revised security category allocation for FY 2013, that is almost exclusively dedicated to DOD.[32]

It appears likely that DOD will have to sacrifice the most (if not all) under budget function 050 to meet the statutory sequestration requirements. Consider that DOD requested over $702 billion for FY 2012, including funding for the overseas contingency operations in Iraq and Afghanistan), and one realizes how aggressively the defense budget may be cut in the coming months.[33]

This axe will fall hardest on DOD for another reason—many programs are altogether exempt from sequestration. The BCA restored provisions of the BBEDCA that exempt many federal programs from any automatic cuts. These exempt programs include Social Security, most veterans' benefits and various other programs, including, among others, most federal retirement programs, many welfare programs and the Washington Metropolitan Area Transit Authority.[34] Additionally, while big ticket budgetary items like Medicare are subject to some mandatory cuts under the BCA, the cut applied to them is a modest two percent.[35] Finally, as the Congressional Research Service has noted, "the impact of sequestration on any given program will depend on the actions and interpretations of OMB."[36]

Currently, CBO estimates that there will be a 10-percent reduction in new discretionary defense appropriations for FY 2013.[37] Within DOD, only some parts of the budgets will be immunized from mandatory cuts. The BBEDCA (and the BCA)[38] authorizes the president to exempt the military personnel account from sequestration.[39]

Less than two weeks before the president's authority to exempt military personnel accounts was set to expire,[40] OMB issued guidance saying that these accounts would *not* be subject to the sequestration requirement.[41] OMB directly acknowledged the effect that this exemption would have on the rest of the defense budget, stating that "[i]t is recognized that this action would increase the sequester in other defense programs."[42]

While the immunization of military personnel accounts and (presumed) corresponding maintenance of troop levels is welcome, the immunization also creates stark problems for the remainder of the defense budget. Of a total requested budget of $647.4 billion for FY 2013 (for budget function 050), DOD estimates that $156.1 billion of that will be devoted to military personnel.[43] That amount represents almost 25 percent of the total defense budget, and now the non-immunized portion of the defense budget—just under $500 billion—may likely have to bear an additional $54.5 billion in mandatory budget cuts.

The Calculation of Mandatory Cuts

Section 302 of the BCA describes how sequestration and further reductions in discretionary spending limits will reduce the deficit over the next nine fiscal years. The calculation for the annual amount is as follows:

- First, starting from a baseline of $1.2 trillion dollars, subtract any deficit reduction achieved by the Supercommittee.[44] Since the Supercommittee failed to achieve any reduction, the $1.2 trillion reduction must be achieved through mandated sequestration and budget cuts.[45]
- Second, the BCA allows for a reduction of 18 percent, approximately $216 billion, to account for debt service avoidance.[46] The remaining amount to be cut over the next nine fiscal years, both through sequestration and reductions in spending caps, is $984 billion.
- Third, divide that result by nine to specify the yearly amount to be sequestered (or the reduction necessary to meet discretionary spending caps in subsequent years).[47] So, each year, approximately $109 billion would be cut from the federal budget.
- Fourth, that reduction would have to be split evenly between the revised security and nonsecurity categories.[48] Thus, the defense budget would have to be cut by approximately $54.5 billion each year up to and including FY 2021.

This amount—approximately $54.5 billion—is then split even further among the categories. Based on a calculation by OMB, under a methodology

not yet determined, both discretionary and direct (mandatory) spending within each category is cut.[49]

Implementing the Cuts: the Two Processes for Budget Reduction

The BCA contains two different processes for mandatory budget cuts—one for FY 2013, and one for FYs 2014–2021.[50] The FY 2013 cuts are those most accurately described as sequestration. On Jan. 2, 2013, mandatory budget cuts kick in, without any input from Congress or the president. These cuts have been described by one policy analyst as "convoluted," "incredibly difficult to implement," and as something that will "cause disruption across the government and private sector well before the sequester even goes into effect."[51] The manner in which OMB will implement the spending cuts is still unclear.

