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THE DEBT CEILING DILEMMA
Pitfalls for Government Contractors

Arnold & Porter Government Contracts & National Security Practice

The *federal debt* is the total amount the government owes to creditors.

The government operates under a deficit, i.e., outlays exceed income.

By statute, the debt ceiling cannot exceed $31.4 trillion.

Time Is Running Out

If the debt ceiling is not raised or an agreement is not reached by June 1, the government cannot borrow more. It will have to solely rely on incoming revenues to finance all obligations.

Starting June 2, the U.S. Government will experience serious cash flow problems.

The Debt Ceiling Is Not the Same Thing as a Government Shutdown.

A shutdown results from a failure to issue valid appropriations.

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The debt ceiling limit does not cancel or change incurred obligations.
It only affects the government's ability to pay.

Debt Ceiling Implications

Government will likely determine payment priorities:

- Entitlements, federal salaries and pensions, and military programs are likely to take priority.
- Contractor payments could fall to the bottom.

Interest Rates Will Increase

Furloughs May Occur

Most federal employees may not work for free

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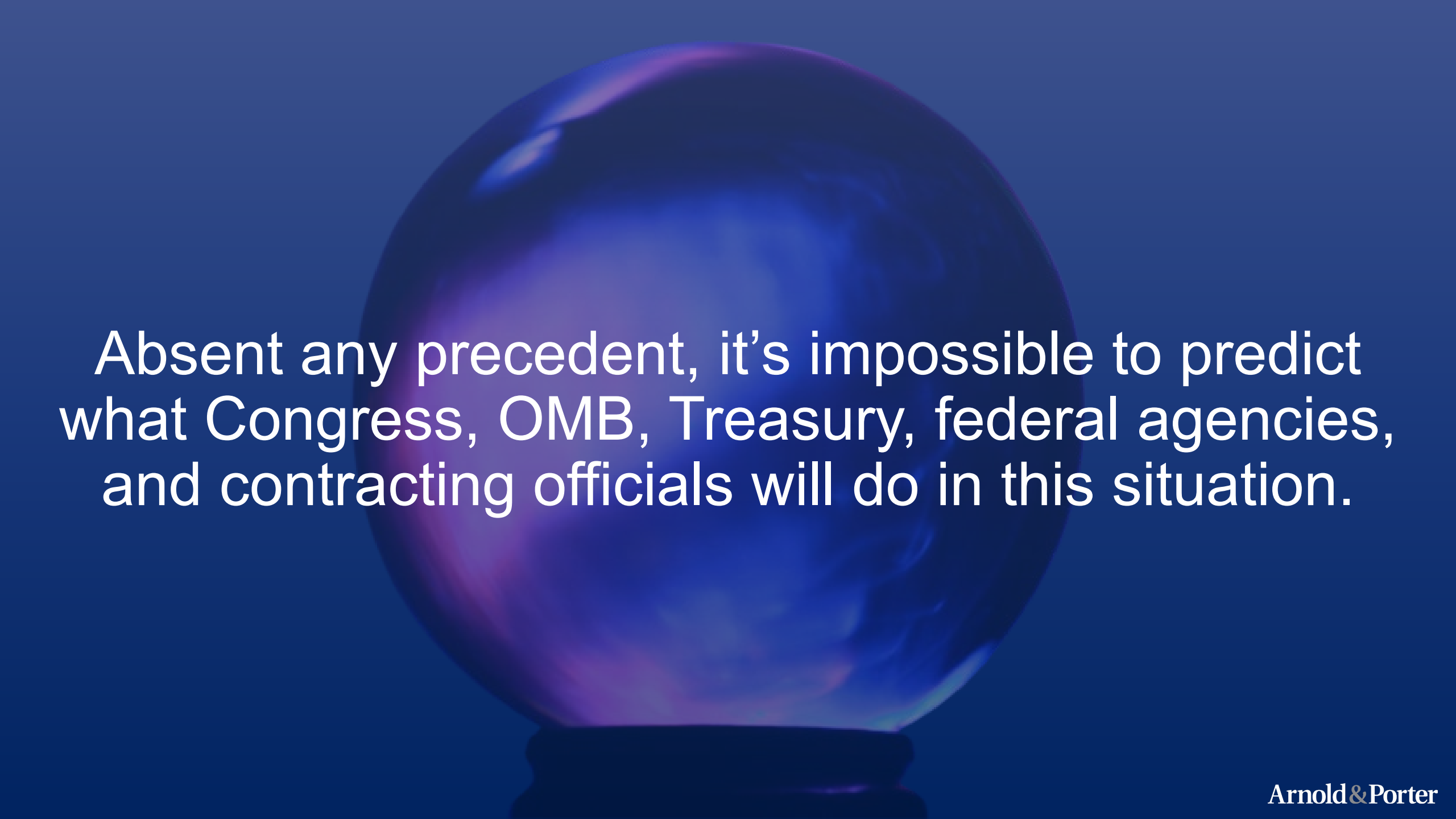
Federal contractors should reach out to contracting officers to determine whether work should continue.

Some contractors may be required to continue working if they are deemed *essential.*


Absent any precedent, it’s impossible to predict what Congress, OMB, Treasury, federal agencies, and contracting officials will do in this situation.

Potential Effects on Federal Contracts

- Suspension of Payments
- Delay of Payments
- Backlog of unpaid bills will grow until revenue is collected
- Performance, competitions, and awards are likely to continue

Potential Stop Work Orders & Terminations

- Government has unilateral right to “stop work” on contracts when it is in the government’s “best interest”
- Government may later order a contractor to resume work or could terminate the contract
- Contractors should establish a separate charge number in the accounting records to identify costs associated with the “stop work” or termination

Government-Issued Stop Work

Contractors may recover equitable adjustment to the contract price

Terminations for Convenience

FAR Part 49 and FAR Part 12
detail contractor cost recovery and procedures

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Recommendations for Contractors

- Discuss with the Agency
  - The priority of your contracts and possible priority for payment
  - Whether work should continue in the absence of a “stop work” order or termination
- Track and document all costs and invoiced amounts for future delayed recover or potential Prompt Payment Act claims
- Seek payments ASAP, even if early cash out may affect the ability to recover more later
- Secure sufficient cash to ensure timely payment to subcontractors and vendors
- Consider hedge company borrowing to extend lines of credit with banks and lenders to prepare before interest rates increase

Remedies for Contractors

- Prompt Payment Act Regulation
- Requires the government to pay interest penalties if it does not pay a contractor by the required payment date
- Sue to recover amounts owed
- Suspend contract performance
- Terminate the contract for convenience

Contractors Should Pursue Proactive Measures

- Gather intelligence on your contracts and their relative fiscal priority
- Submit careful and documented invoices
- Pursue alternative lines of credit
- Review your contractual rights for recovery

Arnold & Porter

Arnold & Porter's leading Government Contracts practice provides a 360-degree approach for clients doing business with the government.

Our team navigates statutory and regulatory constraints, identifies and mitigates risks, and addresses evolving legal developments and compliance issues for clients.

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