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CRISIS MANAGEMENT AND FIRST AID: WHEN GOVERNMENT CONTRACTORS ARE THE HEADLINERS

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HOT TOPICS IN COST LAW

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OOPS 2014

Executive Compensation Cap

Section 803 of FY12 NDAA

- Extended the OFPP Act cap applicability to all employees working on DoD, NASA, and Coast Guard contracts.
- Cap still applicable only to top five executives for civilian contracts.
- Statute passed December 31, 2011, but implementing regulations not issued until June 26, 2013.
- FY12 cap: $952,308 (for costs incurred after (1/1/12)

Executive Compensation Cap

Section 803 of FY12 NDAA

- The statutory language states that the changes apply to: "costs of compensation incurred after January 1, 2012, under contracts entered into ***before, on, or after*** the date of the enactment of this Act."
- This language sets up three distinct time periods:
  - Contracts awarded prior to December 31, 2011
  - Contracts awarded on/after 12/31/11 and before the June 26, 2013 implementing regulations
  - Contracts awarded on/after 6/26/2013

Executive Compensation Cap

Section 803 of FY12 NDAA

- Contracts awarded before December 31, 2011
  - Allowable Cost and Payment clause directs the government to issue payments "in accordance with [FAR] subpart 31.2 . . . in effect on the date [of contract award]."
  - Case law is fairly clear that retroactive application of a law that causes a contract breach is not permissible, and a regulation purporting to change a cost principle retroactively was held to effect a contract breach.
  - Regulations have not been issued to implement a retroactive application of Section 803.

Executive Compensation Cap

Section 803 of FY12 NDAA

- Contracts awarded on/after December 31, 2011 and before June 26, 2013
  - The June 26, 2013 interim regulations implement Section 803's changes to the compensation cap for costs incurred as of January 1, 2012.
  - Multiple legal issues will need to be resolved to definitively determine whether Section 803's changes apply to costs incurred between 1/1/12 and 6/26/13.
  - This is currently a gray area; contractors are taking different approaches depending on their risk tolerances.

Executive Compensation Cap

Section 803 of FY12 NDAA

- Contracts awarded on/after June 26, 2013
  - The June 26, 2013 interim regulations revised the cost principle at FAR 31.205-6(p) to implement Section 803's changes to the compensation cap.
  - It is clear that for costs incurred after June 26, 2013, the cap applies to all employees' compensation costs, for work on DoD, NASA, and Coast Guard contracts.

Executive Compensation Cap

Bipartisan Budget Act of 2013

- BBA set a new compensation limit of $487,000
- BBA applies to all contractor employees, regardless of the type of contract involved (i.e., both defense and civilian)
  - Eliminates the OFPP Act formula
  - Will be adjusted for inflation
  - Allows for "narrowly targeted" exemptions for qualified "specialists" (e.g., highly qualified scientists, engineers)
  - Applicable to subcontractor compensation costs

Executive Compensation Cap

Bipartisan Budget Act of 2013

- BBA signed into law December 26, 2013
- BBA states that the new compensation limit will be applicable to costs claimed on contracts and subcontracts awarded on or after 180 days after enactment – i.e., June 24, 2014.
- FAR 31.205-6(p) has not yet been revised to reflect the BBA changes.

Executive Compensation Cap

Compliance Tips:

- Once the BBA is implemented via a FAR change, contractors will likely need:
  - 1. One set of rates applying the $487,000 cap for contracts awarded on/after BBA implementation.
  - 2. At least one set of rates applying the OFPP Act cap for contracts awarded prior to the BBA.
  - 3. If the contractor has significant DoD/NASA/Coast Guard work awarded prior to the BBA, it might need a separate set of rates for those contracts (applying the OFPP Act cap to all employees).

CDA Statute of Limitations

- The Contract Disputes Act, 41 U.S.C. §§ 7101-7109, sets forth certain prerequisites for the exercise of jurisdiction over claims, including 6-year SOL
- Claims submitted more than six years after **accrual** are not valid and cognizable under 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** …
- "Contracting parties cannot establish a statute of limitations longer than that set forth in the Contract Disputes Act, where the Government is a party … [th]us, parties may set a shorter limitations period, but not a longer one."
- Key takeaway: once a contracting party is aware of the basis for its claim, it is "on the clock" and should not rely on discussions or agreements with the other party to resolve a dispute or toll the statute of limitations, at the expense of preserving its claim.

