

COST & PRICING ISSUES*

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I. ALLOWABILITY OF COSTS

A. Legal Proceeding Costs

At issue in *DynCorp*, ASBCA No. 49714, 06-1 B.C.A. ¶ 33,181, was the allowability of legal costs incurred in a series of investigations at the National Training Center, Fort Irwin, California, where DynCorp was performing a cost reimbursement support services contract. Over a two-year period, the Army Criminal Investigative Division (“CID”) and FBI investigated (1) the death of a soldier when the tracked vehicle he was riding in became engulfed in flames, (2) alleged falsification of biomedical support activity records by DynCorp employees, (3) alleged falsification of vehicle maintenance records by DynCorp employees, and (4) alleged fraudulent misuse of government credit cards by DynCorp employees. The ASBCA concluded that the investigation into the soldier’s death was separate from the other investigations, and that there was no evidence of any misconduct because the investigators determined the death was accidental. However, the board found that the other three investigations were part of the same proceeding based on the following facts: (1) all of the investigations grew out of a new economic crimes unit, and involved the same contract, same military installation, and similar wrongdoing over a relatively short period of time, and (2) the FBI assigned only a single report number and reported the results to the same Assistant United States Attorney. Accordingly, because the “proceeding” ended with the criminal conviction of a DynCorp employee, the ASBCA held the costs were unallowable.

B. State Taxes

The Federal Circuit held in *Information Systems & Networks Corp. v. United States*, 437 F.3d 1173 (Fed. Cir. 2006), that state income taxes paid by a Subchapter S corporation on behalf of its sole shareholder are not allowable costs.

II. DEFECTIVE PRICING

We reported last year that the ASBCA, in its decision on reconsideration in *United Technologies Corp.*, ASBCA Nos. 51410 *et al.*, 05-1 B.C.A. ¶ 32,860, held that because neither DCAA, the Air Force price analyst, nor the Contracting Officer reviewed the cost or pricing data accompanying UTC’s best and final offer before awarding a contract based on the BAFO pricing, UTC had successfully rebutted the presumption that the Air Force relied on the defective cost or pricing. On appeal to the Federal Circuit, the Air Force argued unsuccessfully “that it is never necessary to establish that it relied upon the defective cost or pricing data to its detriment, as it is sufficient to establish that the contract price offered by [UTC] was calculated using the defective cost or pricing data.” The Federal Circuit disagreed, and reaffirmed that reliance on defective data is a necessary element of a TINA claim. The Federal Circuit also rejected the Air Force’s related argument “that the presumption cannot be rebutted in an instance in which the allegedly defective data was used in calculating the contract price.” The Federal Circuit held that this argument was foreclosed by its decision in *Universal Restoration, Inc. v. United States*, where the court “found the presumption of causation rebutted even though the defective data was used in calculating the contract price.” *Wynne v. United Techs. Corp.*, 463 F.3d 1261 (Fed. Cir. 2006).

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III. CONTRACT PRICING AND RELATED CLAUSES

A. Negligent Estimates and Other Breaches

The Court of Federal Claims held in *Engineered Demolition Inc. v. United States*, 70 Fed. Cl. 580 (2006), that an estimate need not be “drastically inaccurate” in order for the contractor to recover. All that is required is that the Government negligently prepared the estimate, or negligently assured the contractor that the estimate was accurate. The contract drawings included in the solicitation indicated that 6,600 cubic yards of waste required removal, while the specifications estimated 8,080 cubic yards. In response to the contractor’s pre-bid question, the Government affirmed that the 8,080 estimate was correct. Engineered Demolition based its bid on that amount, and subsequently submitted a claim when the actual amount proved to be 6,677 cubic yards. The court denied the Government’s motion to dismiss, holding that because “[t]he record ... reflects no rationale or justification for the government’s affirmation of the higher estimate..., the court cannot hold that the government did not breach the contract as a matter of law.”

B. Limitation of Cost Clause

The ASBCA held in *International Tech. Corp.*, ASBCA No. 54136, 2006 WL 2130425 (A.S.B.C.A July 17, 2006), that the contractor’s responsibility for reviewing a subcontractor’s request for equitable adjustment before submitting it to the Government does not excuse the contractor from giving timely notice under the LOC clause. The ASBCA stated: “[T]he LOC clause does not limit a contractor’s notice obligations to those costs proven to be allowable to a certitude. Rather, the notice is required when the contractor ‘has reason to believe’ of expected cost increases.”

C. FAR 52.222-43, Fair Labor Standards Act and Service Contract Act – Price Adjustment (Multiple Year and Option Contracts)

We reported last year that the ASBCA in *Lear Siegler Services, Inc.*, ASBCA No. 54449 (Apr. 11, 2005), denied the contractor’s appeal for the increased costs of providing the defined benefit health & welfare benefits specified in its and the predecessor contractor’s collective bargaining agreement. The ASBCA concluded that no price adjustment was due because under the Department of Labor regulations, a successor contractor may provide “equivalent” fringe benefits by making cash payments of at least the predecessor’s cost of providing the defined benefit. The Federal Circuit reversed and granted summary judgment in the contractor’s favor. *Lear Siegler Services, Inc. v. Rumsfeld*, 457 F.3d 1262 (Fed. Cir. 2006). Observing that the DOL “[r]egulations make clear that the term ‘wage determination’ includes a CBA-defined benefit level,” the court held that “the Price Adjustment Clause is triggered by changes in an employer’s cost of compliance” with a wage determination or CBA, even if there is no change in the level of benefit provided by the defined benefit plan. The court found “no merit” in the “government’s argument that the Price Adjustment Clause does not apply because LSI can somehow satisfy its fringe-benefit obligations by making equivalent payments directly to its employees.”

