SESSION 8

COST & PRICING ISSUES*

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I. ALLOWABILITY OF COSTS

A. Independent Research & Development Costs

We reported two years ago that the U.S. District Court for the Eastern District of Virginia held in *U.S. v. Newport News Shipbuilding, Inc.*, 276 F. Supp. 2d 539 (E.D. Va. 2003), that work *implicitly* required by a contract does not qualify as IR&D. The *Newport News* court stated that the dividing line between IR&D and work required in the performance of a contract is not whether the work is explicitly or implicitly required, but rather, whether the work is performed before or after the contract is signed. The Court of Federal Claims reached the opposite result on similar facts in *ATK Thiokol, Inc. v. U.S.*, 2005 WL 3216923 (Fed. Cl. Nov. 30, 2005). Relying on CAS 402 Interpretation No. 1 and the Federal Circuit's decision in *Boeing Co. v. U.S.*, 862 F.2d 290 (Fed. Cir. 1989), the Court of Federal Claims held that "whether a cost is 'required in the performance of a contract' is controlled by the contracting parties' intent, as determined by traditional contract interpretation on a case-by-case basis." ATK Thiokol's commercial contract expressly excluded certain development costs that were implicitly required to perform the contract. Finding that the development costs were properly allocated as indirect costs across all of Thiokol's contracts, both government and commercial, and noting that the Government did not contend the costs were unreasonable, the court held that the costs were allowable under FAR 31.205-18(c).

B. Legal Fees

In *Fluor Hanford, Inc. v. U.S.*, 66 Fed. Cl. 230 (2005), the Court of Federal Claims held that the costs of successfully defending against a *qui tam* suit in which the U.S. does not intervene are limited to 80 percent. Following *Boeing North American, Inc. v. Roche*, 298 F.3d 1274 (Fed. Cir. 2002), the court held that FAR 31.205-47(c)(2) applied retroactively to Fluor's contract awarded in 1996.

Similarly relying on *Boeing*, the ASBCA held in *Southwest Marine, Inc.*, ASBCA No. 54,234, 2005-1 BCA ¶ 32,892, that costs incurred in the unsuccessful defense of a citizen's suit for violation of the Clean Water Act were "similar" to costs made unallowable by FAR 31.205-47(b)(2) and were therefore unallowable.

In *S.A.S. Bianchi UGO FU Gabbriello*, ASBCA No. 53800, 05-2 BCA ¶ 33089, the ASBCA held that the contractor was entitled to repayment of a progress payment that was mistakenly transmitted to the contractor's formerly designated bank, after the contractor had notified the government that payments should be transmitted to a different bank, because the old bank refused to release the funds to the contractor. However, the board denied the contractor's claim for legal costs incurred in litigation with its suppliers and subcontractors as a result of the contractor's failure to make timely payments.

C. State Taxes

In *Greenwood Associates, L.P. v. Perry*, 399 F.3d 1317, 1319 (Fed. Cir. 2005), the Federal Circuit held that "the phrase 'taxes paid for' a certain year refers to taxes *accrued* during that year,

regardless of when those taxes are actually paid." Accordingly, the court held that the Government was not liable, under a tax adjustment clause in the contractor's lease, for a tax increase that took effect in the base year of lease, even though it was not payable until following year.

The Court of Federal Claims held in *Information Systems & Networks Corp. v. U.S.*, 64 Fed. Cl. 599 (2005), that the contractor was not entitled to reimbursement for state income tax payments incurred under its negotiated fixed-price contracts because even if the contracting officer, in negotiating the contract's fixed price, erroneously believed the costs were unallowable, not every allowable cost must be specifically represented, or recaptured, in a fixed-price contract. The court stated: "Unlike cost-reimbursement contracts, the focus of a fixed-price negotiation is on total price, rather than individual costs. While a fixed-price negotiation may rely on cost principles to establish a frame of reference for negotiating the overall price, the goal of the negotiation is not to remunerate the contractor for each individual allowable cost. Instead, the goal is to reach a 'fair and reasonable' price based upon the universe of costs."