There is a great deal of awkwardness to the timing of next January's sequestration. The Government will begin its FY 2013 obligations approximately one month before a presidential election. Congress, otherwise distracted by its campaigns, may make little headway on defusing the sequestration time bomb. Furthermore, President Obama stated that he will not sign legislation that immunizes the defense industry from the effects of sequestration, and has characterized Congress as waffling between protecting the Bush-era tax cuts and making "tough choices" to reduce the deficit, all while risking the military budget.[52]

Once the election occurs, a lame-duck Congress (and potentially a lame-duck president) would have to try to legislate past the threat of sequestration. Furthermore, Congress and the president would have to deal with the imminent expiration of the Bush-era tax cuts, the payroll tax cut and emergency unemployment benefits, which are set to expire on or about December 31.[53] As the CBO has stated,

> Fiscal restraint will have a much larger impact on the economy in 2013. The increases in taxes and decreases in government benefits will lead households to cut back their purchases of goods and services, and the decline in funding for government programs will lead to further cuts in purchases. That drop in demand will, in turn, lead businesses to lower their production, employment, and investment. *The magnitude of those responses is hard to judge*.[54]

The timing of the cuts may also produce uncertain effects. The mandatory cuts for FY 2013 occur after the first quarter is complete, while the mandatory cuts for FY 2014 onward occur on the first day of each fiscal year (October 1).[55] As the sequestration deadline looms larger, federal agencies may begin to anticipate the sequestration process, and reduce their first quarter contract awards in scope, number, and value to keep the budget pool available for sequestration as large as possible for flexibility in implementing the anticipated budget reductions.

Another factor that makes the effects of the cuts opaque is the manner in which they are distributed among the different parts of the federal budget. The BCA calls for a reduction in both the security and nonsecurity budgets by a uniform percentage to achieve the desired spending cuts (instead of just eliminating certain programs outright, for instance).[56] This application of a uniform percentage cut to all line items in each category may produce the most uncertainty for Government contractors.[57] One report provides a hypothetical example—if just over $54 billion in spending reductions is required (which is the case given that the Supercommittee failed to agree on budget reductions), and $546 billion in defense spending is not exempt from sequestration, each nonexempt "account" would be reduced by a uniform 9.9 percent.[58]

The FY 2013 Mandatory Cuts

The FY 2013 cuts are the only ones to be attained by applying a mandatory percentage cut uniformly to the defense and non-defense budgets.[59] Even though the FY 2013 cuts are scheduled to take place on Jan. 2, 2013 under current law, the size of the mandatory percentage reduction is still unclear (even though we now know that military personnel accounts will be exempt).[60] One commentator estimated that the mandatory uniform percentage could have been 7.5 percent if military personnel accounts were not exempt from the sequestration process.[61] However, because military personnel accounts are exempt, the mandatory uniform percentage could be as high as 10 percent.[62] Until OMB provides more guidance on what exactly must be cut, and at what level, it remains unclear how large the percentage cut will

need to be to meet the sequestration requirements.[63] Note also that overseas contingency operations and war costs are not exempt from the sequestration process, but DOD may attempt to spare these account to the extent possible.[64]

The FYs 2014–2021 Cuts

The next eight years of budget control take the form of mandated reductions in discretionary spending caps, instead of imposing automatic cuts on those budget accounts to which funds have already been appropriated.[65] This ability to reduce the discretionary spending limits will provide both Congress and the president greater flexibility in determining how to allocate scarce budget resources, instead of being forced to spread out cuts uniformly across all non-exempt budget accounts.[66] Thus, DOD would not have to endure budget cuts across all non-exempt accounts by a uniform percentage.[67] Instead, "the Appropriations Committee will decide how to live within the newly reduced defense funding caps."[68] So, if Congress could cancel the FY 2013 sequestration process, while still forcing itself it adhere to the new, lower discretionary spending caps, it would avoid the imposition of a uniform cut across all defense budget accounts. Instead, during those subsequent years, Congress and the president could determine which programs would be reduced or eliminated.

However, should congressional appropriations in a given category exceed the amount permitted by the BCA's mandated discretionary spending caps, a uniform sequestration process would again be triggered.[69] Thus, absent a change to the BCA, the threat of sequestration would accompany any future failure by Congress to appropriate funds according to the revised discretionary spending caps.

What Will Be Cut? Defining Programs, Projects and Activities

The BCA adopts the language of the BBEDCA, and states that "the same percentage sequestration shall apply to all programs, projects, and activities within a budget account."[70] The legislation does not define program, project or activity, but states that each will be clarified by appropriation acts or presidential budgets.[71] While the definitions of programs, projects, and activities under the BBEDCA and BCA remain unclear, they appear to refer to individual line items in appropriations bills or budgets submitted to Congress. Democrats in the House of Representatives argue that sequestration requires "program-by-program" cuts, "with every non-exempt program cut by the percentage required to reach the calculated deficit reduction target for that year."[72] However, the same members also note that it is up to OMB to decide which programs are exempt or not exempt from the mandatory cuts.[73]

If the FY 1986 sequestration is any example, identifying programs, projects and activities may prove to be confusing for implementing agencies. In its evaluation of that year's sequestration, GAO stated that it "found widespread confusion among agencies in applying the program, project, and activity definitions," and that "[t]his confusion often reflected the ambiguities of the definitions themselves."[74] Like most other federal agencies, DOD used the following definition for programs, projects and activities: the " '[m]ost specific level of budget items identified' in the appropriations act and accompanying committee reports."[75] If OMB or DOD chooses to focus on "specific level[s] of budget items," Government contractors could receive more budgetary scrutiny.