Statute of Limitations Case Law – CAS Noncompliance

Sikorsky v. United States, COFC Nos. 09–844C & 10–741C (March 27, 2013)

- Government claimed contractor had misallocated $80 million of indirect costs in violation of CAS 418.
- Court held that Government did not have actual or constructive knowledge of its potential claim against contractor for alleged CAS violation, where "[t]he requisite information was not available to the government."
- Court distinguished Sikorsky case from other decisions holding that an audit need not be completed for a Government claim to accrue.
- Though claim determined to be timely, Government ultimately failed to prove that contractor violated CAS 418.
- Update: The government did not appeal this decision

Statute of Limitations Case Law – Accounting Change

Appeal of Raytheon Co., ASBCA No. 57801 (April 22, 2013)

- Board dismissed the Government's CAS-based claims relating to 3 out of the 4 accounting practice changes.
- Raytheon had submitted a revised Disclosure Statement and ROM cost impact assessment more than 6 years before CO's final decision asserting claim.
- Board allowed one of four claims to proceed "where Raytheon only reported the fact of a change, not the implications of it or other data," a reminder to contractors of the importance of complying with the regulatory requirement to provide timely estimates of the impacts of accounting changes.
- Board noted that "[c]laim accrual does not depend on the degree of detail provided, whether the contractor revises the calculations later, or whether the contractor characterizes the impact as 'immaterial,'" but is pegged instead to when the contractor "notified the Government of a specific, adverse cost impact flowing from [the change]."

Statute of Limitations Case Law – CAS Noncompliance

Appeal of Fluor Corp., ASBCA No. 57852 (December 3, 2013)

- Board held that the government's claim relating to an alleged CAS 403 noncompliance "was a continuing claim inherently susceptible to being broken down into a series of independent distinct events."
  - Namely, each payment by the government for a CAS-non-compliant billing.
- Thus, the board held that, under the CDA's statute of limitations, the government "knew or should have known" that it had a claim against the contractor as of the date the compliance audit was completed (for amounts paid before that date), but that claims for the same alleged CAS noncompliance in subsequent years would not accrue until the amounts at issue for those years had been billed and paid.
- Result that may save some government claims from the CDA's 6-year SOL.

Statute of Limitations Case Law

- Discussion – where are we now?
  - ICS Claims
  - CAS Noncompliance Claims
  - Accounting Change Claims
  - TINA

Recent Cost-related Decisions

The Boeing Co., ASBCA Nos. 57549 et al. (2013)

- Boeing argued that the governing statute (41 U.S.C. 1503(b)) expressly allows the offset of simultaneous increased and decreased cost changes for purposes of making a price adjustment on CAS-covered contracts.
- The government argued that the governing regulation (FAR 30.606(a)(3)), as amended on April 8, 2005, prohibits offsetting multiple accounting practice changes.
- ASBCA held that Boeing could properly combine simultaneous cost accounting practice changes for the purpose of computing the aggregate cost impact to the government.
  - However, the Board interpreted the pre-2005 version of FAR 30.606(a)(3), which applied to the contracts at issue in the case
  - Still unanswered is whether offsetting is permitted under the current version of FAR 30.606(a)(3)

Recent Cost-related Decisions

Lockheed Martin Corp. v. U.S., No. 08-1160 (D.D.C. Apr. 22, 2014)

- Lockheed brought a CERCLA action against the Government, seeking recovery of past and future response costs to remediate the environmental contamination caused by corporate predecessor's operation of three rocket motor-production facilities in California from 1954 to 1975.
- Three ways for contractors to recover old remediation costs
  - As indirect cost in the appropriate pool
  - As direct cost under specific indemnification provisions in specific contracts
  - Under the equitable contribution provisions of CERCLA
- LM tried all three
  - Recovered and continues to recover in indirect rates
  - Sought indemnification under old contracts (but dropped that case)
  - Sought contribution under CERCLA for past and future costs
- Court declined to required Government contribution under CERCLA for prior costs already recovered in rates.
- Court required equitable participation by the Government in future remediation costs.
- LM will presumably continue to recover future costs in its rates, net of CERCLA contribution.

