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A Perfect Storm Is Brewing: What DCAA Audit Tardiness, Audit Backlog and Recent Judicial Decisions Mean For Contractors

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Driven by government inaction, a perfect storm looms. This storm threatens to eradicate millions of dollars of potential overpayments to contractors. In terms of lost dollars, the results may be disastrous. The government has seeded this storm by its inexplicable failure to audit contractor incurred cost and other proposals within a reasonable time, with some open audits dating back to 1996. Sequestration budget cuts will only compound the problem as the Defense Contract Audit Agency (''DCAA'') is expected to furlough auditors for 22 days[1] in the face of a massive backlog of 25,000 incurred costs proposals worth $573 billion.[2] Although DCAA has instituted measures to ''catch up'' by auditing concurrent years, raising the dollar threshold and adding personnel, the backlog has not materially decreased.[3] The proverbial chickens are now coming home to roost; judicial application of the Contract Disputes Act's (''CDA's'') six year statute of limitations has sided, for the most part, with the contractor.[4] The first round of judicial decisions addressing this tardiness suggest that the damage inflicted may be significant. The most recent board decision, *Raytheon Missile Systems*, affirms that DCAA delays have now caught up with the government. This decision underscores the courts' and the boards' refusal to allow the government to rely on tardy DCAA audits to excuse late government claims. This article frames the jurisdictional standard issue, assesses this recent run of contractor-favorable decisions and explains the practical ramifications for contractors.

Statute of Limitations Under the Contract Disputes Act (CDA). The statute of limitations (''SOL'') under the Contract Disputes Act (''CDA'')[5] is applicable to a government (or contractor) claim when the contract at issue was awarded after October 1, 1995.[6] Where the CDA's SOL is applicable, both government and contractor claims must be submitted within six years of ''accrual'' of the claim.

The CDA SOL provides in relevant part:

> Each claim by a contractor against the Federal Government relating to a contract and each claim by the Federal Government against a contractor relating to a contract shall be submitted within 6 years after the accrual of the claim.
>
> [7]

The CDA does not define the term ''accrual of a claim,'' but the FAR's implementing regulations define accrual of a claim to mean ''the date when all events, that fix the alleged liability of either the Government or the contractor and permit assertion of the claim, **were known or should have been known**.''[8] The FAR further provides that, ''[f]or liability to be fixed, some injury must have occurred. However, monetary damages need

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[1] Knauth, Dietrich, ''Defense Auditor Struggles with Backlog as Furloughs Loom,'' LAW360 (March 14, 2013), http://www.law360.com/governmentcontracts/articles/423932/defense-auditor-struggles-with-backlog-as-furloughs-loom.

[2] GAO, DEFENSE CONTRACTING: DOD INITIATIVE TO ADDRESS AUDIT BACKLOG SHOWS PROMISE, BUT ADDITIONAL MANAGEMENT ATTENTION NEEDED TO CLOSE AGING CONTRACTS, GAO-13-131, December 18, 2012, *available at* http://www.gao.gov/assets/660/650970.pdf.

[3] In 2011, the DCAA only completed 349 audits of incurred costs. *See* Fn. 1. As discussed below, DCAA may also attempt to ''restart the clock'' by returning proposals to contractors due to inadequacy. The success of that approach remains to be seen, but based on recent judicial decisions noting that a party cannot use ''gamesmanship'' to unilaterally control the statute of limitations (''SOL'') clock, the agency will have a difficult time winning.

[4] 41 U.S.C. 7103(a)(4).

[5] *See* 41 U.S.C. 7102.

[6] *See* FAR § 33.206..

[7] 41 U.S.C. § 7103(a)(4)(A).

[8] FAR § 33.201 (emphasis added).