Similarly, as one author has observed about the current approach to identifying affected programs, projects and activities, "the lack of guidance ... from OMB and mixed signals from lawmakers as to whether the cuts will be allowed to take effect only stoke[s] ... uncertainty."[76] It could also produce some wildly disruptive effects on all manners of programs, projects and activities.[77] Some programs, projects or activities consist of only a few very large procurement projects, such as most weapon program acquisitions.[78] Furthermore, mandatory cuts in larger programs, projects or activities would significantly reduce economies of scale, add delays to already stretched schedules and raise costs, potentially triggering Nunn-McCurdy breaches,[79] contract terminations and program cancellations. Finally, some line items are personnel heavy, so federal agencies may have to prepare to lay off or furlough employees during the run-up to a presidential election.[80]

The Reduction-in-Force Implications of Sequestration

The possibility of significant workforce reductions is similarly problematic for Government con-

tractors.[81] Sequestration may create a situation in which Government contractors with more than 100 employees have to provide advance written notice of probable workforce reductions.[82] The Worker Adjustment and Retraining Notification (WARN) Act applies if an employer closes a plant or engages in a "mass layoff."[83] "Mass layoff" is defined as a reduction in force that results in an employment loss[84] at a single site that either affects 33 percent of the workforce *and* at least 50 employees, or affects at least 500 employees.[85] This requirement would apply to many Government contractors.

There are three exceptions to this notice requirement, however—only one of which is likely applicable in the context of sequestration.[86] The WARN Act includes an exception to the 60-day notice requirement "if the closing or mass layoff is *caused by business circumstances that were not reasonably foreseeable* as of the time that notice would have been required."[87] Government contractors may be able to claim that because the *specific* effects of sequestration are not yet "reasonably foreseeable," they do not yet have to issue any WARN Act notifications.

The Department of Labor recently issued guidance that the WARN Act does *not* apply in the context of sequestration.[88] DOL emphasized that it was unclear what contracts would be affected and what would be the relevant termination dates.[89] DOL also noted the unforeseeable aspects and outcomes of sequestration, stating that "even the occurrence of sequestration is not necessarily foreseeable."[90] In short, DOL suggested that even though sequestration is becoming more likely, its details are sufficiently unclear that the WARN Act does not yet apply: "[E]mployers now have virtually no information from which to determine whether their contracts will be affected, [and] there is no basis on which to form a business judgment."[91] DOL also pointed to two cases from the U.S. courts of appeals for the Fifth and Eighth Circuits to reach the conclusion that "[a]s long as the likelihood and timing of contract cancellation remains speculative, an employer is not obligated to provide WARN notifications."[92]

Although neither case involves mandated budget cuts, they do provide insight as to how a court might view a failure to provide timely WARN Act notifications. In *Halkias v. Gen. Dynamics Corp.*, 137 F.3d 333 (5th Cir. 1998), the secretary of defense canceled a contract to manufacture the A-12 Avenger.[93] After months of cost overruns and suggestions from DOD that the contract was in jeopardy, the defense contractor received informal word on Dec. 14, 1990 that the secretary of defense had asked the Navy to show cause as to why the contract should not be canceled.[94] On December 17, the Navy directed the contractor to meet certain requirements by Jan. 2, 1991, or risk having the contract canceled.[95] On Dec. 21, 1990, the contractor issued WARN notifications, and on Jan. 7, 1991, the secretary of defense canceled the contract effective immediately.[96] This sudden cancellation, which resulted in the layoff of thousands of employees, prevented the contractor from providing 60-day advance notifications as normally required under the WARN Act.[97]

