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The Contract Disputes Act Statute Of Limitations: Take Your Time, DOD

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While the Department of Defense looks to achieve massive efficiency savings, the Defense Contract Audit Agency and the Defense Contract Management Agency are faced with the harsh reality that millions of dollars of disputed contract costs may be lost because the agencies failed to act within the six-year statute of limitations specified in the Contracts Disputes Act. Conversely, from a contractor's perspective, one bright side to the current state of audit and contract administration gridlock is that it may provide contractors opportunities to clear out the growing backlog of audit issues and preclude otherwise meritorious Government claims.

The CDA's Statute of Limitations

On Oct. 13, 1994, President Clinton signed into law the Federal Acquisition Streamlining Act of 1994.² FASA is perhaps best remembered for establishing a preference for commercial "off-the-shelf" items. However, a less celebrated provision of FASA was the establishment of a six-year statute of limitations for claims under the CDA. As amended by FASA, the CDA requires that "Each claim by a contractor against the Federal Government relating to a contract and each claim by the Federal Government against a contractor relating to a contract shall be submitted within 6 years after the accrual of the claim."³ The U.S. Court of Appeals for the Federal

Circuit has held that the six-year statute of limitations is a jurisdictional prerequisite, but also subject to equitable tolling.⁴

FASA did not establish an applicability date for the CDA statute of limitations, nor define the "accrual of the claim." Both were subsequently established in the Federal Acquisition Regulation. More specifically, FAR 33.206(b) states that the six-year statute of limitations applies to contracts awarded on or after Oct. 1, 1995, and FAR 33.201 defines the "accrual of the claim" as:

The date when all events, that fix the alleged liability of either the Government or the contractor and permit assertion of the claim, were known or should have been known. For liability to be fixed, some injury must have occurred. However, monetary damages need not have been incurred.

The FAR applicability date was tested and upheld in *Motorola, Inc. v. West*.⁵ However, the precise contours of the "accrual of the claim," i.e., the date when the clock starts ticking for the six-year statute of limitations, are continuing to evolve through case law.

Claim Accrual Dates

In *Gray Personnel, Inc.*, the first case to address the newly enacted limitations period, the Armed Services Board of Contract Appeals applied the CDA statute of limitations to a requirements contract on a delivery order-by-delivery order basis.⁶ 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 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 FAR 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 unnecessary 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 Const. Co., Inc.*, 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.⁷

The ASBCA dismissed an appeal arising out of a construction contractor’s claim for impact and delay costs because the claim was submitted six years and one day after construction was completed, even though the contractor continued to perform “punch list” work.⁸ The ASBCA rejected the contractor’s arguments that the complexity of the claim warranted a longer period, and that the extent of costs incurred could not have been known until after completion of work on the contract. Following *Gray Personnel*, the ASBCA held that “for a claim to accrue, the contractor must have actually begun performance and incurred some extra costs for liability to be fixed,” but it is not necessary that the change or contract be completed for liability to be fixed. Finding that “all of the events which fixed the alleged liability of the government were known or should have been known by 1 June 1999 [when work on the contract was complete],” the ASBCA held that the contractor’s claims were time-barred and dismissed the appeal.

In *DynCorp International LLC*, the ASBCA applied the “continuing claim” doctrine to hold that the portions of DynCorp’s mistake in bid claim attributable to the contract option years were timely even if the portion attributable to the base year was not.⁹ The board stated:

With respect to the option years, we believe the claim is subject to the continuing claim doctrine which we have determined to have application to government contract cases. Under that doctrine, a “claim must be inherently susceptible to being broken down into a series of independent and distinct events or wrongs, each having its own associated damages.” Only the base year was initially awarded. Each subsequent year was to be separately awarded at the government’s option. Thus, if the government chose not to award additional option years, there would be no claim for those years. Therefore, the portions of the claim attributable to each option year are distinct events with its own associated damages. *Gray Personnel* at 165,476–77, citing *Brown Park Estates-Fairfield Development Co. v. United States*, 127 F.3d 1449–1456 (Fed. Cir. 1997). Option Year 1 was awarded on 30 January 2001 and the certified claim was submitted on 25 January 2007, less than 6 years later. Thus the claims for Option Year 1 and those options thereafter exercised are properly before us.

