GOVERNMENT CONTRACTS

CONTRACTORS: GETTING THEIR DUE

With tight competition for government contracts, more companies can be expected to dispute federal payments in court—a strategy that can boost the bottom line and strengthen the law department's position as a partner with the business.

Companies everywhere are under constant pressure to keep costs down and find more revenue, but that is especially true for those working under government contracts. "There are more companies competing for fewer dollars in the federal market," says Stephen McBrady, a partner in Crowell & Moring's Government Contracts Group. "That leads them to keep getting leaner and leaner—and that expectation is now being extended to the legal department."

This pressure is translating into an increased interest in pursuing the recovery of funds that the government owes companies. "We're already seeing an increase in litigation focused on recovery," says McBrady. "That trend is expected to accelerate over the next couple of years. The government contracting market is extremely competitive, with margins that tend to be razor thin, which means that more corporate legal departments are going to be seeking new and different ways to recover money from the government."

KEY POINTS

Focusing on collections
More companies are seeking to recover money owed by the federal government.

Court successes
Claims litigation is helping recoup millions required by contract or statute.

Sharing the risk
Law departments are interested in alternative fee arrangements that help reduce risk and costs in pursuing federal claims.

There is a broad range of activities that lend themselves to potential recovery efforts. These include increased contract performance costs attributable to government action or delay, costs stemming from government-initiated contract termination, or other costs that contractors are entitled to by contract or statute.

"Each of these circumstances shares one central feature: when performing on behalf of the government, the contractor incurred additional expenses that the government has a legal obligation to pay," says McBrady. "This is not a windfall for the contractor—it's a way of being made whole for their work. Corporate legal departments in the government contracts market are starting to view recovery claims that way—as a method for recouping funds owed to them, which would otherwise be lost to the business. Not pursuing them is like providing a windfall for the government."

HOLDING THE GOVERNMENT TO ITS WORD

This trend is already well underway. For example, under the American Recovery and Reinvestment Act—part of the 2008 congressional stimulus package—the government has an obligation to make payments to companies that made certain investments in renewable energy. "In a variety of cases, the government has not lived up to that obligation," says McBrady. So there are now lawsuits proceeding in federal court that aim to collect that money. Those suits got a boost late in 2016, when the U.S. Court of Federal Claims rejected the government's arguments for reducing renewable energy grants called for by the act and awarded a group of wind farms more than $206 million.

Perhaps most notable are the Affordable Care Act "risk corridors" cases currently working their way through the courts. The law says that if insurers participating in ACA health care exchanges incur a certain level of losses, the government is required to provide payments to mitigate a portion of those losses. Due to a variety of factors, a number of insurers did incur such losses. However, says McBrady, "the government has failed to make statutorily mandated payments, and instead made a series of arguments about why it's not obligated to pay. And the only way to resolve that is by resorting to court."

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McBrady notes that there are currently three dozen of these lawsuits pending in federal court as companies look for funds they are owed under the statutory mandate. And there's a lot at stake. In early 2017, the U.S. Court of Federal Claims ordered the government to pay $214 million to Oregon-based Moda Health for such claims, and the total claims currently being litigated run into the billions. Given the high-profile politics and constant changes surrounding the ACA, it seems likely that more ACA-related litigation will emerge in the coming year.

Beyond statutorily mandated payments, companies are scrutinizing government contractual obligations—at times holding the government accountable for agreements made long ago. For example, from World War II through the end of the Cold War, companies that manufactured munitions and other military equipment for the government were often given contracts with broad indemnification clauses in them—aimed, typically, at inducing companies to provide critical goods and services, and avoiding delays in defense programs. Years later, however, some of those companies have run into toxic tort suits related to their plants and former plants. Now, says McBrady, "more companies are looking at those indemnification clauses and trying to get the government to pay its share of remediation costs and legal fees associated with environmental problems arising from their work for the U.S. government." And some are finding success: In January 2017, the U.S. Court of Federal Claims ordered the government to pay a group of oil companies $99.6 million for site-cleanup costs incurred in the 1990s and later litigation costs, all stemming from contracts to supply high-octane aviation fuel during World War II.

STRENGTHENING THE BUSINESS PROPOSITION

As legal departments pursue these recoveries, many are also looking to alternative fee arrangements with outside counsel. "Law departments will now proactively go to law firms with a potential claim and ask if they are willing to share in the risk through success fees and contingency arrangements," says McBrady. Recovery litigation lends itself to these kinds of approaches. "There are really straightforward metrics for measuring success," he says. "Did we win the case? Did we lose the case? Did we win half of what we claimed? Did we win all of what we claimed?"

Alternative fee arrangements can also bolster the business case for recovery efforts, helping legal departments allocate resources more effectively, reduce upfront legal spending, and limit litigation risk. Moreover, says McBrady, "the legal department does not have to go to the business and ask for money to file a claim." But the business can still benefit. "As one client told me, the first time he ever got a hug from his business client was when he dropped off a $20 million check from the government," says McBrady.

Overall, with a proactive approach to identifying and pursuing recovery opportunities—and the use of cost-effective partnering models with outside counsel—legal departments can play a more prominent role in helping the business. They can deliver significant funds to their internal business clients and thereby break out of the traditional mold of being viewed as a cost-and-compliance center—potentially becoming a revenue center contributing to the company's financial success.

A SIMPLER APPROACH?

As legal departments turn their attention to recovering money from the government, they can consider an option that may save time and money—alternative dispute resolution.

ADR can take various forms, from informal mediation to trial-like arrangements that include witnesses. And these approaches can be effective. The Armed Services Board of Contract Appeals, where many government contracts claims are litigated, reports that 93 percent of its cases that went to ADR in FY 2016 were settled successfully.

Often, ADR can be faster and less expensive than full-scale litigation, and when it is successful, it can lead to a quick and *non-appealable* resolution. With legal departments keeping a closer watch on the bottom line, says Crowell & Moring's Stephen McBrady, "ADR is likely to play a growing role in government contract disputes in the coming year or two, particularly in matters where both sides have an interest in quickly reaching a final resolution, and where confidentiality is key."