

# Caught in the Federal Procurement Fish Bowl

*26th Annual Ounce of Prevention Seminar*

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## **Contract Cost and Pricing**

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# Environmental Costs

- Government's reimbursement of environmental remediation costs through indirect costs allocated to government contracts does not preclude the contractor's Superfund claim against the Government.
- Credits clause (FAR 31.201-5), as well as a party-specific settlement agreement, will act to prevent double recovery, because the contractor will be required to reimburse the Government for any previously-reimbursed costs that the contractor recovers under CERCLA.

*Lockheed Martin Corp. v. United States*, 664 F. Supp. 2d 14 (D.D.C. 2009)

# Allowable Cost and Payment Clause

- The allowable amount for both direct and indirect costs is determined by the FAR 31.2 cost principles in effect on the date of contract award
- Contractors can file a Contract Disputes Act challenge to a CO's determination of an interim billing rate

*ATK Launch Systems, Inc.*, ASBCA Nos. 55395 et al., 09-1 BCA 34118 (Apr. 9, 2009)

# Prompt Payment Act Interest

- Government is entitled to withhold payment of interest only when the government disputes the contractor's performance or the contractor's invoice is defective; a dispute about the government's payment is not legitimate grounds to withhold payment of interest

*Delta Air Lines, Inc. v. General Services Administration*, CBCA No. 1306, 2009 WL 221103 (Jan. 23, 2009)

## IR&D Cost

- R&D cost is not allowable IR&D if it is “required in the performance of a contract” or “sponsored by a grant”
- 30+ year dispute whether costs “implicitly required” in performance of a contract may be allowable IR&D
- Govt avoided litigation of the issue
  - Some advance agreements effectively allowed implicitly required R&D
  - Some auditors and COs disallowed implicitly required R&D
  - Government itself frequently agreed explicitly to exclude “implicitly required” R&D from contract SOW
- Issue in false claims investigations, but never resolved
- *Newport News* (E.D. VA) held in 2003 that implicitly required costs were not allowable IR&D

## IR&D Cost: *ATK Thiokol*

- ATK undertook R&D effort to improve product
- ATK agreed to sell the improved product to Mitsubishi, with specific modifications to meet Mitsubishi's needs
- Contract specifically provided for Mitsubishi to pay R&D necessary to meet its specific needs, but not for generic R&D effort
- Accounting practice was to treat R&D as indirect unless
  - Particular contract required incurrence of the cost;
  - Particular contract paid for the cost; or
  - No reasonably foreseeable benefit to more than one cost objective

## IR&D Cost: *ATK Thiokol* (cont'd)

- Contractors have “considerable freedom” in classifying costs
- Because the generic R&D effort was not specifically required by the contract with Mitsubishi, it was allowable IR&D in accordance with ATK’s practices
- Effectively overrules cases suggesting that any cost that *can be* identified with a final cost objective *must be* treated as a direct cost, without regard to how the costs are classified in the contractor’s accounting system

*ATK Thiokol, Inc. v. United States*, 598 Fed. Cir. 1329 (2010)

## Post-ATK Thiokol Issues

- ATK/Mitsubishi contract was clear, but that is unusual -- how “specific” must a requirement be to disqualify an effort as IR&D?
- Is the standard for what is “required” the same for commercial contracts and Govt contracts?
- Many contractors have not claimed “implicitly required” R&D costs – will that change?
- Will Govt change the regulations and if so, how?