The ASBCA held in *Todd Pacific Shipyards Corp.* that a breach of contract claim could not accrue before contract award, even if the parties’ accounting dispute predated the contract.¹⁰

Finally, the ASBCA found a Government defective-pricing claim time-barred by the CDA’s statute of limitations in *McDonnell Douglas Services, Inc.*¹¹ The ASBCA explained that “[i]n evaluating when the claimed liability was fixed,” the board “first examine[s] the legal basis of the claim.” For “a defective pricing claim, the government is required to prove that: (1) the information in dispute is ‘cost or pricing data’ under TINA; (2) the cost or pricing data was not meaningfully disclosed; and (3) the government relied to its detriment upon the inaccurate, noncurrent or incomplete data presented by the contractor.” And, “once nondisclosure is established a rebuttable presumption arises that a contract price increase was a natural and probable consequence of that disclosure.” *McDonnell Douglas Helicopter Sys.*, ASBCA 50447 et al., 00-2 BCA ¶ 31,082. Citing *Gray Personnel*,

the ASBCA noted: “Once a party is on notice that it has a potential claim, the statute of limitations can start to run.” In addition, the board observed, “[w]hen monetary damages are alleged, some extra costs must have been incurred before liability can be fixed and a claim accrued, but there is no requirement that a sum certain be established.”

The ASBCA in *McDonnell Douglas Services, Inc.* held that it did not need to determine the precise date that the Government knew or should have known the facts necessary to establish the claim because “the undisputed and uncontrovertible facts demonstrate that the government had established the basis for its defective pricing claim against the prime contractor well before, and definitely no later than, 14 May 2002, more than six years before the COs’ June 2008 decisions issued.” In the same case, the ASBCA rejected the Government’s arguments that:

- The Board should interpret the CDA’s six-year limitation period more liberally for a Government claim.
- The Government does not have the requisite knowledge when only the auditor, and not the Contracting Officer, is in possession of the facts.

Because the Government’s defective pricing claims accrued more than six years prior to the CO’s decisions asserting them, the ASBCA held that the claims were time-barred by the CDA statute of limitations, and consequently, the Government’s claims were “not viable and cannot be considered.”

While *McDonnell Douglas Services, Inc.* and the other decisions discussed above answer several important questions, they do not answer perhaps the most important question—precisely when does the clock start ticking for defective pricing and other Government claims? Besides defective pricing claims, issues that commonly result in Government claims include Cost Accounting Standards noncompliances, changes in cost accounting practices, final indirect cost rate differentials and associated penalties for expressly unallowable costs, and questioned direct costs. In recent years, the number of Government claims has more than doubled.¹² If contractors understand when the clock starts ticking for each, they can develop strategies to settle time-barred issues without having to resort to litigation.

So When Does the Clock Start?

A Government claim for a *CAS noncompliance or failure to follow the contractor’s disclosed or established cost accounting practices* should accrue no later than the occurrence of all three of the following events:

- (1) The contractor begins following the noncompliant or inconsistent practice,
- (2) Some increased costs are paid as a result thereof, and
- (3) The Government knows or should know of the noncompliance.

For a noncompliant practice described in the contractor’s Cost Accounting Standards Board Disclosure Statement, the Government has constructive knowledge upon the contractor’s submission of the Disclosure Statement. For an undisclosed noncompliance, the Government should be charged with constructive knowledge—and the claim should accrue—on the date of the earliest Government audit work paper identifying the audit lead.

Similarly, a Government claim for the *cost impact of a disclosed change in cost accounting practice* should accrue as soon as:

- (1) The contractor implements the changed practice,
- (2) Some increased costs are paid as a result thereof, and
- (3) The contractor notifies the Government of the change.

A Government claim for the cost impact of an *undisclosed* change in cost accounting practice should be treated the same as a Government claim for an undisclosed CAS noncompliance for purposes of applying the CDA statute of limitations.

A Government claim to *disallow indirect costs* should accrue as soon as:

- (1) The contractor first claims and the Government reimburses the unallowable cost, and
- (2) The contractor submits its final indirect cost rate proposal for the fiscal year in which the cost was first incurred.

A Government claim to assess *penalties in connection with any such expressly unallowable costs* should accrue at the same time. On the other hand, a Government claim to disallow *direct costs* arguably should—given the greater visibility of such costs—accrue as soon as:

- (1) The contractor first claims the unallowable cost, and
- (2) The Government reimburses it.

At the latest, a Government claim to disallow a *direct cost* should accrue at the earlier of (i) any DCAA Form 1 or other notice questioning the cost, or (ii) the contractor's incurred cost submission for the first fiscal year in which the cost was incurred.