The contractor in *JDD, Inc.*, ASBCA No. 55282, 06-2 B.C.A. ¶ 33,345, was the incumbent contractor for a NASA janitorial services contract, and its CBA provided for an annual wage increase for the next two years. JDD's price proposal for the follow-on contract did not include a wage escalation for the second year of the contract even though its CBA was incorporated in the solicitation. JDD was awarded the follow-on contract, and after the contract's first anniversary, submitted a claim for the increased wages required by the CBA. The contracting officer denied the claim on the basis that JDD's prices should have included annual wage increases for the first two contract years as set forth in the CBA. The ASBCA disagreed, holding that: "[T]he provisions of FAR 52.222-41 and 52.222-43 required appellant to warrant that its offer did not include an allowance for increased costs for which the government had agreed to make adjustment for actual wage increases on the contract anniversary dates under the applicable CBA wage determination. Appellant is entitled to a price adjustment for actual wage rate increases under the CBA wage determination that went into effect on the second anniversary date of the contract"

D. "Illegal" Contract Terms

We reported last year that the Court of Federal Claims in *United Pacific Ins. Co. v. United States*, 68 Fed. Cl. 152 (2005), dismissed an action by a surety seeking costs incurred in completing a construction project. After an earlier decision holding that the surety lacked standing to pursue pre-takeover agreement claims, the surety sought relief contending that the original construction contract was illegal because the construction project was split into three contracts to avoid the ceiling for funding military construction projects. The court held that the statutes allowing an agency to fund minor military construction and repair projects using operations and maintenance (O&M) funds without following the legislative oversight procedures required for major military construction projects are not enforceable through private causes of action. The Federal Circuit affirmed, agreeing with the CFC that the surety's claim was precluded by the Circuit's en banc decision in *AT&T v. United States*, 177 F.3d 1368 (Fed. Cir. 1999). *United Pacific Ins. Co. v. United States*, 464 F.3d 1325 (Fed. Cir. 2006).

Dingle v. Halliburton Co., slip op., 2006 WL 2729286 (S.D. Tex. Sept. 25, 2006), involved claims by employees of Halliburton subsidiary Kellogg, Brown & Root Services, Inc. ("KBR") for overtime pay for work performed in Iraq and Kuwait under KBR's Logistics Civil Augmentation Program ("LOGCAP") III contract. The task orders for work performed in those countries incorporated FAR clause 52.222-4, Contract Work Hours and Safety Standards Act -- Overtime Compensation, despite the FAR 22.305(d) directive to not include the clause in contracts for work to be performed outside the United States. The employees argued that, notwithstanding the FAR guidance, KBR was bound by the clause because it accepted the task orders with the clause incorporated in them. The district court disagreed, concluding that statutes and regulations overrule contradictory terms in contracts with government agencies. Accordingly, the court held "that any task order performed outside of the United States should be

read as if it did not contain Clause 52.222-4, no matter what the contract clause matrix may indicate.”

IV. TERMINATION PRICING

The Federal Circuit held in *Jacobs Engineering Group, Inc. v. United States*, 434 F.3d 1378 (Fed. Cir. 2006), that a contractor under a cost-sharing contract in which the Government was required to reimburse 80 percent of the contractor’s costs was entitled to recover all of its costs when the Government terminated the contract for convenience. The court observed that cost-sharing contracts are appropriate when the contractor agrees to absorb a portion of the costs in the expectation of substantial compensating benefits, and, as a result of the termination, Jacobs Engineering was denied the opportunity to obtain those benefits. Additionally, in interpreting the Termination (Cost Reimbursement) clause at FAR 52.249-6, the court construed “reimbursable” as synonymous with “allowable,” concluding that: “The termination clause’s reference to ‘all costs reimbursable’ under the contract appears designed to incorporate the contract’s division between reimbursable and non-reimbursable costs.”

In *International Data Products Corp. v. United States*, 70 Fed. Cl. 387 (2006), Court of Federal Claims held that not only does a contractor have no obligation to provide warranty services and software upgrades after its contract is terminated for convenience, but it is also not entitled to recover its costs of doing so at the contracting officer’s direction. The contractor performed the warranty and software upgrade work under protest, and later submitted a claim for its costs. The court reasoned that the Government could not breach or constructively change a contract that had already been terminated, and there could be no implied-in-fact contract to perform the additional work because there was no meeting of the minds as to whether the contract required the contractor to perform the work. Accordingly, the court held that there was no basis for the contractor to recover under a theory of constructive change, breach of contract, or cardinal change, and the court lacked jurisdiction over the contractor’s quantum meruit claim.