II. CONTRACT PRICING AND RELATED CLAUSES

A. "Illegal" Contract Terms

In *Short Brothers, PLC v. U.S.*, 65 Fed. Cl. 695 (2005), the contractor filed suit against the U.S. seeking to recover cost overruns on a firm-fixed-price development contract to supply the Army National Guard with a commercial aircraft converted to a military aircraft. The contractor experienced cost overruns of almost $60 million on a $150 million contract. In an earlier proceeding, the Court of Federal Claims ruled against the contractor on its claims based on the illegal contract type and impossibility. The court then granted summary judgment in favor of the Government on all of the contractor's alternative theories of liability, including commercial impracticability, superior knowledge, and mutual mistake.

In *Gould, Inc. v. U.S.*, 66 Fed. Cl. 253 (2005), the Court of Federal Claims held that the contractor was not entitled to any relief based on Navy's violation of the statutory and regulatory requirements for multiyear contracts. The court stated that: "In order for a contractor to assert a claim founded in a statutory violation, the Plaintiff must show that the provision was intended by Congress for the benefit of the contractor. Or, framed in the negative, a contractor may not rely on the violation of a provision intended for the benefit of the government."

The Court of Federal Claims in *United Pacific Ins. Co. v. U.S.*, 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 with-

out following the legislative oversight procedures required for major military construction projects are not enforceable through private causes of action.

Fluor Enters., Inc. v. U.S., 64 Fed. Cl. 461 (2005), involved a Government claim, asserted three years after contract performance, demanding repayment of fees that allegedly exceeded the 6 percent limitation for architect-engineering (A&E) services. The contract at issue in the case was very broad and somewhat open-ended, requiring Fluor to provide comprehensive project planning and construction management, including A&E services, on a level-of-effort basis. 64 Fed. Cl. at 465. Because the agency failed to make a *pre-contract* estimate of the cost of the construction projects, the court held that the A&E portion of the contract was *void ab initio*. 64 Fed. Cl. 491-92. However, because the contract was fully performed, the court held that Fluor was entitled to the reasonable value of its services under an implied-in-fact contract theory. 64 Fed. Cl. at 497.

The ASBCA held in *MPR Assocs., Inc.*, ASBCA No. 54689, 2005 WL 2840533 (ASBCA Oct. 27, 2005), that the Government was bound by an ACO's oral agreement to allow a cost made unallowable by FAR 31.205-36(b)(3) because there was no "plain illegality" and the ACO's interpretation of the cost principle was not "clearly unreasonable."

B. Economic Price Adjustment Clauses

We reported two years ago about a three-way split in the Court of Federal Claims' decisions involving the Defense Energy Support Center's EPA clause included in numerous contracts for the supply of jet fuel. The Federal Circuit held in *Tesoro Hawaii Corp. v. U.S.*, 405 F.3d 1339 (Fed. Cir. 2005), that DESC's market-based EPA clause was consistent with FAR 16.203-1.

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

In *Lear Siegler Services, Inc*., ASBCA No. 54449 (April 11, 2005), both the predecessor and successor contractors' collective bargaining agreements (CBAs) provided for health and welfare (H&W) benefits in the form of a "defined-benefit" plan. After the Government exercised the first option year, the contractor submitted a request for equitable adjustment under FAR 52.222-43, Fair Labor Standards Act and Service Contract Act – Price Adjustment (Multiple Year and Option Contracts). Relying on actuarial premiums, the contractor requested a price adjustment to cover anticipated increases in its H&W costs for the first option year. The ASBCA denied the appeal, holding that a contractor subject to a CBA that provides "defined benefit" H&W benefits is not entitled to a price adjustment for the increased cost of providing benefits 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. Accordingly, because the contractor's increased costs did not result from compliance with a wage determination, the ASBCA denied the appeal.