Finally, a Government defective pricing claim should accrue as soon as:

- (1) The final “handshake” on price, and
- (2) The earlier of (i) the date the CO first learns or should have learned that the cost or pricing data was incomplete, noncurrent, or inaccurate, or (ii) the date of the earliest Government audit work paper identifying a defective pricing audit lead.

The Growing Backlog of CDA Issues

Luckily for contractors, the Government has been asleep at the switch for a long time, perhaps long enough for many potential Government claims to now be time-barred. And while the Government was sleeping, the backlog of unresolved issues potentially affected by the CDA statute of limitations grew and aged significantly. DOD is awake not but its continued focus on contractor business systems will ensure that the backlog of unresolved CDA issues will continue to grow and age. As a result, contractors will continue to benefit from DOD's inability to initiate timely Government claims. Just how big is DOD's current backlog?

Within DOD, issues that result in CDA claims are generally first identified by a DCAA audit. In accordance with DOD Instruction 7640.02, DOD tracks administrative contracting officers' resolution of DCAA audits and the DOD Inspector General reports summary level data on the status of the audit findings

in its Semi-Annual Report to Congress. ACOs are expected to take all required actions on DCAA findings and recommendations within 12 months after the date the audit report is issued. However, in its Sept. 30, 2008 Semi-Annual Report to Congress, the DOD IG reported that 513 DCAA audits had not been resolved within the 12 month timeline.

In 2008, DCMA increased its focus on the overage audits. However, those efforts appear to have been inadequate. In 2010, DCMA reported overage audits as a material weakness in the agency's 2010 Statement of Assurance. In an effort to improve performance, the DCMA Director in April 2010 reviewed the unresolved overage audits that were more than four years old. Audits more than four years overage are by definition audit reports that the ACOs have not resolved five or more years after the date of the audit report. Since the clock starts ticking for all CDA issues before the audit reports are issued, many of the unresolved audit issues were likely time-barred by the time of the Director's review.

In addition, tracking audit resolution is not enough to ensure that the underlying audit issues are resolved in time. On August 17, 2010, the DOD IG issued a “Notice of Concern” to alert DCMA about a languishing DCAA audit report and potential CDA statute of limitation issues. The DCAA audit report, issued on June 14, 2002, identified a \$7.4 million dollar cost impact that resulted from unilateral cost accounting changes that were implemented by a segment of a major aerospace contractor on January 1, 2001. On September 17, 2003, the cognizant ACO deemed the changes to be adequate and compliant but not desirable to the Government. As such, the Government would not pay any resulting increased costs. The DOD IG found that eight years after the audit report had been issued, the ACO had failed to recoup the \$7.4 million in increased costs and noted that failing to assert the claim within the six-year statute of limitation could jeopardize the Government's ability to recover the costs.

In its Aug. 30, 2010 response to the DOD IG's Notice of Concern, DCMA said that they had identified 94 additional unresolved cost impacts at another segment of the same aerospace contractor that were not tracked and not required to be tracked in the DOD's Contract Audit Follow-Up (CAFU) system. Some of these unresolved cost impacts dated back to

accounting changes made as early as 2000. DCMA told the DOD IG:

In accordance with the DoDI 7640.02, Policy for Follow-Up on Contract Audit Reports, Cost Accounting Standards (CAS) noncompliance audits (DCAA activity code 19200) are “dispositioned” in CAFU when the administrative contracting officer (ACO) issues a written final determination of compliance or noncompliance. Any associated CAS cost impact audit reports are “dispositioned” when the ACO executes a bilateral modification that resolves the cost impact or issues a final decision and unilaterally adjusts the contracts in accordance with FAR 30.606, Resolving Cost Impacts. In the period between disposition of the CAS noncompliance report and receipt of the audit report on the CAS cost impact, CAFU does not track the unresolved cost impacts. In addition, audits on contractors’ CAS Disclosure Statements (DCAA activity code 19100) are not even tracked in CAFU. Like the CAS noncompliance audits, many of these audits subsequently result in required cost impacts.

In addition, DCMA committed to take immediate action to identify all unresolved cost impacts with statute of limitations issues. DCMA stated:

... [W]e are implementing a three phase strategy to fully assess the severity of, and reasons for, this situation. Phase one will identify the comprehensive list of unresolved cost impacts. *Phase two will identify the unresolved cost impacts with statute of limitations issues* and reasons contractual remedies were not pursued. Phase three will be to put in place a resolution plan based on the findings from phases one and two.