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not have been incurred.''[9] In applying these regulations, courts and boards have found that a claim accrues under the CDA when: (1) ''all the events have occurred which fix the contractor's liability and entitle the claimant to institute an action,'' and (2) the government ''knew or should have known of its claim.''[10]

The accrual determination is a factual analysis. To determine when injury occurred and liability became fixed, boards ''start by examining the legal basis of the particular claim.''[11] ''The question of whether a claimant should know of its claim is a fact-bound inquiry that depends on the reasonableness of the claimant's actions.''[12] When monetary damages are alleged, some extra costs must have been incurred before liability can be fixed and a claim accrued, but there is no requirement that a sum certain be established.[13] Once a claim accrues, the CDA SOL will run on a government claim until the CO issues a written final decision.

Application of 'Accrual' Clock: Raytheon Missile Systems and 'Friends'. The recent run of pro-contractor cases have clarified when the government should have known a claim accrues in the context of a contractor's cost-related submissions. It is apparent now that a government claim accrues under the CDA at the time of the contractor's submission (incurred cost proposal, CAS disclosure, etc.) or shortly thereafter.

The most recent case confirms this test. In *Raytheon Missile Systems*,[14] the Armed Services Board of Contract Appeals (''ASBCA'' or ''Board'') held that the government's $17 million claim against Raytheon was time-barred under the CDA six-year SOL.[15] The *Raytheon* case arose from a $375 million firm-fixed price contract between U.S. Naval Air Systems Command and Raytheon to manufacture Tomahawk Missiles. The government sought to disallow $17 million in overhead costs that Raytheon had charged in connection with a Lockheed Martin Corp. subcontract. As part of the contract negotiation process in 1999, Raytheon had provided the government with a price proposal that showed that the Lockheed Martin subcontract was not priced as a ''major'' subcontract requiring reduced rates, in potential violation of its 1999 Cost Accounting Standards (''CAS'') disclosure to the Defense Contract Management Agency (''DCMA''). The government did not bring a claim against Raytheon until DCAA finished its audit in 2006 and informed the Contracting Officer (''CO'') of the discrepancy. The board, however, found the contractor's CAS non-compliance ''was perfectly knowable in 1999 because Raytheon disclosed the underlying facts about its subcontract burdens to the government at that time.''[16] The board held that a CDA claim cannot be suspended pending actions by the DCAA to complete its audit: ''[A] single party [cannot] postpone unilaterally and indefinitely the running of the statute of limitations.''[17] Instead, a claim accrual ''turns upon what facts are reasonably knowable.''[18] This decision further protects contractors against tardy claims that might result from DCAA's backlog of 25,000 incurred cost audits, some of which date back to 1996.

The board also flatly rejected the government's contention that a CDA claim does not accrue until the CO knows or should have known about the discrepancy, noting that ''if that were the case, then both contractors and the government could suspend accrual by internally compartmentalizing relevant information and insulating senior decision makers for as long as they choose.''[19] The board stressed that ''nothing in FAR 33.201 . . . contemplates permitting such gamesmanship.''[20]

Raytheon Missile Systems, notably, does not stand alone. It stands on the shoulders of several recent cases that resulted in the dismissal or rejection of government legal positions for government claims related to costs questioned via tardy DCAA audits. These include the following:

■ A few months prior to this *Raytheon Missile Systems* decision, Raytheon achieved success before the ASBCA in *Raytheon Co*.[21] In this case, the government sought to recover increased costs resulting from a contractor's inclusion of allegedly unallowed costs in its incurred cost submission (''ICS''). The contractor pointed out that more than six years had passed since it submitted the relevant ICSs. The government argued, *inter alia*, that its claim was timely because the DCAA audit on one of the ICSs in question had been completed within the SOL although the ICS had been submitted outside the SOL. Significantly, the board held that the ICS submissions marked the time at which the government knew or should have known about the inclusion of the costs. The board explained that based upon ''the information available to DCAA about the program at the time . . . , we agree with Raytheon that the government should have known [of facts], which in the government's present view makes the related costs unallowable.''[22] Thus, *Raytheon Co.* imputed the DCAA's knowledge of the underlying facts of a claim to the government as a whole and held that the CO's knowledge alone is not dispositive of when the government knew or should have known of the facts underlying the claim.[23]

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[9] FAR § 33.201.

