Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

AFA Considerations For Gov't Contract Claims Litigation

By **Stephen McBrady**

Stephen McBrady

Law360, New York (July 14, 2017, 11:57 AM EDT) -- Government contractors consider filing claims against the government for any number of reasons. Some common fact patterns include increased performance costs attributable to government action or delay; costs resulting from government-initiated contract termination; costs of remediating certain environmental pollution and toxic tort litigation (when covered by indemnification clauses); and other costs to which contractors are entitled by operation of contract or statute. Each of these circumstances share one central feature — when performing on behalf of the government, the contractor incurred additional expense for which the government has a legal obligation to pay.

The last element is an important aspect of claims litigation, because the point of filing a claim is to make the contractor whole consistent with the contract, statute, or other relevant factors giving rise to the claim. Claims litigation is not about achieving a "windfall" for the contractor. (Quite the opposite, one could make the argument that contractors who leave substantial claims on the table are in fact giving the government a windfall). In the end, the question of whether to pursue a claim under a given set of facts is a decision involving various, sometimes competing, legal and business concerns.

This article focuses on one critical aspect of that decision: How can contractors and their outside law firms structure the pricing of claims litigation so that each side shares the risk and expense of pursuing a claim?

Alternative Fee Arrangements

Ten years ago, so-called "alternative fee arrangements" (AFAs) were unusual in government contracts claims litigation. Firms were reluctant to give up on the traditional hourly billing model, and contractors were sometimes hesitant to agree to pricing structures outside of their traditional norms. Many factors have led both sides to evolve. For example, some corporate legal departments have sought to "break the mold" of legal-department-as-cost-center, and instead proactively identify potential claims recovery opportunities, bringing money to their internal business clients. These entrepreneurial legal departments have in turn sought a broader menu of options for financing such litigation. Fast-forward to today, and many law firms and their corporate clients are experienced and eager to engage one another with creative AFAs that align their interests, balancing upside and downside risk to both parties. In fact, today it is rare to see a "request for proposals" for legal services in the government contracting space that does

not include an opportunity to pitch AFAs as a means of partnering between the law firm and the client.

The focus on AFAs is specifically relevant to claims litigation, because litigation provides a relatively simple means of evaluating "success" based upon established milestones. Did we win? Did we lose? Did we settle? Each of these outcome-determinations can be weighed at the outset of an engagement, as the parties seek to reach an equitable division of risk and reward. More importantly, these milestones can be weighed in the context of what the contractor is trying to achieve through its AFA.

Benefits of an AFA

When negotiating an AFA that serves the client's goals, the key consideration for both parties is to identify the client's overriding interests — "must-haves" — at the outset, and structure the AFA to achieve those ends. Some clients approach law firms with very solid claims, but limited ability to pay litigation fees short-term. This may be due to balance sheet issues, or simply a corporate decision to focus legal spending in other areas. In either case, clients are seeking to "defer" legal spending while pursuing the case.

Deferral of legal fees can take many forms. In a pure contingency setting, clients pay no legal fees, in exchange for giving the law firm a portion of their recovery to the law firm upon successful recovery from the government. If they do not recover, there is no payment to the law firm. Partial contingencies proceed along the same lines, with the parties agreeing to reduced payments to the law firm, i.e., progress billing, in exchange for enhanced payment in the event of recovery — which could come in the form of enhanced billable rates, or a percentage of the amount recovered via settlement or judgment. In addition to these models, numerous other structure such as "hold backs" "budget/collar" and "success fee" arrangements have gained traction in recent years, by focusing on controlling legal spend and incentivizing positive outcomes.

When properly crafted, each of these AFAs aligns the client's interest with the law firm's interest — and "hedges" both sides' downside risk (no recovery, or limited recovery) by giving both sides a potential upside reward (enhanced value).

Understanding the Claim

In tailoring the structure of the AFA to the client's needs, a key consideration for both parties is the quality of the potential claim. That is not to say that law firms and their clients should walk away from "hard" claims. Rather, the key is to properly assess the litigation risk of any claim, and factor that into the discussion. Just as a difficult claim may require the parties to price in additional risk, a claim that is relatively straightforward, or requires little factual development, may warrant a lower success fee. In a contingency setting, the willingness of both sides to agree on a fee percentage is often driven by the weighing of the known facts and the state of play — there is no "one size fits all."