As we proceed, we will work with DCAA to ensure that we have adequate controls and procedures to prevent future occurrences. While the Department currently tracks the resolution of individual audits, the Department does not currently track the overall resolution of the underlying issue. As the six year statute of limitations applies to the resolution of the underlying issues, we are working with DCAA to develop a mechanism to effectively track timely resolution of the underlying issues.¹³

Soon after responding to the DOD IG, the directors of DCMA and DCAA announced a joint “Cost Recovery Initiative.” In their joint October 29, 2010 memorandum, the agency directors said:

The Defense Contract Management Agency (DCMA) and Defense Contract Audit Agency (DCAA) are launching a joint agency initiative aimed at aggressively targeting contractual opportunities to recover taxpayer dollars by dispositioning reportable audits, suspended/disallowed costs, cost accounting proactive changes, and other cost allowability and allocability issues. This Cost Recovery Initiative is a coordinated plan to prioritize our collective efforts to recover costs and close audit issues.

Currently, there are almost 400 reportable audits and about 300 Form 1s valued at \$295M that are awaiting the Administrative Contracting Officers’ (ACOs) disposition. Additionally, there are a substantial number of other open cost allowability and allocability issues awaiting resolution.

Our goal is not only returning needed funds to the Department and the American taxpayer; but, clearing backlogs of issues that will enable the Department and contractors to move forward and focus on current contracting challenges, as well. The potential for monetary return and other benefits from this effort requires that we place a high-priority on the successful disposition of these matters.¹⁴

By January 2011, the number of identified unresolved audits had grown from almost 400 to over 450.¹⁵ In February 2011, DCMA reported to industry that the number had grown to 705. And these numbers are just the unresolved reportable audits—they do not include approximately 300 DCAA Form 1s valued at \$295 million or the “substantial number of other open cost allowability and allocability issues.” Further, the numbers do not include any “languishing” audits or audit issues for DOD contracts not administered by DCMA or the civilian agencies.

The Cost Recovery Initiative appears to be an almost heroic attempt to resolve reportable audits and Form 1s before any Government claims to disallow the costs become time-barred under CDA. But what about the audit reports that DCAA has yet to issue? As discussed earlier, the CDA clock could start ticking on incurred cost proposals upon the contractor’s submission. Will the risk of time-barred claims under the CDA statute of limitations be enough to get the auditors auditing costs again?

In its final report to Congress, the Commission on Wartime Contracting in Iraq and Afghanistan stated that at current staffing levels, DCAA’s backlog

of unaudited incurred costs will exceed \$1 trillion in 2016.¹⁶ While DCAA staffing may be an issue, other issues seem to be contributing to the steep decline in the number of completed audits. The two most significant of which are GAO's audit criticizing DCAA¹⁷ and DCAA's obsession with contractor's business systems.¹⁸

Since the GAO issued its now infamous report in July 2008, the number of DCAA issued audits has dropped sharply.

	2008	2009	2010
Number of Audits	30,352	21,276	11,731

The trend continues in 2011. For the six months ending March 2011, the DOD IG reported that DCAA completed 3,821 "reportable audits," 35 percent fewer than reported for the same period in 2010. Hardest hit have been the audits that commonly result in Government claims under the CDA. For example, the number of incurred cost audits issued has dropped 77 percent and the number of CAS audits has dropped 60 percent since the GAO report was issued. The reality is that DCAA has more staff than it had in 2008 so simply adding more staff does not seem to be the cure. While the backlog continues to grow, DCAA is focusing its limited resources on the discretionary business system audits instead of core cost audits that commonly result in claims. Ironically, many potential CDA claims will be time-barred before DCAA even starts its audit. At that point, why bother auditing? For contractors, DCAA's misplaced focus on internal controls rather than actual costs incurred could be the silver lining in the dark cloud created by DOD's new business systems rule.

What Contractors Can Do

The CDA statute of limitations can be an effective shield against Government claims. Providing early written notification to the cognizant ACO of changes in cost accounting practice or potentially disputed costs or cost accounting practices may expedite (and provide evidence to establish) the accrual of potential Government claims and avoid claims that the limitations period should be equitably tolled.