In *Ardco, Inc.*, AGBCA No. 2003-183-1, 2006 WL 2150346 (A.G.B.C.A. Aug. 2, 2006), the Agriculture Board of Contract Appeals rejected an attempt by the Forest Service to use FAR 52.249-2 to shield the Government from damages for a breach that was independent of any attempt to cancel the contract. Ardco and the FS entered into an indefinite delivery, indefinite quantity, requirements contract to provide aircraft during fire season. The contract provided that Ardco would be paid a daily rate for each day during the fire season when its aircraft were required to be available. In addition, Ardco was to be paid an hourly rate for each hour of flight time. There was no guarantee that any flight time would be required, but the parties agreed that the FS was obligated to procure all of flight time it needed from Ardco. During the course of performance, a FS employee negligently damaged one of Ardco’s aircraft by driving a forklift into it. The FS continued to pay Ardco the daily rate while the aircraft was being repaired, but purchased flight time from another contractor. Ardco submitted a claim for anticipatory profits for the flight time it had

anticipated during the mandatory availability period. The AGBCA concluded that the Termination for Convenience clause was never intended to be used for independent breaches – where the Government hinders the contractor’s ability to perform – but did not intend to cancel the contract. Relying instead on breach of requirements contract cases, the AGBCA held that anticipatory profits is the appropriate measure of damages when the Government diverts work covered by a requirements contract to another contractor.

V. FALSE CLAIMS ACT

In *United States ex rel. DRC, Inc. v. Custer Battles, LLC*, 444 F. Supp. 2d 678 (E.D. Va. 2006), the U.S. District Court for the Eastern District of Virginia overturned a jury verdict against Custer Battles, LLC for false claims submitted to the Coalition Provisional Authority. In an earlier proceeding we reported last year, the court held that a demand for payment of “vested funds” or “seized funds” constitutes a “claim” under the False Claims Act; but a demand for payment from the Development Fund for Iraq does not since DFI funds are merely in the Government’s possession and control and not actually owned by the U.S. Government. The case proceeded to trial on a single CPA contract funded with “vested” or “seized” assets. Following the jury verdict, the defendants moved for judgment as a matter of law, arguing among other things that there was no evidence that a false claim or false statement in support of a false claim had been presented to a U.S. Government officer or employee acting in his or her official capacity. The court found that it was not enough that the claims were *paid* with U.S. Government funds; rather, to satisfy the presentment requirement of 31 U.S.C.A. § 3729(a)(1), a plaintiff must show that the defendant presented, or caused to be presented, false claims to U.S. Government employees or officers working in their official capacity. The court found that although the normal practice was for the CPA to submit contractor invoices to the U.S. Army for payment (which *would* have satisfied the presentment element), that practice was not followed in this instance because the payment to Custer Battles had been an advance. Hence, the relators in *Custer Battles* could satisfy the presentment requirement only by establishing that the CPA was a U.S. Government entity. The court found that the CPA was an international entity created by the coalition forces, not a U.S. Government entity, and that the U.S. Government personnel working for the CPA were working in their capacity as CPA employees rather than U.S. Government employees. Accordingly, because the relators failed to establish that a claim or statement in support of a claim was presented to the U.S. Government, the court held that the defendants were entitled to judgment as a matter of law with respect to two of the three counts of the complaint.

The federal circuits are split as to the issue of whether presentment to the Government is a necessary element for all subsections of the FCA. In *United States ex rel. Sanders v. Allison Engine Co.*, 471 F.3d 610, 2006 WL 3716362 (6th Cir. Dec. 19, 2006), the Sixth Circuit held that presentment is required under subsection (a)(1) of 31 U.S.C.A. § 3279, but not under subsections (a)(2) and (a)(3). For subsections (a)(2) and (a)(3), the court held that the relator need only “show that the government money was used to pay the false claim or fraudulent claim.”

VI. CONTRACT DISPUTES ACT**A. Interest**

In a questionable application of *Raytheon Co. v. White*, 305 F.3d 1354 (Fed. Cir. 2002), the Federal Circuit held in *Richlin Security Serv. Co. v. Chertoff*, 437 F.3d 1296 (Fed. Cir.), *cert. denied*, 127 S.Ct. 253 (2006), that Richlin was not entitled to CDA interest despite having won its appeal for increased wages because “the government paid the amounts awarded into an escrow account, and those funds were used to pay the employees and the tax authorities,” and, consequently, “[t]he award of back wages did not compensate Richlin for any past, present or future out-of-pocket expense.”

B. Standing to Appeal

The ASBCA dismissed the appeal in *Dual, Inc.*, ASBCA Nos. 53827 & 53889 (Mar. 29, 2006), because the contractor’s corporate charter had been forfeited for failure to pay Maryland state taxes. While the charter was forfeited, the government terminated the contract for convenience, the defunct corporation’s president submitted a termination settlement proposal, the contracting officer issued a final decision denying the contractor’s termination settlement proposal and asserting a government claim for a refund of alleged overpayments under the contract, and the contractor’s president filed a notice of appeal. The board held that it lacked jurisdiction because under Maryland law, corporate officers do not have authority to act for defunct corporations except to wind up the corporation’s affairs. Although the charter was subsequently reinstated, and under Maryland law retrospectively validated the capacity of the corporation, the ASBCA held that it was too late because by the time the charter was revived, the 1-year period for filing a termination settlement proposal and 90-day period for appealing the contracting officer’s final decision had already passed.