# Regulations

- Pension Harmonization Rule, CAS 412 and 413 (proposed rule)
  - Purpose: Harmonize CAS 412 and 413 with Pension Protection Act of 2006, which amended the minimum funding requirements of contributions to pension plans under ERISA
  - Intended result: Lessen the difference between the amount of pension cost reimbursable to the contractor per CAS and the amount of pension contribution required to be made per ERISA

# Regulations

- Pension Harmonization Rule, cont'd
  - Proposed changes to CAS 412 and 413 include:
    - Recognition of a “minimum actuarial liability,” consistent with the PPA minimum required contribution
    - Reduction of amortization period for gains and losses from 15 to 10 years
    - Five-year transition method to phase-in recognition of adjustments of actuarial accrued liability and normal cost
  - A number of new illustrations showing the measurement, assignment, and allocation of pension costs are included
  - Comments are due by July 9, 2010

# Regulations

- Pension Harmonization Rule, cont'd
  - Possibility for equitable adjustment to recoup increased pension costs incurred as a result of PPA, but not recoverable until receive CAS-covered contract incorporating CAS Harmonization Rule
    - Five-year transition period
    - Detailed cost impact almost certainly required
    - Adjustment will be based on net impact on all CAS-covered contracts
    - May negotiate adjustments contract-by-contract or on some consolidated basis

# Regulations

- Pension Harmonization Rule, cont'd
  - For those contractors who receive new CAS-covered contracts on an infrequent basis –
    - CAS Board suggests that, once the Harmonization Rule is published as a final rule, such contractors request a voluntary change in accounting method and request that the contracting officer consider the change as a desirable change
    - This would allow the contractor to request an equitable adjustment to recover its increased pension costs sooner than if it has to wait for its next CAS-covered contract

# CAS 413 & Interest: *Raytheon*

- Facts
  - Segment closing with overfunded pension plan
  - Alleged noncompliance with CAS 413 for failure to negotiate the Govt's share of the surplus
  - Govt demands \$487K plus *simple* interest
  - Raytheon pays principal within 30 days
- ASBCA #1
  - Failure to pay the Govt share of the surplus in same period as the segment closing violates CAS 413
  - Awards *compound* interest
- ASBCA #2
  - No noncompliance
  - Compound interest issue left as *dicta*

## CAS 413 & Interest: *Raytheon* (cont'd)

- Federal Circuit agrees with first ASBCA decision
  - Failure to refund in the same year as segment closing violates CAS 413
  - Ignores fact that adjustments cannot be completed within a year
  - Awards compound interest based on precedent not involving CAS
  - All but acknowledges that precedent was incorrectly decided

*Gates v. Raytheon Co.*, 584 F.3d 1062 (Fed. Cir. 2009)

# CAS 413 & PRB Costs

- *Raytheon Co. v United States*, 2010 WL 1783454 (Fed. Cl.)
  - PRB costs (primarily retiree medical and life insurance) covered by so-called 401 (h) subaccounts in the contractor's pension plan (a relatively uncommon situation) are not "pension benefits"
  - Not subject to the provisions of CAS 413 requiring "segment closing" adjustments for pension costs
- *General Electric Co. v. United States*, 2010 WL 1837706 (Fed. Cl.)
  - Pay-as-you-go benefit plans covering retired employees and dependents (by far the more common situation) are not subject to the CAS 413 segment-closing provisions
- Decisions effectively preclude contractors from recovering unfunded PRB costs in connection with segment closings, absent specific promise to indemnify the contractor for the unfunded liability

# PRB Costs: Regulations

- “Catch 22” for contractors using the accrual method of calculating post-retirement benefit (PRB) costs
  - Fund entire amount measured under FAS 106 to be reimbursed for the costs on Govt contracts, or
  - Fund only amount deductible under the IRC and forgo reimbursement of the full FAS 106 amount
- FAR 31.205-6(o) amended, as of Jan. 11, 2010, to allow contractors the option to measure accrued PRB costs using either FAS 106 or the IRC criteria (FAR)

# Regulations

- Revised Travel Cost Principle (FAR 31.205-46) (final rule, effective 1/11/2010)
  - For airfare allowability, standard is now the “lowest priced airfare available to the contractor,” rather than “lowest customary standard, coach, or equivalent airfare”
  - Driving concern: contractors’ negotiated airfare agreements with travel providers usually result in lower rates