The "type" of claim is also a factor. For example, in a construction setting, contractors who approach law firms with potential claims for differing site conditions have a well-developed framework in which to evaluate the claim, owing to decades of relevant litigation and many published decisions. On the other hand, the range of outcomes and/or cost to litigate a cost disallowance claim involving a cost principle that is rarely (or never) litigated might be more difficult to predict. In either case, diligence at the outset of the claim is important for law firms and contractors. Law firms in particular should be willing to invest time and resources to adequately assess the claim.

Forum

Another factor to consider when pursuing a claim is the forum in which to pursue the claim. Contractors can elect to litigate Contract Disputes Act claims, for example, in either the Court of Federal Claims or at the boards of contract appeals. At the outset, it is often not possible to say which forum presents a better opportunity to achieve a successful result. That is largely dependent upon the quality of the legal strategy and the merits of the underlying claim. But it is true that each forum presents different opportunities and risks. At the boards of contract appeals, claims are litigated by agency counsel, and the contracting officer retains ultimate control of the decision to settle or litigate. Thus, even in cases that have proceeded well into litigation, the CO may exercise her right to engage in negotiations to resolve the claim. When a claim is at the COFC, the government's case will be litigated by the U.S. Department of Justice, not the agency, and the authority to settle the case transfers from the CO to the DOJ, which may reduce the chance of a settlement in many cases.

Another factor that distinguishes litigating claims at the boards from practice at the COFC is that board litigation tends to have less motions practice, and a less formal approach to discovery, whereas the COFC is a more traditional courtroom setting, and has a reputation for more motions practice. Responding to additional motions practice can lead to additional expense in litigation; on the other hand, the COFC also has traditionally had a reputation for resolving cases more readily on summary judgment and/or motions to dismiss. With respect to claims where either of those outcomes seems achievable, the parties may weigh the possibility of a "quick win" into their calculus. Finally, the risk of a DOJ counterclaim for fraud (not typically present at the boards of contract appeals) is another factor that must be considered when choosing forum.

In sum, this early decision of where to pursue a claim may have a significant impact on the structure of an AFA to pursue the claim, as both parties' assessment of pricing should reflect the cost of achieving the desired result and the likely timeline.

Alternative Dispute Resolution

Finally, alternative dispute resolution is, or should be, a factor in every discussion regarding whether and how to pursue a claim. Some cases do not lend themselves to ADR, but in many cases, some form of ADR is an option worth considering.

The Armed Services Board of Contract Appeals, for example, encourages "[r]esolution of a dispute at the earliest stage feasible, by the fastest and least expensive method possible," for the benefit of parties. Although the board's focus is judicial economy, it is not lost on contractors or the government that a more expedient result also frees up resources to focus on other critical tasks. Accordingly, the board provides a process for ADR of pre-claim and pre-final decision matters, in addition to appeals pending before the board.

The board will not force parties to enter into ADR, but when the parties agree to ADR, the board is willing to accommodate a range of different proceedings, from informal mediation to trial-like arrangements including witnesses. The board's impressive success rate in resolving disputes that go to ADR is well-known. Published statistics report that over 90 percent of the cases where the parties agree to ADR are successfully resolved. Relative to litigation, ADR is faster and less expensive than full-scale dispute, and if successful, can result in a resolution within a day or two. On the other hand, ADR can sometimes yield less than a full recovery, particularly where "gray areas" contribute to the desire to conduct ADR. Thus, for contractors and outside law firms considering potential claims, it is highly relevant to consider whether

ADR is likely to reduce the resources expended while producing a desirable result; whether the government seems likely to agree to ADR; and whether the relevant forum is conducive to ADR.

Like the decision regarding whether to pursue a claim at the COFC or the boards of contract appeals, evaluating the pros and cons of ADR should be part of the contractor's (and the law firm's) toolkit when assessing the most appropriate AFA.

Conclusion

Corporate legal departments in the government contracts market increasingly view claims litigation as a way to recoup funds owed by the government, which would otherwise be lost to the business. More and more, clients are also seeking alternative fee arrangements to pursue these claims. The business objectives underlying this momentum include resource allocation, reducing upfront legal spend, hedging litigation risk, and fostering long-term partnerships with their outside counsel. But in all cases, the message to law firms is clear: In addition to providing sound legal advice and charting a path to victory, lawyers must focus on value-based billing and fee structures that put a premium on achieving successful outcomes.

Stephen McBrady is a partner in the Washington, D.C., office of Crowell & Moring LLP.