L-3 Comms. Corp., ASBCA No. 54920, 2006 WL 2349233 (Jul. 27, 2006), presents a creative use of the Contract Disputes Act. Precluded by the Federal Acquisition Streamlining Act from protesting the Air Force’s decision to award a delivery order to another awardee under a multiple award, ID/IQ contract, L-3 Communications Corporation chose instead to submit a certified claim for breach of AF FAR Supplement clause 5352.216-9001, Awarding Orders Under Multiple Award Contracts, which was incorporated in the contract. As required by FAR 16.504(a)(4)(iv), the clause describes the procedures the Air Force will use in providing the multiple award contractors a fair opportunity to compete for task orders in excess of \$2,500. L-3 claimed that the Air Force’s selection of another awardee’s proposal for the delivery order was contrary to the stated evaluation criteria, and therefore breached the Awarding Orders clause. The Air Force moved to dismiss, arguing that L-3’s claim was in essence a bid protest prohibited by statute. The ASBCA denied the motion, holding that it has jurisdiction under the CDA to consider L-3’s breach of contract claim. The ASBCA observed that: “The same actions of the government in awarding a delivery order under a multiple award indefinite quantity contract may theoretically be grounds for both a ‘protest’ seeking to cancel or modify

the award and a 'claim' for damages for breach of the Awarding Orders clause of the contract."

C. Statute of Limitations

In *Gray Personnel, Inc.*, ASBCA No. 54652, 2006 WL 2390292 (Aug. 9, 2006), the ASBCA applied the six-year statute of limitations to a requirements contract on a delivery order-by-delivery order basis. The contractor in *Gray Personnel* alleged that the Government had constructively changed its personal services requirements contract from one for the supply of full-time-equivalent nursing services to one for the supply of "as needed" nursing services. The ASBCA reasoned that in order for a contractor to assert a claim for a constructive change, the Government must have enlarged its performance requirements, and, absent a delivery order, no performance was required under the requirements contract. Accordingly, the ASBCA concluded, "the government's potential liability for enlarging appellant's performance requirements could not be 'fixed' until the government had issued a delivery order authorizing performance, and required appellant to provide 'as needed' services under that order." Applying the second and third sentences of the definition, the ASBCA found that while the drafters apparently contemplated the possibility of nonmonetary injury, because the contractor in that case alleged monetary damages, "appellant must have actually begun performance and incurred some extra costs for liability to be fixed." However, the ASBCA found that it was not necessary for the contractor to have completed performance of a delivery order for liability to be fixed. The ASBCA held that the contractor's claim was barred to the extent it was based on delivery orders that required services beginning more than six years prior to the contractor's submission of the claim to the contracting officer.

In *Emerson Constr. Co.*, ASBCA No. 55165, 2006 WL 2468080 (A.S.B.C.A. Aug. 17, 2006), the ASBCA held that a claim under FAR 52.211-18, Variation in Estimated Quantity, based on the Government's failure to order the estimated quantities specified in the contract for the base year, accrues on the last day of the base year period on which orders could be placed. The ASBCA held that the contractor's claim was timely because it was postmarked within the limitations period, even though it was not received by the contracting officer until after the period expired.

D. Complaint Seeking "Such Additional Amounts As May Be Due" Does Not Render Claim Defective for Lack of a Sum Certain

In *Todd Pacific Shipyards Corp.*, ASBCA No. 55126, 2006 WL 3071259 (A.S.B.C.A. Oct. 18, 2006), the Navy moved to dismiss the contractor's appeal on the ground that portions of the complaint requested indeterminate amounts that were not in its claim to the contracting officer, resulting in new claims that are not in a sum certain which the ASBCA lacks jurisdiction to consider. In particular, each count of the contractor's complaint included a prayer that the ASBCA sustain the appeal, award the amounts requested in the contractor's appeal, and award "such additional amounts as may be due." The ASBCA denied the motion, concluding that while the complaint expanded on the legal theories articulated in the contractor's

claim, it was nevertheless based on the same operative facts as the claim submitted to the contracting officer. The ASBCA stated that: “Once a claim has been submitted to the CO in a sum certain, an increase (or reduction) on appeal in the amount claimed does not render the monetary claim a new one, as long as the same operative facts are at issue. A contractor can increase the amount sought in its proper CDA claim to the CO when the increase is reasonably based upon further information developed in litigation before the Board.”

E. Indirect Cost Decision Not Limited to “Test Contract”

The Court of Federal Claims in *ATK Thiokol, Inc. v. United States*, 72 Fed. Cl. 306 (2006); 48 GC ¶ 300, rejected the Government’s attempt to limit the court’s earlier decision regarding the allowability of independent research and development costs to the single “test” contract selected for the purpose of resolving the dispute. The court observed that the consequences of the Government’s proposed limiting of the court’s decision to the single representative contract used by the parties for processing the dispute “would force needless and wasteful litigation on not only the contractor, ATK, and the Government, but on the Court as well,” because “ATK would now need to file all new claims on each and every contract to which the IR&D and B&P costs covered by the Court’s decision are allocable during the relevant periods.”

F. No Claim Necessary for Government to Collect Amount Found Due in Prior ASBCA Appeal

In *United States v. T&W Edmier Corp.*, 465 F.3d 764 (7th Cir. 2006), the U.S. Court of Appeals for the Seventh Circuit held that the government need not assert a CDA claim in order to recover an overpayment ensuing from a decision by the ASBCA that the government owes the contractor less than the contracting officer’s final decision awarded. In the earlier proceeding, the ASBCA determined that Edmier was entitled to \$1.6 million less on its claim than the amount awarded by the contracting officer’s final decision. When Edmier refused the government’s request to refund the excess \$1.6 million, the government filed a collection action in district court. The Seventh Circuit rejected Edmier’s argument that the district court lacked subject matter jurisdiction because the government had not asserted a CDA claim.