[10] *See Am. Ordnance LLC v. United States*, 83 Fed. Cl. 559, 574-75 (2008); *McDonnell Douglas*, ASBCA No. 56568, 10-1 BCA ¶ 34,325 at 169,528-29 (finding claim barred when DCAA findings put government on notice of potential claim); *Boeing Co.*, ASBCA No. 57490, 12-1 BCA ¶ 34,918 (a claim accrues when the events giving rises to liability were know or should have been known).

[11] *Gray Personnel, Inc.*, ASBCA No. 54,652, 06-2 BCA ¶ 33,378 at 165,475; see also *McDonnell Douglas*, 10-1 BCA ¶ 34,325 at 169,527-29 (claim barred when ''the government's underlying theory of liability was set'' more than six years before contracting officer's final decision).

[12] *See Sikorsky Aircraft Corp. v. United States*, 105 Fed. Cl. 657 (2012) (*citing Holmes v. United States*, 657 F.3d 1303, 1320 (Fed. Cir. 2011)). Indeed, it is an ''objective standard,'' actual knowledge of all relevant facts is not required. *Id.* (*citing Fallini v. United States*, 56 F.3d 1378, 1380 (Fed. Cir. 1995)).

[13] *McDonnell Douglas*, ASBCA No. 56568, 10-1 BCA ¶ 34,325.

[14] ASBCA No. 58011 (Jan. 28, 2013).

[15] *See* 41 U.S.C. 7103(a)(4)(A).

[16] *Raytheon Mission Systems*, ASBCA No. 58011 (Jan. 28, 2013), at page 5.

[17] *Id.*

[18] *Id.*

[19] *Id.*

[20] *Id.*

[21] ASBCA Nos. 57576, 57689, 13-1 BCA ¶ 35,209 (Dec. 17, 2012).

[22] 13-1 BCA ¶ 35,209 at 172,752.

[23] The board did reject the SOL preclusion for other claims because, in those instances, the government could not have

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■ Raytheon scored another victory a few months earlier in *Raytheon Co. v. United States*,[24] where the court determined that the government's $25 million claim against the contractor was time-barred by the statute of limitations because the government had actual knowledge of its claim nine years earlier when the parties agreed to costs in an advance agreement. There, the court held that the government claim began to accrue when the contractor submitted cost information to support the advance agreement, and not when DCAA finally audited that information.[25]

■ Similarly, in *Sikorsky Aircraft Corp. v. United States*,[26] the government claimed that the contractor owed approximately $80 million due to alleged violations of the CAS. The contractor argued that the claim fell outside the SOL, but the government attempted to argue that the claim did not accrue until the government completed the administrative process for addressing violations of the CAS. The court did not decide the motion for summary judgment at issue due to multiple factual issues; however, it notably did reject the government's legal position, holding that the government cannot hide behind its administrative procedures to assert that its claims do not accrue until these procedures have been completed.[27]

Managing the 'Perfect Storm'. The good news for contractors, of course, is that these decisions are not outliers. Indeed, as noted above, the backlog of potentially untimely DCAA audits is massive. Thus, contractors should consider these practical recommendations:

■ *Assess the Facts*: While each circumstance will require independent factual development about DCAA's actions, contractor-DCAA communications, and the visibility of the particular cost or allocation in the contractor submission, the situation is ripe for contractor success. Indeed, the government recognizes its vulnerability on this issue and is scrambling to issue final decisions that will be considered timely. Thus, contractors who are facing the potential issuance of final CO decisions should act now to marshal facts and relevant documents in order to be proactive in assessing and asserting their statute of limitations positions. Moreover, if the contractor assesses its SOL arguments and finds them persuasive, the SOL application will also provide strong negotiating positions for outstanding proposals.