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D. "Subject to the Availability of Funds"

We reported two years ago that in one of the few cases to interpret the phrase, "subject to the availability of funds," the Federal Circuit held in *Thompson v. Cherokee Nation of Oklahoma*, 334 F.3d 1075 (Fed. Cir. 2003), that the Department of Health and Human Services breached its contract with the Cherokee Nation of Oklahoma by failing to reprogram funds to satisfy its payment obligations under the contract. The court held "that there were available appropriations to pay the appellee its full indirect costs, because there were no statutory caps on funding in the appropriations acts for the relevant fiscal years, and that the Secretary has not shown that full payment would require the Secretary 'to reduce funding for programs, projects, or activities serving [another] tribe.'" The Tenth Circuit reached the opposite result on the same issue involving the same statute. See *Cherokee Nation of Okla. v. Thompson*, 311 F.3d 1054, 1066 (10th Cir. 2002). The Supreme Court on March 1, 2005 affirmed the Federal Circuit decision, reversed the Tenth Circuit decision, and remanded both cases. See *Cherokee Nation of Oklahoma v. Leavitt*, 543 U.S. 631 (2005).

III. TERMINATION PRICING

In *Lockheed Martin Corp. v. England*, 424 F.3d 1199 (Fed. Cir. 2005), the Federal Circuit affirmed the ASBCA's holding that the prime contractor under a terminated, cost-reimbursement contract is not entitled to profit on its subcontractors' work included in the subcontractors' termination settlement proposals regardless of whether (1) the subcontractors' work has been delivered or (2) the subcontracts are firm-fixed-price.

In *Advanced Team Concepts Inc. v. U.S.*, 68 Fed. Cl. 147, 152 (2005), the Court of Federal Claims declined to read a termination for convenience clause into an implied-in-fact contract to provide instructors for a Government training facility because the court found that the Government's cancellation of the contract was not for the Government's benefit, but rather so that the training facility could hire its former director to teach some of the classes that the contractor was supposed to teach. The court stated: "On the facts here it seems clear that the termination for convenience was not for the government's benefit but for that of a former employee. This is bad faith. Therefore, the *Christian* Doctrine does not apply."

The ASBCA held in *Ryste & Ricas, Inc.*, ASBCA No. 54514, 2005 WL 3030977 (ASBCA Nov. 10, 2005), that when the board converts a default termination to a termination to convenience, the one-year period for submitting a termination settlement proposal begins to run upon receipt of the board's decision, not when the appeal period expires.

In *International Data Products Corp. v. U.S.*, 64 Fed. Cl. 642 (2005), the Court of Federal Claims held that the "total contract price" of an IDIQ contract for purposes of computing the termination settlement amount is the price for the minimum value of services the Government was obligated to purchase plus the value of services the Government ordered in excess of that amount.

IV. FALSE CLAIMS ACT

In a case of first impression, the U.S. District Court for the Eastern District of Virginia considered the issue whether the False Claims Act applies to claims submitted to the Coalition Provisional Authority (CPA), the agency that governed Iraq for thirteen months after the overthrow of Sadam Hussien's regime. The court found that, for False Claims Act purposes, there is an important difference between projects funded by the Development Fund for Iraq on the one hand, and projects funded by Seized and Vested Funds on the other. See *U.S. ex rel. DRC, Inc. v. Custer Battles, LLC*, 376 F.Supp.2d 617 (E.D. Va. 2005). In particular, the court held that "Iraqi state-owned cash and other movable property seized by American and other Coalition troops in Iraq as occupying forces, once transferred to the custody of the 336th FINCOM, became government property to be expended at the direction and discretion of the United States," and, therefore, "a demand for payment therefrom constituted a 'claim' under the FCA." *Id*. at 644-45. On the other hand, the court held that because the Development Fund for Iraq belongs to the Iraqi people, "any demands for payment from the DFI were not 'claims' within the meaning of the FCA." Id. at 646.

V. CONTRACT DISPUTES ACT

A. Interest

In *Advanced Injection Molding, Inc. v. General Servs. Admin.*, GSBCA No. 16504, 2005 WL 2483342 (GSBCA Sept. 30, 2005), the GSBCA held that Debt Collection Act, 31 USCA § 3717(a), requires the payment of interest on overpayments from the date of the contracting officer's final decision demanding repayment, even though the commercial item contract in that case was not required to and did not include the Interest clause at FAR 52.232-17.