# Regulations

- Revised Travel Cost Principle, cont'd
  - DCAA issued guidance March 22, 2010
    - Will question airfare costs claimed in excess of the lowest airfare available through direct negotiation with airlines or travel agents
    - Contractors' policies and procedures should provide for advance planning of travel to assure that lowest priced airfare available to the contractor is documented and utilized as the baseline allowable airfare cost
    - Contractors must consider nonrefundable airfares and lower airfares negotiated with airlines, travel service providers, credit card companies, etc. when scheduling travel

# Regulations

- Oversight of Contractor Business Systems, DFARS Subpart 242.70 (proposed rule)
  - Applicable to accounting systems, estimating systems, purchasing systems, earned value management systems (“EVMS”), material management and accounting systems “MMAS”), and property management systems
  - Will require contractors to “establish and maintain acceptable business systems”; identifies attributes of an acceptable system

# Regulations

- Oversight of Contractor Business Systems, cont'd
  - System deficiencies identified during audit must be reported to the ACO
  - ACO authorized to implement a 10% withhold on payments due the contractor
  - Generally, total withhold is capped at 50% of payments due contractor, but under certain circumstances, 100% of payments may be withheld

# Regulations

- Labor Relations Costs Principle, FAR 31.205-21 (proposed rule)
  - Proposes to make unallowable those costs incurred in promoting or opposing union organizing
  - Effectuates government policy to remain impartial concerning labor-management disputes involving government contractors

# Regulations

- Excessive Pass-Through Costs, FAR 52.215-22, -23 (interim rule)
  - Proposes new solicitation provision and contract clause, which require offerors and contractors to identify the percentage of work that will be subcontracted
  - When subcontract costs exceed 70% of total cost of work, offerors and contractors must show that they added value to the subcontract work in order to add indirect costs/profit to the subcontract costs

# CDA Statute of Limitations

- 1996 – Subcontractor submits allegedly defective data
- 1998, 2000 – DCAA alleges grounds for defective pricing
- 2002 – DCAA recommends downward price adjustment
- 2008 – CO final decisions
- FAR 33.201 – Claim accrues when all events that fix alleged liability are known or should have been known
- CDA statute of limitations is 6 years
- Govt argues for more liberal interpretation of limitations period for Govt claims

# CDA Statute of Limitations (cont'd)

- TINA claimed liability is “fixed” when
  - Disputed information is "cost or pricing data";
  - Cost or pricing data was not meaningfully disclosed; and
  - Govt relied to its detriment on the inaccurate or incomplete data
- Basis for defective pricing claim established more than 6 years before the final decisions
- Final decisions were time-barred
- No distinction in CDA between Govt and contractor claims with regard to statute of limitations

*McDonnell Douglas Svcs., Inc.*, ASBCA No. 56568, 10-1  
BCA 34325

# Adequacy of Records

- Security subcontractor's labor records destroyed in Iraq
- CO said labor costs were not allocable because of lack of documentation that they were incurred for the prime contract
- Testimony from employees who were in Iraq and knew the security forces was sufficient
- Contract clauses do not require “nice neat little files”

*BearingPoint, Inc.*, ASBCA No. 55354, 09-2 BCA 34289

# Recent Audit Issues

- Costs of dependent health insurance
  - Employees may claim coverage (inadvertently or deliberately) for dependents who are ineligible
  - If the contractor pays costs for ineligible dependents, are the costs unallowable?
    - Does it matter whether the employee knew dependent was ineligible?
    - Expressly unallowable or unallowable only if no reasonable controls?
    - How to determine amount of unallowable costs?
  - DCAA position is very aggressive

## Recent Audit Issues (cont'd)

- “Bounty hunters”
  - Presidential memorandum directing expansion in recovery audits (now “Payment Recapture Audits”) to identify and reclaim “improper” payments (e.g., duplicate payments, payments for services not rendered, overpayments, and payments to fictitious vendors)
  - Points approvingly to use of professional and specialized auditors whose compensation is tied to findings of overpayments
- Losses on investments in pension plans: OMB suggests that when contractors lose money on pension plan investments the costs should be unallowable