Although there was "no doubt that the evidence showed [the contractor] knew of the possibility of contract cancellation and mass lay-offs as early as June 1990," the court did not find that the cancellation of the contract was "reasonably foreseeable."[98] According to the Fifth Circuit, no one "could have concluded that contract cancellation was a foreseeable probability until the last minute," when the contractor received informal word that the secretary of defense had issued a show cause order.[99] Up to that point, the court noted, the secretary of defense had supported the program as essential to national defense.[100] As a result, the court held that the cancellation was not "reasonably foreseeable" and did not become a "foreseeable probability" until the Government's issuance of the show cause order.[101]

Another case, *Loehrer v. McDonnell Douglas Corp.*, 98 F.3d 1056 (8th Cir. 1996), also dealt with purported WARN Act notification failures arising out of the A-12 Avenger program.[102] The facts and timeline were essentially the same as in *Halkias*, and the court emphasized the fact that the secretary of defense had expressed an interest in reducing the scope of the contract, which could have served as a warning sign to the contractor.[103] Yet, as the Fifth Circuit held in *Halkias*, the Eighth Circuit held that the cancellation was not "reasonably foreseeable."[104]

In *Loehrer,* the court stated that "[t]he test for determining when business circumstances are not reasonably foreseeable focuses on an employer's

business judgment. The employer must exercise such commercially reasonable business judgment as would a similarly situated employer in predicting the demands of its particular market." The court went on to specify that the exception applies if "it may still fairly be said that the eventual plant closing or mass layoff is caused by a sudden, dramatic, and unexpected event outside the employer's control."[105] Despite indications that the contract was in jeopardy, the cancellation was not "reasonably foreseeable" until the issuance of the show cause order.[106]

Like the cancellations in these two cases, any contract cancellations that result from sequestration would occur in the "unique, politically charged area of defense contracts."[107] Furthermore, they involve a situation in which cancellation is one of many possibilities, but is not certain. In both *Halkias* and *Loehrer*, the A-12 contracts could have been canceled or restructured, or the cost overruns simply could have been absorbed by the contractors.[108] Similarly, contracts affected by sequestration may not be canceled outright, but could be reduced in scope or put on temporary hold. This uncertainty of outcomes might reduce a contractor's exposure through application of the unforeseeable business circumstances exception should it fail to issue all proper WARN Act notifications.[109]

Moreover, another factor might "buttress[] [a contractor's] optimism" that a given contract will not be canceled: the political factor, and namely, the fact that political leaders continually assure the public and the media that they will defuse the sequestration time bomb before the start of next year.[110] Just as Congress had "expressed ongoing conditional support for the A-12,"[111] current political leaders have stated their desire to prevent the drastic effects of sequestration from occurring.[112] These assurances might create a situation in which a contract cancellation is no longer "reasonably foreseeable," but is one of many possibilities that may not trigger WARN Act obligations.

On the other hand, relying on the WARN Act's unforeseeable business circumstances exception to the 60-day notice requirement in issuing layoff or employment termination notices shifts the burden to the Government contractor to prove that the exception applies, such as in the procedure followed in the *Halkias* and *Loehrer* cases. While Government contractors may attempt to rely on the DOL WARN Act guidance issued on July 30, 2012 in support of such an argument in a judicial enforcement proceeding, there are additional pitfalls in such an approach. As set forth in DOL's own regulations implementing the WARN Act, DOL has no legal standing in any WARN Act enforcement proceeding pursued in a judicial forum.[113] Furthermore, DOL has no authority to issue advisory opinions in specific cases.[114] Finally, DOL's implementing regulations state that advance notice is "encouraged" even in "ambiguous situations."[115] Accordingly, as the July 30, 2012 DOL guidance is not an implementing regulation issued under statutory authority and somewhat contradicts DOL's previously issued regulations, it may receive little deference or even no weight in a judicial enforcement proceeding filed by an employee terminated or laid off by a Government contractor without the 60-day advance notice required by the WARN Act. The DOL regulations sum up the point aptly as follows: "It is therefore prudent for employers to weigh the desirability of advance notice against the possibility of expensive and time-consuming litigation to resolve disputes where notice has not been given."[116]

A Recent Judicial Decision Relating to Federal Budget Shortfalls

A recent U.S. Supreme Court decision, *Salazar v. Ramah Navajo Chapter*, 132 S.Ct. 2181 (2012), suggests that as long as Government contractors are paid out of a general appropriations pool, and the Government can pay any one contractor in full, the Government is obligated to pay all contractors drawing from that pool in full.[117] This may help to soften the blow of sequestration's mandatory cuts. However, the Government could decide to shrink the value of contracts at the beginning of FY 2013 if it appears that the automatic sequestration will actually occur.