Contractors should also be alert to the possibility that the Government may assert time-barred claims. Because the Federal Circuit has held that the CDA statute of limitations is jurisdictional, a litigant should be able to assert a statute of limitations defense at any point in the proceedings. On the other hand, a contractor that agrees to *settle* an untimely claim will likely be bound by the settlement agreement even if the underlying claim was time-barred. It is unlikely that DCAA in conducting its audit or the ACO in asserting a Government claim will inform the contractor that the Government's claim is time-barred. Thus, it would be prudent for contractors to keep track of the "ticking clock" on all aging issues, and document each time that the Government knew or should have known of the issue. Doing so, and challenging any asserted issues that are likely time-barred, could be an effective strategy for clearing out the backlog of audit issues without the need for litigation.

The CDA statute of limitations also applies to contractors' claims against the Government. Therefore, contractors should also keep track of the "ticking clock" on all aging issues that may ultimately be disputed and ensure that, when necessary, claims are filed timely.

❖ Endnotes

- 1 Robin Schulze is a Director in Baker Tilly's Government Contractor Advisory Services practice. Prior to joining Baker Tilly, Robin was the Director of Contract Policy at the Defense Contract Management Agency. Karen L. Manos is a partner resident in the Washington, DC office of Gibson, Dunn & Crutcher, LLP, and co-chair of the firm's Government and Commercial Contracts Practice.
- 2 P.L. 103-355, § 2351, 108 Stat. 3243, 3322 (1994).
- 3 41 USCA § 7103(a)(4)(A). There is an exception for claims involving fraud. See 41 USCA § 7103(a)(4)(B) ("Subparagraph (A) of this paragraph does not apply to a claim by the Federal Government against a contractor that is based on a claim by the contractor involving fraud."). This exception may explain the sharp increase we are seeing in fraud referrals for routine, but aging, contract cost accounting matters.
- 4 See Arctic Slope Native Association, Ltd. v. Sebelius, 583 F.3d 785 (Fed. Cir. 2009), cert. denied 130 S. Ct. 3505, 177 L. Ed. 2d 1091 (2010); but see Menominee Indian Tribe of Wisconsin v. U.S., 614 F.3d 519 (D.C. Cir. 2010) (holding that the CDA's six-year statute of limitations is a claim-processing rule rather than a prerequisite to the court's jurisdiction).
- 5 See Motorola, Inc. v. West, 125 F.3d 1470 (Fed. Cir. 1997).
- 6 Gray Personnel, Inc., ASBCA 54652, 06-2 BCA ¶ 33,378.
- 7 Emerson Const. Co., Inc., ASBCA 55165, 06-2 BCA ¶ 33,382.
- 8 Robinson Quality Constructors, ASBCA 55784, 09-1 BCA ¶ 34,048, appeal dismissed, 2010 WL 1816478 (Fed. Cir. 2010).
- 9 Dyncorp Int'l LLC, ASBCA 56078, 09-2 BCA ¶ 34,290.

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- 10 Todd Pacific Shipyards Corp., ASBCA 55126, 10-1 BCA ¶ 34,368.
 - 11 McDonnell Douglas Services, Inc., ASBCA 56568, 10-1 BCA ¶ 34,325.
 - 12 See Appendix E to DOD IG's Semiannual Report to Congress.
 - 13 See DOD IG Report D-2011-6-006, "Hotline Allegation Regarding the Failure of Defense Contract Management Agency Philadelphia to Settle an Audit of a Significant Cost Accounting Change" (March 22, 2011).
 - 14 Memorandum from Patrick J. Fitzgerald and Charlie E. Williams, Jr., "Cost Recovery Initiative" (Oct. 29, 2010).
 - 15 See DCAA MRD, "Audit Guidance on DCMA/DCAA Cost Recovery Initiative (CRI) and Related Rough Order of Magnitude (ROM) Calculations for Unresolved CAS Cost Impact Issues" (11-PAC-001(R)) (Jan. 18, 2011).
 - 16 Commission on Wartime Contracting in Iraq and Afghanistan Final Report to Congress, *Transforming Wartime Contracting: Controlling Costs, Reducing Risks* (August 2011).
 - 17 See, e.g., GAO, *DCAA Audits: Allegations that Certain Audits at Three Locations did not meet Professional Standards were Substantiated* (GAO-08-857) (July 2008). For an interesting discussion of the GAO reports and their consequences, see the Feature Article in the March 2010 issue of this REPORT, Richard C. Loeb, "GAO vs. DCAA—And the Winner Is? ... Contractors," 5 CP&A Rep. ¶ 15.
 - 18 See e.g., Karen L. Manos, "Contractor Business System Audits: The Coming Train Wreck," 5 CP&A Rep. ¶ 52.