B. Breach of Implied Covenant of Good Faith and Fair Dealing

In *Centex Corp. v. U.S.*, 395 F.3d 1283 (Fed. Cir. 2005), the Federal Circuit held that Congress's enactment of legislation retroactively eliminating favorable tax treatment for entities acquiring failing thrifts breached the implied covenant of good faith and fair dealing because it deprived the plaintiff thrifts of a substantial part of the benefit of their bargain with the Federal Savings and Loan Insurance Corporation. Citing Restatement (Second) of Contracts § 205, court stated: "The covenant of good faith and fair dealing is an implied duty that each party to a contract owes to its contracting partner. The covenant imposes obligations on both contracting parties that include the duty not to interfere with the other party's performance and not to act so as to destroy the reasonable expectations of the other party regarding the fruits of the contract."

Similarly relying on Restatement (Second) of Contracts § 205, the Court of Federal Claims concluded in *Tecom, Inc. v. U.S.*, 66 Fed. Cl. 736 (2005), that bad faith is *not* necessary to establish a breach of the implied duty to cooperate and not hinder performance.

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C. Receipt of Final Decision

In *Riley & Ephriam Construction Co. v. U.S.*, 408 F.3d 1369 (Fed. Cir. 2005), the Federal Circuit held that the burden is on the Government to prove by objective evidence the contractor's "actual physical receipt" of a contracting officer's final decision. Reversing the Court of Federal Claims, the Federal Circuit held that neither the CO's testimony that the final decision was successfully faxed to the contractor's attorney, nor the fact that the final decision was received at the attorney's post office box (but returned as undeliverable), was sufficient evidence of receipt.

In *Tyrone Shanks*, ASBCA No. 5438, 05-2 BCA ¶ 33069, the final decision was not sent by certified mail, return receipt requested, and in moving to dismiss the contractor's appeal, the Government relied on an affidavit from the CO setting forth the normal times for mail delivery. The board denied the motion, holding that "the government has failed to carry its burden of establishing the date appellant received the CO's 8 December 2003 letter to show that appellant's notice of appeal was untimely."

D. Demand for a "Sum Certain"

The ASBCA held in *Sandoval Plumbing Repair, Inc., d/b/a Sandoval Constr. Co.*, ASBCA No. 54640, 05-2 BCA ¶ 33,072, that a demand for an amount "no less than" or "in excess of" a stated dollar amount is not a demand for a sum certain, and therefore not a valid CDA claim. Sandoval made a demand for payment of "no less than $1,072,957.05, plus all additional days of delay at $3,612.65 per day until the date of termination on March 8, 2004." In response to the Government's motion to dismiss the appeal, Sandoval argued that the "sum certain" requirement was satisfied by the fact that $1,072,957.05 is divisible by the claimed daily rate ($3,612.65) into exactly the number of days of delay (297 days) prior to the submission of the contractor's claim, and that the "additional days of delay" may be derived by multiplying the $3,612.65 daily rate times the 127 days from 2 November 2003 through 8 March 2004. The ASBCA dismissed that portion of the appeal, reasoning that: "No matter what certainty might be present in the calculation of the $1,072,957.05 amount, or in the calculation of an amount for the additional days of delay, Sandoval's claim letter qualified those amounts by the phrase 'no less than.'"

VI. COST ACCOUNTING STANDARDS

A. Pension Costs

In *General Motors Corp. v. U.S.*, 66 Fed. Cl. 153 (2005), the Court of Federal Claims rejected three of the Government's defenses against GM's pension deficit claims. The court held that neither (1) GM's failure to fund the segment closing adjustment amount in the year of the segment closing, (2) its release of claims under closed cost type contracts, nor (3) the Limitation of Cost clause and Limitation of Funds clause barred GM from recovering any segment-closing adjustment that it might be owed pursuant to a segment-closing under CAS 413.

B. Exemption for T&M Contracts for Commercial Services

The CAS Board on Jan. 4, 2006 published a notice of proposed rulemaking to revise the commercial item exemption to include time-and-materials and labor-hour contracts. See 71 Fed. Reg. 313 (Jan. 4, 2006).