Nevertheless, the holding of *Salazar* reaffirms the Government's obligation to pay contractors for work performed even if appropriations allocated for those contracts are exhausted.[118] In *Salazar*, several tribes had contracted with the Department of the Interior to provide services in their com-

munities.[119] Under the Indian Self-Determination and Education Assistance Act (ISDA), 25 USCA § 450 et seq., the tribes were entitled to the "full amount" of "contract support costs."[120] Although Interior had been allocated sufficient funds to pay any individual contract in full, it had not received enough money from Congress to satisfy all of its contractual obligations.[121] Lacking sufficient funds to pay all contractors in full, the Government paid each contractor a pro rata share of the available funds.[122] The Ramah Navajo Chapter brought suit pursuant to the Contract Disputes Act for the balance of the funds due under its contract.[123]

The court held that the rule of *Cherokee Nation of Okla. v. Leavitt*, 125 S.Ct. 1172 (2005), applied: "When a Government contractor is one of several persons to be paid out of a larger appropriation sufficient in itself to pay the contractor ... the Government is responsible to the contractor for the full amount ... even if the agency exhausts the appropriation in service of other permissible ends."[124] The court reasoned that if the contractor knows the Government has appropriated sufficient funds, it can trust that the Government will fulfill its obligations.[125] A Government contractor should not have the responsibility of knowing "how much of that appropriation remains available for it at any given time."[126]

The Government's contractual obligation persisted despite (1) language in ISDA that made payment "subject to the availability of appropriations," (2) congressional appropriations language that said funds available for contract support costs were "not to exceed" a certain amount, and (3) a proviso in ISDA that relieved the secretary of the interior of any obligation to reduce funds serving a tribe to make those funds available to another tribe.[127] The court found that (a) funds were available because Congress had appropriated sufficient funds to pay any contractor in full, (b) the "not to exceed" language did not prevent the agency from allocating funds among multiple contractors, and (c) the secretary's ability to make funding choices did not eliminate the Government's contractual liability.[128] Additionally, the court found that "ordinary principles of Government contracting law" dictated the result.[129] Ultimately, as long as contractors are paid out of a lump sum appropriated by Congress meant to pay multiple contractors, the Government would be obligated to fulfill its contractual obligations to any contractor.[130]

Under the sequestration regime, even if a program, project or activity is slashed by the uniform percentage, the aggregate amount of appropriated funds will likely be large enough to pay each contract in full. Under *Salazar*, all those contractors who draw from the same appropriations pool would be able to recover the full value of their performed contract work despite any funding sequestration.

Conclusion

As the summer ends and the final run-up to the presidential election begins, the potential effects of sequestration remain unclear and are likely to be very disruptive. While the political stalemate continues, there are a host of questions left unanswered. How will the awkward timing of the mandatory cuts affect the flow of federal funds both before and after the sequestration is triggered? What will be the vulnerability of Government contractors? What will the size of the mandatory reduction percentage be?

For now, one can see the broad outlines of how sequestration and the revision of discretionary spending caps will play out, but the details, absent guidance from OMB, remain lacking. Until the ticking threat of the sequestration doomsday device is defused by Congress and the president, Government contractors should prepare for months of uncertainty and reductions in the value, scope and number of their Government contracts, by either sequestration or other congressional budget actions to avoid sequestration.

❖ Endnotes

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2 Sequestration was "[o]riginally a legal term referring generally to the act of valuable property being taken into custody by an agent of the court and locked away for safekeeping, usually to prevent the property from being disposed of or abused before a dispute over its ownership can be resolved. But the term has been adapted by Congress in recent years to describe a new fiscal policy procedure originally provided for in the Gramm-Rudman-Hollings Deficit Reduction Act of 1985—an effort to reform Congressional voting procedures so as to make the size of the Federal government's budget deficit a matter of conscious choice rather than simply the arithmetical outcome of a decentralized appropriations process in which no one ever looked at the cumulative results until it was too

late to change them." Paul M. Johnson, "A Glossary of Political Economy Terms," available at *www.auburn.edu/~johnspm/gloss/sequestration*.

3 See Congressional Budget Office, "Economic Effects of Reducing the Fiscal Restraint that is Scheduled to Occur in 2013," at 1–2 (May 2012), available at *www.cbo.gov/sites/default/files/cbofiles/attachments/FiscalRestraint_0.pdf*.

4 Kim Geiger, "Panetta: Cuts to Defense Spending Would Be 'Disastrous,' " L.A. Times (May 27, 2012), available at *articles.latimes.com/2012/may/27/news/la-pn-panetta-planned-cuts-to-defense-spending-would-be-disastrous-20120527*.