G. Intentionally Inflated Claim Results in \$50.6 Million Judgment Against Contractor

Daewoo Eng’g & Constr. Co., Ltd. v. United States, 73 Fed. Cl. 547 (2006), provides a particularly egregious example of the type of claim that section 604 of the Contract Disputes Act was designed to prevent. The case arose out of an Army Corps of Engineers road building project on a tropical island in the North Pacific. The contractor submitted a certified claim for nearly \$64 million, of which approximately \$13 million ostensibly represented the contractor’s actual costs and more than \$50 million represented possible future costs. The project manager who certified the claim testified that at least \$50 million of the claim was intended to convince the Government of the seriousness of situation so that the Corps would

approve the contractor's preferred method of soil compaction. However, the contractor's legal theory did not support recovery of even the \$13 million. In commenting on the contractor's lack of a coherent legal theory, the court observed: "It appeared Daewoo did not expect to find itself in court trying to justify its case; perhaps it thought defendant would pay a negotiated amount. The purpose of the Contract Disputes Act is to prevent this sort of gamesmanship." The contractor's case was so poorly presented that the court permitted the Government to amend its answer, after the contractor presented its case, in order to add fraud counterclaims under the False Claims Act, the Special Plea in Fraud statute and the CDA, as well as a claim for fraud in the inducement. The court granted the Government's belated motion to amend its answer despite the contractor's claim of unfair prejudice, reasoning that: "The evidence of fraud arose from and during the testimony of plaintiff's own witnesses, during its case-in-chief The Government showed primarily through cross-examination that it was not liable on plaintiff's claims, and that Daewoo's claims were fraudulent." Indeed, the court noted that it "made an effort to warn plaintiff of the dangers developing in its case, and to urge that counsel resolve the matter with defendant rather than forcing an Opinion of this nature." The court found in favor of the Government on all of the counterclaims, and entered judgment in favor of the United States for \$50,629,855.88 plus a False Claims Act penalty of \$10,000. The court also noted that it had "concerns about the behavior of plaintiff's counsel in these respects and others, and expect[s] that they will wish to offer explanations to the court at an appropriate time."

VII. PRICING CLAIMS

Applied Companies, Inc., ASBCA No. 54506, 06-1 B.C.A. ¶ 33,269, involved a claim for breach of a requirements contract based on the Government's negligent estimate of the number of cylinders required under the contract. The Government terminated the contract for convenience before any deliveries were made because the parties could not agree on revised pricing. The contractor sought reimbursement for the fixed overhead costs it was unable to recover as a result of the Government's breach, arguing that it was "entitled to recover unabsorbed overhead pursuant to *Nicon* through application of an adapted version of the *Eichleay* formula." The ASBCA disagreed, holding that "unabsorbed overhead may be recovered only under the *Eichleay* formula, and a strict prerequisite for application of the *Eichleay* formula is government caused delay."

In *Grumman Aerospace Corp.*, ASBCA No. 48006, 06-1 B.C.A. ¶ 33,216, the ASBCA rejected the Government's argument that because the contractor failed to use actual cost data to support its claims, the contractor was not entitled to an equitable adjustment for any of the claims on which the board found entitlement. However, while agreeing with the contractor that it was impracticable to reasonably and accurately prove the claims through actual cost data, the ASBCA found that the contractor failed to prove three of the four elements necessary to use the Total Cost Method. In particular, the ASBCA found that Grumman failed to prove the reasonableness of its bid, the reasonableness of its actual costs, and, most importantly, its lack of responsibility for the added costs.

VIII. COST ACCOUNTING STANDARDS**A. Determining Increased Costs Paid in the Aggregate**

In *Lockheed Martin Corp. v. United States*, 70 Fed. Cl. 245 (2006), the Court of Federal Claims rejected the Government's argument that 48 C.F.R. § 9903.306(e) precludes a contractor from offsetting cost decreases on fixed-price contracts against cost increases on cost-reimbursement contracts. The court stated that under 41 U.S.C. § 422(h)(3), "where there are multiple 'relevant contracts,' the 'increased cost' to the United States is determined by considering the costs among those contracts in the aggregate." Citing DCAA's January 9, 2002 audit guidance on calculating cost impacts, the court observed that while § 9903.306 does not define decreased costs on fixed-price contracts, "the CAS statute presumes that there can be decreased costs paid by the government since it provides for adjustment to recover only increased costs paid in the aggregate." Decreased costs paid by the United States occur when more costs are accumulated on fixed-price contracts after an accounting change, or when the price negotiated using the noncompliant practice is less than the price that would have been negotiated using compliant practices. Thus, the court concluded, § 9903.306 and even DCAA's January 9, 2002 guidance, when properly interpreted, are consistent with the statutory prohibition against recovery of increased costs in the aggregate.

