Costs

Terry Albertson
Steve McBrady
Skye Mathieson

Agenda

I. Update on Audit Delays and Statute of Limitations Issues

II. Statutory and Regulatory Update and Related Guidance

III. Discussion of Cost Cases

CDA Statute of Limitations

- The Contract Disputes Act, 41 U.S.C. §§ 7101-7109, includes a 6-year SOL
- Claims submitted more than six years after **accrual** are barred by the CDA
- CDA does not define the term "accrual." The Board (and the Court) rely on the Federal Acquisition Regulation 33.201 definition:

  … **the date when all events, which fix the alleged liability** of either the Government or the contractor and permit the assertion of the claim, **were known or should have been known** ...
- Until recently, SOL was held to be "jurisdictional," which meant that the boards and COFC lacked jurisdiction over claims beyond the 6-year window -- SOL could be raised at any time, by either party, or the court, and it could not be waived or tolled by agreement of the parties
- In *Sikorsky*, the Federal Circuit made a significant change in the SOL landscape

CDA Statute of Limitations

Sikorsky Aircraft Corp. v. United States, 2013-5096, -5099 (December 10, 2014)

- Government alleged that Sikorsky had allocated certain costs in noncompliance with CAS 418 during the 1999 to 2005 period.
- COFC held that the CDA SOL had not run, and concluded that the government had not shown that Sikorsky's allocation practice failed to comply with CAS 418.
- Government appealed the COFC's ruling on the merits, and Sikorsky cross-appealed, arguing that the CDA SOL had run and that the COFC's ruling on SOL had to be addressed before the merits because the CDA SOL is jurisdictional.
- Court held that the statute of limitations is "not jurisdictional" and "need not be addressed before deciding the merits."

CDA Statute of Limitations

The Boeing Co., ASBCA 58660

- Facts: Boeing unilaterally changed its cost accounting practice.
  - Over 6 years before the final decision, Boeing submitted a revised Disclosure Statement and made a PowerPoint presentation to the Gov't on its FPRP.
  - Under 6 years, Boeing submitted its general dollar magnitude cost impact analysis.
  - Gov't claim for increased costs resulting from Boeing's unilateral change to cost accounting practice.
- Held: Denied Boeing's motion to dismiss (interlocutory):
  - Need evidence re: contents of the "shorthand" PowerPoint briefing.
  - Board had held in *Raytheon* that Disclosure Statement revision, alone, does not trigger the 6-year CDA clock.

CDA Statute of Limitations

Combat Support Associates, ASBCA 58945 (Oct. 22, 2014)

- Facts: Contractor submitted its adequate incurred cost submission. Over 6 years later, Gov't brought claim to disallow costs.
- Held: Denied contractor's motion to dismiss.
  - Submission of adequate incurred cost submission does not, alone, trigger running of CDA 6-year clock.
  - Clock starts when contractor submits the underlying "supporting data" from which the Gov't learned, or should have learned, of the basis of its claim.
  - Interlocutory decision – subject to modification after hearing.

CDA Statute of Limitations

***Kellogg Brown & Root Services, Inc.*, ASBCA No. 58492 (August 18, 2014)**

- Claims arising under a cost-type services contract for dining facilities in Iraq.
- ASBCA held that it lacked jurisdiction to hear claims under CDA statute of limitations:
  - Contractor's claim did not "relate back" to an earlier claim submitted and then withdrawn before the CO issued a final decision (which the Board considers the "functional equivalent" of a voluntary dismissal under Fed. R. Civ. P. 41);
  - Rejected contractor's argument that claims on a cost-type contract accrue only *after* the Government's refusal to pay the contractor's reimbursement for incurred costs;
  - Contractor's extended negotiations with its subcontractor did not meet the standard for equitable tolling, which is applicable only "in situations where the claimant has actively pursued his judicial remedies by filing a defective pleading during the statutory period, or where the complainant has been induced or tricked by his adversary's misconduct into allowing the filing deadline to pass."