5 Stephanie Gaskell, "Panetta: Sequestration Threatens 'Critical' Programs," Politico (June 29, 2012), available at *www.politico.com/blogs/on-congress/2012/06/panetta-sequestration-threatens-critical-programs-127788.html*.

6 Rosalind S. Helderman and Ed O'Keefe, "Obama Budget Chief Jeffrey Zients to Congress: Sequestration 'Not the Responsible Way' to Cut Debt," Washington Post (Aug. 1, 2012), available at *www.washingtonpost.com/blogs/2chambers/post/obama-budget-chief-to-congress-sequestration-not-the-responsible-way-to-cut-debt/2012/08/01/gJQAtxpQOX_blog.html*.

7 See Budget Control Act of 2011, P.L. 112-25, 125 Stat. 240.

8 BCA § 401(b)(2), 125 Stat. at 259.

9 See, e.g., Lori Montgomery and Paul Kane, "Supercommittee Announces Failure in Effort to Tame Debt," Washington Post (Nov. 21, 2011), available at *www.washingtonpost.com/business/economy/debt-committee-failure-will-become-official-with-written-joint-statement/2011/11/21/gIQAfRmCiN_story.html*.

10 E.g., Karen Spar, Congressional Research Service, R42050, "Budget 'Sequestration' and Selected Program Exemptions and Special Rules," at 1 (2012).

11 Id.

12 BCA § 302(B)(2), 125 Stat. at 256.

13 BCA § 302(B)(3)–(5), 125 Stat. at 256–257.

14 Id.

15 Id.

16 See Balanced Budget and Emergency Deficit Control Act of 1985, P.L. 99-177, 99 Stat. 1037.

17 See id.

18 See Budget Enforcement Mechanisms: Hearing Before the S. Comm. on Fin., 112th Cong. 5 (statement of Phil Gramm, Vice Chairman, UBS Investment Bank).

19 See Robert Keith, CRS, RS20398, "Budget Sequesters: A Brief Review" (2004).

20 Id.

21 Id. at 3.

22 CBO and Office of Management and Budget, "Sequestration Report for Fiscal Year 1986: A Summary," at 15 (Jan. 15, 1986).

23 Id.

24 Id. (emphasis added).

25 BCA § 302, 125 Stat. at 256.

26 See § 101, 125 Stat. at 245.

27 Id.

28 Id.

29 BCA § 302(a), 125 Stat. at 256.

30 Id.

31 BCA § 101, 125 Stat. at 245.

32 BCA § 302, 125 Stat. at 256; see also Part III.B.2, infra.

33 See Office of the Under Secretary of Defense, National Defense Budget Estimates for FY 2012, at 15 (March 2011), available at *comptroller.defense.gov/defbudget/fy2012/FY12_Green_Book.pdf*.

34 2 USCA § 905; Spar, "Budget 'Sequestration,' " at 5–7; see also Letter from Steve D. Aitken, Deputy Gen. Counsel, OMB, to Julia C. Matta, Assistant Gen. Counsel for Appropriations & Budget, U.S. GAO (April 23, 2012) (expressing view that "all programs administered by the VA, including Veterans' Medical Care, are exempt from sequestration").

35 BCA § 302, 125 Stat. at 258 ("the percentage reduction for the Medicare programs specified in section 256(d) shall not be more than 2 percent for a fiscal year").

36 See Spar, "Budget 'Sequestration,' " at 5.

37 See CBO, "Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act," at 2 (Sept. 12, 2011), available at *www.cbo.gov/sites/default/files/cbofiles/attachments/09-12-BudgetControlAct.pdf*. Within DOD, some parts of the budgets may be immunized from mandatory cuts. The BBEDCA (and reiterated by the BCA, § 101, 125 Stat. at 241) authorizes the president to exempt the military personnel account from sequestration. 2 USCA § 905(f) ("The President may, with respect to any military personnel account, exempt that account from sequestration").

38 § 101, 125 Stat. at 241.

39 2 USCA § 905(f) ("The President may, with respect to any military personnel account, exempt that account from sequestration").

40 The authority was set to expire on August 10. See 2 USCA § 904(a). Earlier this summer, OMB acknowledged this authority but did not exempt military personnel accounts. See Letter from Jeffrey D. Zients, Acting Director, OMB, to Representative Howard P. McKeon, Chairman, House Committee on Armed Services, n. 1 (June 15, 2012) available at *www.whitehouse.gov/sites/default/files/omb/legislative/letters/response-letter-to-chairman-mckeon-ros-lehtinen-rogers-06152012.pdf* ("OMB also explained … that the BCA provides that the President may exercise special authority under Section 255(f) of BBEDCA to exempt any military personnel account from a sequester, subject to a further reduction of other accounts").