B. Pension Costs

In *Viacom, Inc. v. United States*, 70 Fed. Cl. 649 (2006), the Court of Federal Claims held that none of the following precludes a contractor's pension deficit claim under either original or revised CAS 413: (1) the contractor's failure to fund the pension deficit in the year of the segment closing; (2) the contractor's failure to comply with notice provisions of the Limitation of Cost and Limitation of Funds clauses; and (3) any general release of claims the contractor may have signed upon receipt of final payment under its closed cost type contracts.. Following its decision in *Teledyne, Inc. v. United States*, the court held that a segment closing that applies revised CAS 413 is a mandatory change in cost accounting practices with regard to pension costs attributable to contracts entered into under original CAS 413, entitling the government to an offsetting equitable adjustment.

C. Allocating Indirect Costs

The ASBCA in *AM General LLC*, ASBCA Nos. 53610 & 54741, 06-1 B.C.A. ¶ 33,190, held that the contractor was in non-compliance with CAS 418 because it failed to establish a separate indirect cost pool for the costs of a building in which only the contractor's commercial "HUMMER" vehicles, and not its military High Mobility Multipurpose Wheeled Vehicles ("HMMWV"), were finished. The ASBCA found it "undisputed that the military HMMWV derived no benefit from the costs incurred in the Armour building because none of the military HMMWVs were manufactured in that building." On that basis alone, ASBCA held that "AM General's single manufacturing overhead pool was not homogeneous in accordance with the requirements of 48 C.F.R. § 9904.418-40(b)." The

board's decision inexplicably fails to address the second required element of a CAS 418-50(b)(2) non-compliance, namely that allocating the costs separately would result in a materially different allocation.

In *Lockheed Martin Corp. v. United States*, 70 Fed. Cl. 745 (2006), discussed above, the Court of Federal Claims found that the contractor's "resource commitment" method of allocating the computer costs based on forecasts that were never revised to reflect actual usage violated CAS 418-40(c)(2) regardless of whether the practice resulted in any increased costs paid by the United States. Brushing aside the contractor's argument that the court need not resolve the CAS compliance issue because there were no increased costs, the court stated that "the root issue whether plaintiff complied with CAS 418 was properly raised by defendant in its cross-motion, leaving plaintiff with no choice but to respond, if it had a response – it could neither rest on its earlier pleadings, nor leap past this liability issue to what is, in effect, a question of damages."

D. Defining "Catastrophic Loss"

The CAS Board on January 26, 2006 published a Staff Discussion Paper soliciting public comments on whether the word "catastrophic" should be replaced with a term such as "significant" or "very large" to eliminate any confusion between CAS 416 and the insurance cost principle at FAR 31.205-19 and more closely align the Standard with what was originally intended. *See* 71 Fed. Reg. 4335 (Jan. 26, 2006).

E. Proposed Changes to FAR Part 30, CAS Administration

The FAR Councils on October 3, 2006 published two proposed rules to revise FAR Part 30. One of the proposed rules is intended to make the FAR consistent with an interim rule published by the CAS Board on May 23, 2005. The interim rule authorized U.K. contractors and subcontractors to file the U.K. Questionnaire on Methods of Allocation of Costs (QMAC) and Supplemental QMAC in lieu of the standard CAS Disclosure Schedule; deleted the CAS exemption at 48 C.F.R. § 9902.201-(b)(12) so that all foreign contracts and subcontracts, including U.K. contracts and subcontracts, are subject to the requirements of CAS 401 and 402; and deleted the clause at 48 C.F.R. § 9903.201-4(d), Consistency in Cost Accounting Practices since the clause is no longer needed for U.K. contracts. The proposed rule would make conforming changes to the FAR by revising FAR 52.230-4, Disclosure and Consistency of Cost Accounting Practices for Contracts Awarded to Foreign Concerns. The second proposed rule would make relatively minor changes to FAR Part 30, the most significant of which would require the cognizant Federal agency official (CFAO) to request and consider the advice of the auditor, as appropriate, when administering the CAS; and add a provision to FAR 30.605 to specify that the cost impact of a noncompliance that affects both cost estimating and cost accumulation shall be determined by combining the separate cost impacts of both. The FAR Councils declined to make the changes requested by industry representatives. In response to concerns that FAR 30.202-6(b), as currently drafted, could preclude contract award when a contractor has submitted a revised Disclosure Statement that has not yet been determined adequate by the CFAO, the Councils stated that the regulations already provide sufficient flexibility, including

waiver authority, to resolve this issue, and the Councils are not aware of any instances in which awards have been delayed pending determinations about the adequacy and/or compliance of revised Disclosure Statements. The Councils also declined to revise the prohibition in FAR 30.606(a) against combining the cost impacts of two or more unilateral accounting changes unless they all result in increased costs.

IX. OTHER REGULATORY DEVELOPMENTS

A. FAR 31.205-11, Depreciation

A final rule that took effect on July 28, 2006, revised the depreciation cost principle to add coverage for the circumstance when a contractor re-acquires title to an asset after a sale and leaseback transaction. *See* FAC 2005-10, Item VI, 71 Fed. Reg. 36939 (Jun. 28, 2006). In that circumstance, allowable depreciation costs are limited to the amount that would have been allowed had the contractor retained title, as adjusted for the rental cost limitation required in connection with a sale and leaseback. DCAA on August 15, 2006 published audit guidance, which points out that the new depreciation limitation applies only to those assets that generated costs in the most recent accounting period prior to the reacquisition. Hence, the guidance notes, the limitation “would not apply in those situations where a contractor has re-acquired an asset subsequent to the passing of a full accounting period after the lease is terminated and the contractor cases use of the asset.”