■ *Inadequate Proposals*: We are also seeing DCAA return contractor proposals it claims are ''inadequate'' in order to improve its backlog statistics.[28] However, the test for proposal adequacy is imprecise and situation-dependent.[29] In any event, it is likely that the agency will also use this strategy in an attempt to ''restart'' the SOL clocks. Depending upon the agency's rationale for return, the contractor should respond quickly and document its approach. It remains to be seen how a court or board will handle this, but based on these recent decisions, they will likely not approve perceived ''gamesmanship'' or returns based upon overly technical format and related rationales. Moreover, a contractor may assert that the very fact DCAA reviewed the proposal in order to determine adequacy triggers the accrual because the agency should have learned of the issue during this review.

■ *Premature Government Claims*: Contractors should anticipate that these recent decisions may force the government to assert potential claims more proactively—and prematurely—in an effort to avoid triggering the SOL. As a result, DCAA issued guidance in September 2012 that emphasized prioritizing the highest-dollar and highest-risk contracts.[30] The guidance also raised the threshold for automatic audits of incurred cost proposals from $15 million to $250 million.[31] It also reduced the number of random-sample audits.[32] While these steps may lead to a welcome reduction in the audit backlog, they also create the risk of rushed audits in which the rights of the contractor may be overlooked.

■ *Mind Your Own House*: Contractors must also be mindful that these SOL principles apply equally to a contractor claim. Thus, contractors should review cost submissions vulnerable to the SOL in order to determine if they have any affirmative claims for increased costs. In other words, if a contractor has potential claims it would have known about at the time of its submissions, it may have to consider filing a preemptive certified claim to protect itself—even where the government may be primarily responsible for the delay.

■ *Continuing Claims*: Contractors should also be alert to any basis to defend against government claims that are within the six year limitation. If these claims can be shown to be dependent upon prior claims barred by the SOL, they may also be rejected under the ''continuing claims'' doctrine. The government will likely assert that each subsequent claim is a new claim, independent of any previous claims barred by the CDA SOL and thus not precluded. The test is whether there is a seminal event that constitutes one cause of action or whether each subsequent refusal to pay constitutes a separate cause of action. Thus, contractors should examine the facts to see if a single event propelled the government claim such that subsequent proposals would be barred by the SOL in addition to the initial claim made over six years ago.[33]

■ *Tolling Agreements*: If the government suggest that the parties enter a tolling agreement, a contractor should consider its options carefully and consider that

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been aware ''actually or constructively'' of any increase costs because the costs were not included in Raytheon's overhead cost submission until a submission made less than six years before the government claim was made. *Id.* at 172,751-52. Thus, the government had suffered no injury of which it should have known.

[24] 104 Fed. Cl. 327 (Apr. 2, 2012).

[25] *Id.* at 333.

[26] 105 Fed. Cl. 657 (July 18, 2012).

[27] *Id.* at 667-74. The government's success in a prior case is distinguishable because, in that case, the contractor's proposal did not provide the information necessary for the government's claim to accrue. *See Lockheed Martin Corp.*, ASBCA No. 57525, 12-1 BCA ¶ 35,017 (March 28, 2012).

[28] *See* FAR 42.705-1(b)(1) (requiring contractor to submit adequate incurred cost proposals).

[29] *See* FAR 42.705-1(b)(2) (noting that the required content and supporting data will vary due to business type, size and other factors).

[30] *See* DCAA Regional Memo 12-PPD-023(R), Sept. 5, 2012.

[31] *Id.*

[32] *Id.*

[33] *SeeHatter v. United States*, 203 F.3d 795 (Fed. Cir. 2000).

Court of Federal Claims has recently noted that the parties cannot establish a longer SOL than the CDA.[34]

[34] *See Raytheon Co.*, 104 Fed. Cl. 327, n.4.

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