41 See Letter from Jeffrey D. Zients, Acting Director, OMB, to The Honorable Joseph R. Biden, Jr., President of the Senate (July 31, 2012), available at *www.whitehouse.gov/sites/default/files/omb/legislative/letters/military-personnel-letter-biden.pdf* ("Consistent with the notification provided to Congress last August, notification is hereby provided of the President's intent to exempt all military personnel accounts from sequester for FY 2013, if a sequester is necessary. This is considered to be in the national interest to safeguard the resources necessary to compensate the men and women serving to defend our Nation and to maintain the force levels required for national security").

42 Id.

43 See Office of the Under Secretary of Defense, National Defense Budget Estimates for FY 2013, at 8 (March 2012), available at *comptroller.defense.gov/defbudget/fy2013/FY13_Green_Book.pdf*.

44 BCA § 302, 125 Stat. at 257.

45 Id.

46 Id.

47 Id.

48 Id.

49 Id.

50 See § 302, 125 Stat. at 256.

51 Bipartisan Policy Center, "Indefensible: The Sequester's Mechanics and Adverse Effects on Nat'l & Econ. Sec.," at 15 (June 2012).

52 President Barack Obama, Remarks by the President to the 113th National Convention of the Veterans of Foreign Wars (July 23, 2012) (stating that "there are a number of Republicans in Congress who ... voted for these cuts. Now they're trying to wriggle out of what they agreed to. Instead of making tough choices to reduce the deficit, they'd rather protect tax cuts for some of the wealthiest Americans, even if it risks big cuts in our military"), available at *www.whitehouse.gov/the-press-office/2012/07/23/remarks-president-113th-national-convention-veterans-foreign-wars*.

53 See CBO, "Economic Effects," at 3.

54 Id. at 5 (emphasis added).

55 See OMB, "Budget Concepts and Budget Process," at 130–131 (2012), available at *www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/concepts.pdf*.

56 BCA § 302, 125 Stat. at 258 ("OMB shall calculate and the President shall order a sequestration ... to reduce each account within the security category or nonsecurity category ... by a uniform percentage").

57 See Bill Heniff, Jr., et al., CRS, R41965, "The Budget Control Act of 2011," at 32 n. 96 (2011).

58 Id. at 32 ("In addition, under ... BBEDCA, the uniform percentage reduction is applied to all programs, projects and activities within a budget account."); but see Loren Thompson, "Budget Uncertainties Provoke Panic in Defense Sector," Forbes (May 22, 2012) (stating that it was unclear whether the uniform rate "must be applied down to the individual program, project and activity level" or whether "the rate would be applied to broad accounts, leaving [the president] considerable discretion.").

59 See BCA § 302, 125 Stat. at 256.

60 See Richard Kogan, Center on Budget and Policy Priorities, "How Across-the-Board Cuts in the Budget Control Act Will Work," at 5 (April 27, 2012).

61 Id.

62 House Armed Services Committee, "Sequestration Implementation Options and the Effects on National Defense: Administration Perspectives," 112th Congress (Aug. 1, 2012) (prepared statement of Dr. Ashton B. Carter, Deputy Secretary of Defense, at 2), available at *armedservices.house.gov/index.cfm/files/serve?File_id=8662f2f6-0692-41c1-b25b-b60527b85aaa*.

63 See Kogan, "How Across-the-Board Cuts in the Budget Control Act Will Work," at 5 (April 27, 2012).

64 HASC, "Sequestration Implementation Options and the Effects on National Defense: Administration Perspectives," 112th Congress (Aug. 1, 2012) (statement of Dr. Ashton B. Carter, Deputy Secretary of Defense).

65 See Heniff, "Budget Control Act of 2011," at 32.

66 Id.

67 Kogan, "How Across-the-Board Cuts in the Budget Control Act Will Work," at 5.

68 Id.

69 Id. at 13–14, 32 (if "discretionary appropriations within a category exceed the spending limit for that category, sequestration is triggered ... [and] [t]he President is required to ... cancel[] budgetary resources in nonexempt accounts, within the category in which the breach occurred.").

70 2 USCA § 906(k); § 302, 125 Stat. at 257.

71 2 USCA § 906(k).