B. FAR 31.205-18, Independent Research & Development and Bid & Proposal Costs

Industry groups have tried unsuccessfully to convince the FAR Councils to revise the B&P cost principle. In a letter dated June 16, 2006, OFPP Associate Administrator Robert A. Burton rejected a September 17, 2004 request by the National Defense Industrial Association to revise the cost principle by (1) conforming the B&P definition to the CAS 420 definition and the cost principle’s definition of IR&D; and (2) including the words “and B&P” after IR&D whenever it appears in paragraph (e) of the cost principle. NDIA’s request explained that these revisions were necessary to resolve concerns about the allowability and allocability of B&P costs incurred in the context of a teaming arrangement as a result of court’s decision in *United States ex rel. Bagley v. TRW, Inc.* and the ASBCA decision in the related case of *TRW, Inc.* OFPP requested the CAAC and DAR Council to open a new FAR case to address NDIA’s concerns. However, after a complete evaluation of the issues, the Councils concluded: (1) the ruling in the Bagley case was consistent with the intent of FAR 31.205-19; (2) there are not any known cases where Government contracting personnel are misapplying the cost principle; and (3) to date, no *qui tam* suits have been filed in the five years since the Bagley case was decided. Accordingly, the Councils determined that no change should be made to the current FAR language.

C. T&M and L-H Contracts

A final rule that took effect February 12, 2007, revised FAR 52.232-7, Payments Under Time-and-Materials and Labor-Hour Contracts, to define

“hourly rate” as the rates prescribed in the contract for payment for labor that meets the labor category qualifications specified in the contract, regardless of whether the services are performed by the contractor, a subcontractor, or a transfer from a division, subsidiary or affiliate of the contractor under common control. *See* FAC 2005-15, 71 Fed. Reg. 74656 (Dec. 12, 2006). On the other hand, “materials” means (1) direct materials, including supplies transferred between divisions, subsidiaries, or affiliates of the contractor under common control; (2) subcontracts for supplies and incidental services for which there is not a labor category specified in the contract; (3) other direct costs, which may include such things as incidental services for which there is not a labor category specified in the contract, travel and computer usage charges; and (4) applicable indirect costs. The final rule also clarified the rules for indirect costs for materials and other direct costs. Paragraph (b)(5) of the amended clause permits the contractor to include in its material costs, allocable indirect costs and other direct costs to the extent they are (1) comprised only of costs that are clearly excluded from the hourly rate, and (2) allocated in accordance with the contractor’s written or established accounting practices. It further provides that indirect costs may not be applied to subcontracts that are paid at the hourly rate. In addition to revising the definitions of “hourly rates” and “materials” and clarifying the rules for indirect costs and other direct costs, the final rule also added three new solicitation provisions to direct how proposals address subcontract labor. For non-commercial item acquisitions that are to be awarded on the basis of adequate price competition, the solicitation provision requires the offeror to specify whether its proposed fixed hourly rates for each labor category apply to labor performed by (1) the offeror, (2) subcontractors, and/or (3) divisions, subsidiaries, or affiliates under a common control. *See* FAR 52.216-29, Time-and-Materials/Labor-Hour Proposal Requirements – Non-Commercial Item Acquisition with Adequate Price Competition (Feb. 2007). In addition, the offeror must establish fixed hourly rates using either (1) separate rates for each category of labor to be performed by the offeror, each subcontractor, and through interdivisional transfers; (2) blended rates for each category of labor; or (3) any combination of separate and blended rates for each category of labor. Although the solicitation provision gives offerors considerable flexibility in pricing their proposals, the FAR permits agencies to adopt procedures authorizing the contracting officer to select one of the three options as mandatory, and/or to require each offer to identify individual subcontractors in its proposal. Exercising this authority, DoD on December 12, 2006, published an interim rule making mandatory the option requiring separate fixed hourly rates for each category of labor performed by the contractor and each subcontractor, and for each category of labor transferred between divisions, subsidiaries, or affiliates under a common control. *See* 71 Fed. Reg. 74469 (Dec. 12, 2006) (adding DFARS 216.601). For non-commercial item contracts awarded without adequate price competition, the solicitation provision requires the offeror to specify separate fixed hourly rates for each category of labor to be performed by (1) the offeror, (2) each subcontractor, and (3) each division, subsidiary, or affiliate of the offeror under a common control. *See* FAR 52.216-30, Time-and-Materials/Labor-Hour Proposal Requirements – Non-Commercial Item Acquisition without Adequate Price Competition (Feb. 2007). The provision also states that the fixed hourly rates for interdivisional transfers shall not include profit for the transferring organization, but may include profit for the prime

contractor. However, the fixed hourly rates for interdivisional transfers of services that meet the FAR 2.101 definition of commercial item may be the established catalog or market rate when it is the established practice of the transferring organization to price interorganizational transfers at other than cost for commercial work of the offeror or any division, subsidiary or affiliate under a common control. The solicitation provision for commercial item acquisitions simply requires the offer to specify whether the fixed hourly rate for each labor category applies to labor performed by (1) the offeror, (2) subcontractors, and/or (3) divisions, subsidiaries, or affiliates of the offeror under a common control. *See* FAR 52.216-31, Time-and-Materials/Labor-Hour Proposal Requirements – Commercial Item Acquisition (Feb. 2007).