C. Employee Stock Option Costs

On July 22, 2005, the CAS Board published a notice of proposed rulemaking that would place the cost accounting rules for ESOP costs exclusively in CAS 415. See 70 Fed. Reg. 42293 (July 22, 2005). Under the proposed rule, contributions made in cash would be measured by the entire amount of the contractor's contribution, whereas contributions made in stock or other property would be measured by the market value of the stock or property at the time the contribution is made. However, the cost would not be assigned until an award or allocation was made to individual employees or employee accounts.

D. CAS 404, Capitalization of Tangible Capital Assets

The CAS Board on June 30, 2005 published a "Correction to final rule" correcting the Illustrations in CAS 404 to conform with the minimum cost criteria for capitalization of $5,000.

E. Disclosure of Cost Accounting Practices

By interim rule effective May 23, 2005, the CAS Board approved the use of an alternative disclosure form for United Kingdom contractors. See 70 Fed. Reg. 29457 (May, 23, 2005).

F. Exemption for Overseas Contracts and Subcontracts

On Sept. 14, 2005, the CAS Board published a Staff Discussion Paper inviting public comments on the exemption for contracts and subcontracts executed and performed entirely outside the U.S., its territories and possessions. See 70 Fed. Reg. 53977 (Sept. 14, 2005).

G. Proposed Changes to CAS Thresholds

The CAS Board has proposed to adjust the CAS application and full coverage thresholds for inflation as follows:

- For contract applicability, from $500,000 to $550,000;
- For applicability to a business unit, from $7.5 million to $8.5 million;
- For waiver authority, from $15 million to $17 million;
- For full coverage, from $50 million to $56.5 million;
- For disclosure statement submissions by a company (other than an educational institution), from $50 million to $56 million;
- For disclosure statement submissions by a segment of a company, from $10 million to $11.5 million; and
- For disclosure statement submissions by an educational institu tion, from $25 million to $28.3 million.

See 70 Fed. Reg. 73423 (Dec. 12, 2005).

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VII. DEFECTIVE PRICING

A. Disclosure of Commercial Sales

The GSBCA held in *Viacom, Inc. – Successor in Interest to Westinghouse Furniture Systems*, GSBCA No. 15871, 05-2 BCA ¶ 33080, that commercial discounts for individual components of system furniture workstations were not cost or pricing data the contractor was required to disclose because the contractor's GSA schedule contract included only complete workstations. The GSBCA further held that commercial discounts for orders in excess of the maximum order limitation included in the solicitation for the GSA schedule contract were irrelevant to the Government's defective pricing claim because GSA failed to show that it had negotiated discounts for orders above the maximum order limitation. Therefore, the GSBCA held, the Government failed to demonstrate that the contracting officer detrimentally relied on the allegedly defective data.

B. Noncommercial Modifications of Commercial Items

We reported last year that Section 818 of the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005 (P.L. 108-375) amended the Truth in Negotiations Act, 10 USCA § 2306a, to provide that the TINA exception for modifications of commercial item contracts 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 was implemented by an interim rule that took effect on June 8, 2005. See 70 Fed. Reg. 33659 (June 8, 2005). The interim rule revised FAR 15.403-1(c)(3) to provide that, for acquisitions funded by DoD, NASA or the Coast Guard, a minor modification of a commercial item is exempt from the requirement for cost and pricing data only if the total cost of the modification does not exceed the greater of $500,000 or 5 percent of the total price of the contract.

C. TINA Threshold

The FAR Councils on December 12, 2005, proposed adjusting the TINA threshold for inflation to $600,000. See 70 Fed. Reg. 73415 (Dec. 12, 2005).

VIII. OTHER REGULATORY DEVELOPMENTS

A. FAR 31.205-6, Compensation for Personal Services

Paragraphs (k) and (o) of FAR 31.205-6, covering deferred compensation and postretirement benefits other than pensions, respectively, were revised by a final rule that took effect on July 8, 2005. See 70 Fed. Reg. 33671 (June 8, 2005). According to the drafters' comments, the revision was intended to improve clarity and structure and remove unnecessary and duplicative language. In addition, the revision added a provision to FAR 31.205-6(o) requiring that the contractor credit the Government's equitable share of previously funded PRB costs when PRB assets revert or inure to the contractor. The Government's share is to be determined based on the Government's previous participation in PRB costs through those contracts for which cost or pricing data were required or which were subject to FAR subpart 31.2.