CDA Statute of Limitations

Laguna Construction Co., ASBCA 58569

- Issue: Claim accrual for direct (subcontract) costs.
- Facts: Cost-type task orders for Iraq reconstruction. Laguna's invoices since 2005 contained subcontract costs. Gov't reimbursed.
  - Feb. 2006 DCAA audit revealed subcontract awards based on inadequate competition and awards to other than lowest bidders. DCAA forwarded "flash report" to ACO.
  - Gov't claim to disallow subcontract costs in Dec. 2012 (>6 yrs).
- Held: For Laguna. Clock triggered by Feb. 2006 flash report.
  - Because these were direct costs, ASBCA didn't look to Incurred Cost Submission.

CDA Statute of Limitations

Coherent Logix. Inc., ASBCA 59725 (Apr. 2, 2015)

- Facts: In 2008, Contractor submitted indirect rate proposal which included $89K in "legal fees." General ledger showed that these were for patent legal costs. Contractor provided the general ledger to DCAA in 2013.
- Claim: Gov't claim in 2014 for Level 1 penalties on expressly unallowable patent legal costs. Over 6 years after rate proposal.
- Held: For Gov't. Claim accrued in 2013 (gen. ledger).
- On the merits, Board upheld the penalties because inclusion was not inadvertent. Rather, Contractor believed patent costs were allowable under FAR 31.205-30(c) (Patent Costs).

DCAA Guidance on "Expressly Unallowable Costs"

DCAA Memorandum for Regional Directors (January 7, 2015)

- DCAA issued guidance to auditors for determining whether certain costs are "expressly unallowable" – and therefore subject to penalties – even when the regulations "do not state in direct terms that the cost is unallowable"
- Guidance is intended to "enhance" the December 18 guidance to similar effect
- This guidance is inconsistent with the CAS 405 definition of "expressly unallowable cost" (i.e., "a particular item or type of cost which, under the express provisions of an applicable law, regulation, or contract, is specifically named and stated to be unallowable")
- Will likely lead to confusion in the audit process and undoubtedly result in DCAA auditors assessing more penalties against contractors on dubious grounds

Uncompensated Overtime (UCOT) – Stealth Regulation

- Rule effective March 2, 2015. 80 Fed. Reg. 4992 (Jan. 29, 2015).
- Amends FAR 52.237-10, *Identification of Uncompensated Overtime*:
  - (b)(1) Whenever there is [UCOT], the adjusted hourly rate (including [UCOT]), rather than the hourly rate, shall be applied to all proposed hours, whether regular or overtime hours.
  - (2) All proposed labor hours subject to the adjusted hourly rate (including [UCOT]) shall be identified as either regular or overtime hours.…This includes [UCOT] hours that are in indirect cost pools for personnel whose regular hours are normally charged direct.
- Problem: Some contractors use the overhead method of accounting for UCOT.
  - DCAA recognizes the overtime method in its audit manual.
  - New rule requires contractors to apply the adjusted labor rate to bid hours, which is inconsistent with the overhead method of accounting.
- Questions: Is the new rule just a disclosure requirement, or do contractors have to use the adjusted rate method for estimating (which would require the same method for accounting)?
  - If the new rule is not just a disclosure requirement, complying with it will require some contractors to make a change in accounting practice. If they change, is this a required change?

Allowability of Legal Costs Related to Whistleblower Proceedings

FAR 31.205-47 Costs related to legal and other proceedings

- New rule amends FAR 31.205-47 to make legal costs related to whistleblower proceedings unallowable if the contractor is found liable for fraud or similar misconduct in the whistleblower proceeding
- Gives the same treatment of costs for settled whistleblower complaints as is currently provided for settlement of proceedings brought by a third party under the False Claims Act in which the United States does not intervene (i.e., costs may be allowable if there was very little likelihood that the whistleblower would have been successful).