D. Use of T&M and L-H Contracts for Commercial Services

Another final rule that took effect on February 12, 2007 allows the use of T&M and LH contracts for commercial services if the following four requirements are met: (1) the service is acquired under a competitively awarded contract or task order; (2) the contracting officer executes a determination and findings (“D&F”) that no other contract type authorized for commercial item contracts is appropriate; (3) there is a ceiling price in the contract or order that the contractor exceeds at its own risk; and (4) any subsequent change in the ceiling price is made only upon a determination, documented in the contract file, that it is in the best interest of the procuring agency to change the ceiling price. *See* FAC 2005-15, 71 Fed. Reg. 74656 (Dec. 12, 2006). In addition, the final rule revised FAR 16.601 to require, for both commercial and non-commercial item contracts, that the D&F to use a T&M or LH contract must be approved by the head of the contracting activity when the contract period, including options, will exceed three years. The final rule also established an extensive Alternate I for FAR 52.212-4, Contract Terms and Conditions – Commercial Items, to be used when a T&M or LH contract is contemplated. The new Alternate I replaces the following paragraphs in the basic clause: (a) Inspection/Acceptance, (e) Definitions, (i) Payments, and (l) Termination for the Government’s Convenience. Alternate paragraph (a) is similar to FAR 52.246-6, Inspection – Time-and-Material and Labor-Hour, used for non-commercial item contracts, in that it provides for the contractor to be reimbursed for rework at the fixed hourly rates reduced to exclude profit (except that the profit rate is presumed to be 10% unless otherwise specified). Alternate paragraph (e) uses the same definitions of “hourly rate” and “materials” as used in the newly revised FAR 52.232-7, Payments Under Time-and-Materials and Labor-Hour Contracts. Alternate paragraph (i) is likely to prove the most controversial for at least three reasons. First, it limits the reimbursement of other direct costs to those listed in the contract or order. Second, it provides for the reimbursement of indirect costs, including but not limited to material handling and subcontract administration) on a pro-rata basis over the period of contract performance at a specified fixed price. The Councils rejected recommendations to permit use of a fixed rate for indirect costs, stating that they “believe use of a fixed rate violates the cost plus percentage of cost contract prohibition.” Third, it contains a broad access to records provision that includes the right to interview employees whose time has been included in any invoices under the contract. Alternate paragraph (l) provides that, in the event of

a termination for convenience, the contractor will be paid for direct labor hours expended before termination at the hourly rates specified in the contract (less any payments already made), plus reasonable charges resulting from the termination that the contractor can demonstrate to the government's satisfaction using its standard record keeping system. The final rule does not address the disconnect between the CAS exemption for commercial item contracts, which is limited to firm-fixed-price and fixed-price with economic price adjustment contracts, and the new FAR provisions permitting the use of commercial T&M and LH contracts. The Councils stated that "[t]he decision as to whether CAS applies to commercial T&M/LH contracts rests with the CAS Board."

E. Performance-Based Payments

The FAR Councils on December 14, 2006, published a proposed rule on the use of performance-based payments ("PBP"). *See* 71 Fed. Reg. 75,186 (Dec. 14, 2006). The proposed rule is intended to increase and improve the efficiency of the use of performance-based payments. Among other things, the proposed rule would specifically address when PBP may be used, including for fixed-price line items and orders, and on indefinite delivery/indefinite quantity contracts. It would also clarify that events not requiring meaningful effort or action must not be included as events or criteria for PBP. Finally, and perhaps most helpfully, the proposed rule would clarify that the contracting officer cannot limit the amount of a PBP payment to a percentage of actual incurred cost for the scheduled event or performance criteria.

F. Submission of Cost or Pricing Data on Noncommercial Modifications of Commercial Items

A final rule that took effect on July 28, 2006, amended the interim rule published on June 8, 2005, and implements Section 818 of the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005. *See* 71 Fed. Reg. 36927 (June 28, 2006). Section 818 amended 10 U.S.C.A. § 2306a to provide that the exception from the requirement to obtain certified cost or pricing data for a commercial item does not apply to noncommercial modifications of a commercial item that are expected to cost, in the aggregate, more than \$500,000 or 5 percent of the total price of the contract, whichever is greater. Section 818 applies to offers submitted, and to modifications of contracts or subcontracts made, on or after June 1, 2005. The statute applies only to contracts or task or delivery orders funded by DoD, NASA, or the Coast Guard, including contracts or task or delivery orders awarded by other agencies using funds provided by DoD, NASA, or the Coast Guard. The change to the interim rule clarifies that the threshold applies to the instant contract action, not to the total value of all contract actions and, as applicable to subcontractors, the threshold applies to the value of the subcontract, not the value of the prime contract.

G. TINA Threshold

A final rule that took effect September 28, 2006 adjusted the TINA threshold for inflation to \$650,000. *See* 71 Fed. Reg. 57363 (Sep. 28, 2006).

NOTES

H. Micro-Purchase Threshold

A final rule that took effect September 28, 2006 adjusted the micro-purchase threshold for inflation to \$3,000. *See* 71 Fed. Reg. 57363 (Sep. 28, 2006). The threshold remains \$2,500 for services subject to the Service Contract Act, and \$2,000 for construction subject to the Davis-Bacon Act. The simplified acquisition threshold was not adjusted.