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B. FAR 31.205-11, Depreciation

A final rule that took effect on July 8, 2005, revised FAR 31.205-11(i)(1) to specifically address the gain or loss recognition of sale and leaseback transactions to be consistent with the date on which the contractor begins to incur an obligation for lease or rental costs. See FAC 2005-04, Item VIII, 70 Fed. Reg. 33673 (June 8, 2005). The same rule included revisions to FAR 31.205-16, Gains and losses on disposition or impairment of depreciable property or other capital assets, and FAR 31.205-36, Rental costs. The FAR Councils rejected a suggestion that the sale and leaseback transaction should be limited to an "either or" negotiation: either apply the depreciation recapture at the time of the sale, or limit the lease cost for the period of time necessary to liquidate an amount equal to the depreciation recapture. However, the Councils added language to FAR 31.205-11(i)(1) and FAR 31.205-36(b)(2) to require an adjustment to the depreciation and rental cost limitations for any gain or loss recognized in accordance with FAR 31.205-16(b), and thereby ensure that the contractor is neither harmed nor benefited, for Government contract costing purposes, by having entered into a sale and leaseback arrangement.

C. FAR 31.205-16, Gains and Losses on Disposition or Impairment of Depreciable Property or Other Capital Assets

A final rule that took effect on July 8, 2005, added a new provision for determining the gain and loss associated with a sale and leaseback arrangement. See 70 Fed. Reg. 33673 (June 8, 2005). When the costs of depreciable property are subject to the sale and leaseback limitations in FAR 31.205-11(i)(1) or FAR 31.205-36(b)(2), the gain or loss is measured by the difference between the net amount realized and the undepreciated balance of the asset on the date the contractor becomes a lessee. However, any loss is limited to the difference between the fair market value and the undepreciated balance of the asset on the date the contractor becomes a lessee.

D. FAR 31.205-35, Relocation Costs

A final rule that took effect on October 31, 2005, revised FAR 31.205-35 to permit contractors the option of being reimbursed on a lump-sum basis for three types of employee relocation costs: finding a new home, travel to the new location, and temporary lodging. See 70 Fed. Reg. 57467 (Sept. 30, 2005). These three types of costs are in addition to the miscellaneous relocation costs for which the cost principle already permitted lump-sum reimbursement. However, in response to concerns that the cost principle would permit the reimbursement of unreasonable costs, the Councils added a provision requiring that the lump-sum costs be "adequately supported by data on the individual elements (*e.g.*, transportation, lodging, and meals) comprising the build-up of the lump-sum amount to be paid based on the circumstances of the particular employee's relocation." In addition, to ensure that contractors that elect to reimburse employees on a lump-sum basis do not claim costs for additional, after-the-fact payments to employees whose actual expenses exceed the lump-sum amount, the amended cost principle states that when reimbursement on a lump-sum basis is used, any adjustments to reflect actual costs are unallowable.

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E. FAR 31.205-36, Rental Costs

Paragraph (b)(2) of FAR 31.205-16 was revised effective July 8, 2005, to add a date for recognition of the gain or loss associated with sale and leaseback transactions. See 70 Fed. Reg. 33673 (June 8, 2005).

F. FAR 31.205-44, Training and Education Costs

FAR 31.205-44 was completely rewritten by a final rule that took effect on October 31, 2005. See 70 Fed. Reg. 57470 (Sept. 30, 2005). The "streamlining" changes eliminated several specific limitations on costs of various types of education, as well as the disparate treatment of full-time and part-time education costs. At the same time, a new "job-relatedness" limitation was added in response to concerns expressed by the American Federation of Government Employees. Prior to this revision, there was no requirement that employee education and training be related to the employee's job in order for the costs to be allowable. The revision also deleted the advance agreement provision formerly found in paragraph (h) of the cost principle.