Independent Research & Dev. (IR&D) Reporting

- Apr. 24, 2014 – DCAA Guidance re DFARS 231.205-18(c)
- Applies to "major contractors" with $11M in IR&D and B&P costs during previous Fiscal Year
- To claim IR&D costs as allowable, contractor must report all "project" information to the Def. Tech. Info. Ctr. (1) NLT 3 months after end of FY in which costs first incurred, and (2) update annually NLT 3 months after end of each FY until completed.
- In performing incurred cost audits, auditors should question unreported IR&D project costs as expressly unallowable costs (penalties).
- If amount is "significant," auditor should also consider:
  - CAS 405 noncompliance
  - Inadequate internal controls ➔ significant deficiency in accounting system

Compensation Caps

- On May 30, 2014, the FAR Councils adopted as final the interim rule amending FAR 31.205-6(p), implementing Section 803 of the NDAA and expanding the senior executive compensation benchmark to all employees for DoD, NASA, and Coat Guard contracts
- On June 24, 2014, an interim rule amended FAR 31.205-6(p) to implement the Bipartisan Budget Act of 2013's compensation cap ($487,000)
- The new cap applies to the cost of compensation for all contractor and subcontractor employees under contracts awarded on or after June 24, 2014
- As a result of the interim rule, many contractors would have contracts subject to both the current and earlier compensation caps in 31.205-6(p)
- October 2014 memorandum from Shay Assad deemed contractors' use of blended rate approach as "practical and cost efficient" solution to implementing the new requirements

Performance Based Payments (PBPs)

- Final Rule effective Mar. 31, 2014; amends DFARS.
- PBPs provide for alternative financing for fixed-price contracts based on achieving milestones.
- New Rule: Essentially converts PBPs into progress payments based on costs:
  - For PBP request, contractor must provide cumulative: (1) PBP value requested, and (2) costs incurred to date.
  - Rule: Cum. PBPs cannot exceed cum. incurred costs. Gov't verification into Contractor's books. PBPs paid monthly.
- Outcome: Defeats purpose of PBPs if contractor cannot get any more than progress payments. PBPs cannot include profit.

Statutory & Regulatory Update & Guidance

DoD Inspector General Review of DCAA Quality Control

- Aug. 21, 2014, DoD Inspector General issued a system review report rating DCAA's system of quality control as "pass with deficiencies."
  - Found 11 of 92 DCAA engagements to contain errors for lacking sufficient documentation and not following the DCAA Contract Audit Manual.
- Sept. 2014, follow-up DoD IG report found 13 of 16 audit reports reviewed contained one or more "significant deficiencies"

Cost Cases – Gov't Required to File Complaint

- Four recent cases where Government required to file a Complaint at the ASBCA
  - *Appeal of Beechcraft Defense Co.*, ASBCA No. 59173 (April 24, 2014)
  - *Appeal of BAE Systems Land & Armaments Inc.*, ASBCA No. 59374 (Nov. 18, 2014)
  - *Appeal of Dynport Vaccine Company LLC*, ASBCA No. 59298 (Jan. 15, 2015)
  - *Appeal of Kellogg Brown & Root Services Inc.*, ASBCA No. 59557 (Jan. 22, 2015)
- When will the Board require the Government to file Complaint?
- Strategic considerations for contractors

Cost Cases – Materiality & CAS 418

Sikorsky Aircraft Corp. v. United States (Fed. Cir. 2014)

- Facts: Sikorsky allocated OH costs of purchasing & handling materiel to cost objectives in proportion to the direct labor costs of each contract (labor base).
- Claim: Gov't $80 million claim for noncompliance with CAS 418 (re: proper allocation of direct and indirect costs)
- Held: For Sikorsky.
  - Test under CAS 418.50(e) turns on whether the "indirect cost pool includes a ***material amount*** of the costs of management or supervision" (CAS 418.50(e))
  - Held "material" means "a significant amount" – *not* merely more than *de minimis*.
  - Compared the costs of mgmt. within the pool to the costs of the total pool and determined that the managers comprised 7 to 14% of the total cost.
  - Held that 7 to 14% of a very large materiel overhead cost pool was *not* "significant."
  - Because it was not significant, it was "not a material amount."