72 Report of the H. Comm. on the Budget, Frequently Asked Questions About Sequestration Under the Budget Control Act of 2011 5 (Dec. 13, 2011).

73 Id.

74 General Accounting Office, Compliance Report for FY 1986: Balanced Budget and Emergency Deficit Control Act of 1985 1 (1986).

75 Id. at 9 (the other agencies using this definition included the departments of Justice, State, Agriculture and Commerce).

76 Bipartisan Policy Center, Indefensible, at 16.

77 See id.

78 Id. (identifying two Virginia Class submarines as one program, project and activity within the Navy shipbuilding and conversion procurement, and arguing that a mandatory cut would make it impossible to complete either ship).

79 Id.; see also 10 USCA § 2433. The Nunn-McCurdy provision of the DOD Authorization Act for FY 1983 requires DOD to report to Congress cost overruns in major acquisition programs that exceed certain thresholds. See CRS Report R41293, "The Nunn-McCurdy Act: Background, Analysis, and Issues for Congress" (June 21, 2010), available at *www.fas.org/sgp/crs/misc/R41293.pdf*.

80 Id. at 16–17.

81 See, e.g., Zachary Goldfarb, "As 'Fiscal Cliff' Looms, Debate over Pre-Election Day Layoff Notices Heats Up," Washington Post (July 30, 2012), *www.washingtonpost.com/business/economy/as-fiscal-cliff-looms-debate-over-pre--election-day-layoff-notices-heats-up/2012/07/30/gJQAxNlSLX_story.html?hpid=z1*.

82 29 USCA § 2101.

83 Id.

84 "Employment loss" is defined in the WARN Act implementing regulations as "(i) an employment termination, other than a discharge for cause, voluntary departure, or retirement, (ii) a layoff exceeding 6 months, or (iii) a reduction in hours of work of individual employees of more than 50% during each month of any 6-month period." 20 CFR § 639.3.

85 29 USCA § 2101(a)(2)–(3).

86 See 29 USCA § 2102(b).

87 29 USCA § 2102(b)(2)(A).

88 Emp't & Training Admin., Dep't of Labor, Training and Employment Guidance Letter No. 3-12, Guidance on the Applicability of the Worker Adjustment and Retraining Notification (WARN) Act, 29 USCA § 2101–2109, to layoffs that may occur among Federal Contractors, including in the Defense Industry as a Result of Sequestration (July 30, 2012), available at *wdr.doleta.gov/directives/attach/TEGL/TEGL_3a_12_acc.pdf*.

89 Id. at 3–4.

90 Id. at 3.

91 Id. at 4.

92 Id. at 5.

93 *Halkias v. Gen. Dynamics Corp.*, 137 F.3d 333, 334 (5th Cir. 1998).

94 Id.

95 Id.

96 Id.

97 Id.

98 Id. at 336–337.

99 Id. at 337.

100 Id.

101 Id.

102 *Loehrer v. McDonnell Douglas Corp.*, 98 F.3d 1056 (8th Cir. 1996).

103 Id. at 1057–1061. For instance, "[i]n his testimony before the Committee, the Secretary recommended a reduction in the number of A-12 Avengers to be produced." Id. at 1057.

104 Id. at 1060.

105 Id. at 1061.

106 Id.

107 Id.

108 E.g., *Halkias*, 137 F.3d at 337.

109 E.g., *Loehrer*, 98 F.3d at 1059.

110 See id. at 1060.

111 Id.

112 President Obama has stated that Congress "can and must act to avoid the sweeping impacts of the sequester." Sequestration and National Security: What You Need to Know, available at *www.barackobama.com/sequestration*. The House of Representative passed a bill to replace the across the board cuts scheduled to take effect on Jan. 2, 2013 with other funding reductions. H.R. 5652, Sequester Replacement Reconciliation Act of 2012 (passed by House on May 10, 2012).

113 20 CFR § 639.1(d).

114 Id.

115 20 CFR § 639.1(e).

116 Id.

117 *Salazar v. Ramah Navajo Chapter*, 567 U.S. ___ (2012) (Slip op. at 2).

118 Id.

119 Id. at 3.

120 Id. at 2.

121 Id. at 4.

122 Id.

123 Id. At the time, the CDA was codified at 41 USCA §§ 601–613. It is now codified at 41 USCA §§ 7101–7109.

124 Id. at 6.

125 Id. at 7.

126 Id.

127 Id. at 4, 5, 12.

128 Id. at 10-12.

129 Id. at 12.

130 Id. at 16.