G. CAS Administration

FAR Subpart 30.6 and the Administration of Cost Accounting Standards clause at FAR 52.230-6 were completely rewritten by a final rule that took effect on April 8, 2005. See 70 Fed. Reg. 11743 (March 9, 2005). Pursuant to FAR 1.108(d), the revised rule applies only to contracts awarded on or after April 8, 2005. There are now very detailed rules governing the cost impact process. For example, the new rule prohibits the cognizant federal agency official (CFAO) from making certain types of offsets, such as between a required change and a unilateral change or between a required change and a CAS noncompliance. The new rule also prohibits the CFAO from combining the cost impacts of multiple changes unless they all result in increased costs to the Government.

H. Proposed "Rewrite" of FAR Part 45

The FAR Councils on Sept. 19, 2005, published a proposed rule to rewrite FAR Part 45. See 70 Fed. Reg. 54878 (Sept. 19, 2005). For cost-reimbursement and T&M contracts, the proposed changes would provide that the Government acquires title only in property that is reimbursed as a direct cost. An apparently unintended consequence of this aspect of the proposed rule is that cost-reimbursement and T&M contractors would be subject to state income tax on overhead property. The proposed rule would also revise FAR 31.205-19 to indicate that, unless the Government has determined that the contractor's property management practices are inadequate and/or present an undue risk to the Government, the cost of insurance is allowable when the contractor is liable and the insurance does not cover loss, damage, destruction, or theft which results from willful misconduct or lack of good faith on the part of the contractor's managerial personnel.

I. Unallowable Costs

A final rule that took effect on October 31, 2005, revised 31.201-6(e) to add specific criteria on the use of statistical sampling as a method to iden-

tify unallowable costs, including the applicability of penalties for failure to exclude certain projected unallowable costs. See 70 Fed. Reg. 57463 (Sept. 30, 2005). The revised provision recommends, but does not require, that the contractor and cognizant ACO enter into an advance agreement regarding the use of statistical sampling methods for identifying and segregating unallowable costs.

J. T&M and L-H Contracts

On Sept. 26, 2005, the FAR Councils published a proposed rule that would allow the use of T&M and L-H contracts for commercial services if the following four requirements are met: (1) the service is acquired under a contract awarded using competitive procedures; (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 70 Fed. Reg. 56318 (Sept. 26, 2005). The proposed rule would allow the contractor to charge for services provided by subcontractor employees at the fixed hourly rates prescribed in the schedule only if the subcontract is specifically identified in the contract or order. In all other cases, subcontract costs would be reimbursed at the prime contractor's actual cost. More favorably, if the contractor provides its own materials that meet the definition of a commercial item, the proposed rule would allow the contractor to charge its catalog or market price for those materials rather than its actual cost. The prefatory comments accompanying the proposed rule leave open two issues that are beyond the FAR Councils' authority to address. First, commercial item contracts that are other than firm-fixed-price or fixed-price with economic price adjustment are not currently exempt from the Cost Accounting Standards. See 48 CFR § 9903.201-1(b)(6). The Councils stated that: "Revisions to CAS requirements is [sic] beyond the scope of this case. The Councils will forward the comments to the CAS Board for the Board's consideration." 70 Fed. Reg. at 56331. The CAS Board subsequently proposed to exempt T&M/LH contracts for commercial services from CAS requirements. 71 Fed. Reg. 313 (Jan. 4, 2006). Second, the Councils expressly declined to address the purported "illegal use of commercial T&M/LH contracts by GSA," stating: "The rule implements Section 1432 of Public Law 108136. Questions over legality of actions agencies may have taken prior to this authority are beyond the scope and authority of the Councils." 70 Fed. Reg. at 56332.

K. OMB Circulars

OMB Circulars A-21, A-87 and A-122 were relocated on August 31, 2005 to Title 2 of the Code of Federal Regulations. See 70 Fed. Reg. 51880 (Aug. 31, 2005). While the old Circulars are still posted on the OMB website, they are not being maintained in current form.

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