Cost Reasonableness

BAE Systems San Francisco Ship Repair, ASBCA No. 58809, 58810

- Two claims under multiple-award, task order contract for the programmed maintenance of a Logistics Support Vessel
- Contractor argued that it was entitled to the amounts verified by the DCAA audit reports as having been incurred
- The contractor bears the burden of demonstrating that costs were reasonable
- Board rejected contractor's assertion that "DCAA has sole authority to audit and to express conclusions" regarding the allowability of claimed costs
- "As a matter of law, it is he CO's prerogative to accept all or part of a contractor's claim or reject the claim entirely. There should be no confusion on this point."

Cost Cases – G&A on T&M Travel

SOS Int'l, Ltd. v. DOJ, CBCA 3678 (Sep. 26, 2014)

- Facts: T&M contract for linguistic services. RFP specified that hourly rates included G&A, profit, and "all costs necessary to perform."
  - Separate CLIN for "travel," which listed exceptions to hourly rate as "transportation, lodging, meals, and incidental expenses"
  - SOS billed G&A on travel costs. Gov't paid, but later rejected.
- Held: For Gov't. G&A not permitted on travel costs because T&M rates were inclusive of "all costs necessary to perform."
  - Travel was not a "material" cost under T&M. Rather, it was "ancillary to" and "not independent of" providing the linguist services.

Private Security Company Costs

***Kellogg, Brown & Root Services, Inc.*, ASBCA Nos. 56358 *et al*.**

- KBR provided the Army with logistical support in Iraq following the 2003 invasion
- When Army could not fully protect subcontractors' convoys from attacks, KBR utilized private security companies
- In December 2005, the Army issued a policy statement that said use of private security companies in Iraq would be authorized on a case-by-case basis
- KBR sought reimbursement for private security costs already incurred, but Army deemed $44 million in private security costs unallowable
- Board held that Government failed to meet its burden of proof in establishing that the cost was unallowable by operation of a specific statute or regulation, because no regulation or contract clause prohibited the use of private security contractors
- Board held the use of private security forces under the circumstances, and the cost of the services, to be reasonable

Cost Cases – CAS vs. FAR

Raytheon Co. v. United States, 747 F.3d 1341 (Fed. Cir. 2014)

- Issue: Are pension segment closing adjustments (CAS 413; FAR 31.205-6(j)(4)) "pension costs" subject to "timely funding" requirement ((j)(2)-(3))
- Facts: Raytheon sought $80M in costs arising out of its adjustment deficit. Costs allocable under CAS 413. Gov't denied costs as unallowable because not "timely funded," a requirement for "pension costs."
- Held: For Raytheon. Segment closing adjustments are not "pension costs" and not subject to the timely funding requirements:
  - Broadens the authority of the CAS when in conflict with the FAR:
    - The CAS's authority over "measurement of a cost" includes defining the *components of costs…*The CAS therefore has the exclusive authority to define the components of a pension cost, while the FAR determines whether that cost — *as defined by the CAS* — is allowable and will be reimbursed by the Government."
  - Gov't bears the burden to prove segment closing adjustments do not comply with CAS, even where contractor filed claim for adjustment.

Fixed Fee

Appeal of Teledyne Brown Eng'g, Inc., ASBCA No. 58636

- Dispute arising out of an incrementally funded CPFF task order
- Government moved for summary judgment, contending that Teledyne was not entitled to the full fixed fee because only approximately one-half the total cost ceiling contemplated by the contract was reached
- Government argued that Teledyne was only entitled to the percentage of the fee corresponding to the percentage of funding actually allocated to the contract
- Teledyne argued that it performed all work required and is entitled to the entire fixed fee
- Board denied Government's motion, holding that Teledyne's entitlement to fixed fee depends on whether its cost-plus-fixed-fee contract is completion form or term form, and material facts remained in dispute on this point

Questions?

Terry Albertson
202-624-2635
talbertson@crowell.com

Steve McBrady
202-624-2547
smcbrady@crowell.com

Skye Mathieson
202-624-2606
smathieson@crowell.com