Recent Cost-related Decisions

General Dynamics Corp. v. Panetta, 714 F.ed 1375 (Fed. Cir. 2013)

- For purposes of calculating the retirement plan forward pricing rate, required by FAR 42.1701, GD used the midyear pension asset value (rather than January 1 value), combined with an agreed-upon pension growth rate (e.g., 8% per year), to create a blended rate for the base year and then applied the 8% growth rate for the remaining years in the 3 to 9 year projection.
- DCMA determined that the blended rate was non-compliant with CAS 412.
- Court affirmed the ASBCA decision and held that GD's use of actual, intra-year pension fund returns in its forward pricing estimates of pension costs violates CAS 412-50(b)(4):
  - both the mid-year market value and blended rate are actuarial assumptions
  - GD's method does not reflect long-term trends so as to avoid distortions caused by short-term fluctuations
  - CAS controls when there is a conflict with FAR and TINA involving allocability of costs

Recent Cost-related Decisions

Appeal of Lockheed Martin Aeronautics, ASBCA No. 56547 (2013)

- Board sustained appeal of $14 million defective pricing claim.
- Government offered four separate recommended price adjustments, including the original RPA asserted in DCAA's post-award audit and adopted by the CO.
- Board held that Government's multiple, inconsistent damages theories failed to demonstrate that the allegedly undisclosed subcontract data led to a higher negotiated prime contract price.
- While Government entitled to presumption that non-disclosure of cost or pricing data resulted in an overstatement of the price, "the presumption is rebuttable and is not a substitute for specific proof establishing the amount of such damages."

Recent Cost-related Decisions

Appeal of Parson-UXB, ASBCA No. 56481 (August 1, 2013)

- Contractor removed unexploded bombs from an uninhabited Hawaiian island under a contract with the Navy. After settling dispute with HI over payment of state excise taxes, it sought reimbursement from the Navy, which the Navy declined to pay.
- Board held that Limitation of Cost and Limitation of Funds clauses did not bar recovery of Hawaii general excise taxes Parsons-UXB required to pay, even though the taxes exceeded the amount of funds allotted to the contract.
- Board held that this was not a situation where the contractor "knew it had incurred costs to the point of an overrun that it failed to communicate to the Government" because "[h]ere, the JV and the Navy partnered in the dispute over a category of costs, state taxes, which generated uncertainty about those costs that was known to all."
- Given that the purpose of the LOC and LOF clauses is to permit the parties to prospectively determine their future dealings, "the Navy was given all the notice it needed."

Recent Cost-related Decisions

Appeal of Boeing, ASBCA No. 57409 (December 3, 2013)

- Boeing appealed a final decision of the TCO denying ratification of most of a subcontract termination settlement agreement.
- Considered whether the Limitation of Funds (LOF) clause of the contract limited the recovery sought by Boeing.
- Holding that the LOF clause limited Boeing's recovery, Board refused to allow recovery of costs incurred in excess of the funded amounts, statingthat, if the contractor incurred costs in excess of the allotted funding, "it was a volunteer and did so for its own account."
- Case serves as a reminder of the risks LOF clauses pose for contractors, who normally must assure that funding on their contracts will be adequate not only for work underway but also for recovery of prime and subcontract costs in the event of a termination for convenience.

Recent Cost-related Decisions

Kellogg Brown & Root Services, Inc. v. U.S., 728 F.3d 1348 (Fed. Cir. 2013)

- Cost reasonableness case, involving costs incurred during wartime in Iraq.
- DCAA challenged certain fixed-price subcontract costs on the basis that the prime contractor had not sufficiently negotiated the subcontract price.
- Federal Circuit rejected the argument that "cost reimbursement contracts require only that the contractor gives its best efforts when performing, and its costs are payable absent gross misconduct."
  - Upheld the lower court ruling that "reasonableness of specific costs 'must be examined with particular care' when the costs incurred may not be subject to effective competitive restraints."

Notable DCAA Audit Guidance

Guidance on Professional and Consultant Service Costs Documentation

- FAR 31.205-33 requires three types of documentation to determine costs are allowable:
  - Details of all agreements
  - Invoices or billings
  - Consultant work product and related documents
- DCAA looks for:
  - An agreement that explains what the consultant will be doing for the contractor
  - Copy of the bill for the actual services rendered, with evidence as to the time expended and nature of services provided
  - Explanation of what the consultant accomplished (drawing, power point presentation, other evidence of service provided)

Notable DCAA Audit Guidance

Guidance on Professional and Consultant Service Costs Documentation

- Guidance directs auditors to use judgment; indicates that alternative evidence can be sufficient (e.g., meeting with the consultant in lieu of reviewing work product)
- Clarifies that not all costs categorized as "consultant" costs qualify as Professional and Consultant Service Costs (e.g., purchased labor)

Notable DCAA Audit Guidance

Guidance on Reliance on Scanned Images

- FAR 4.703(c) allows contractors to duplicate and store original records in electronic form. Contractors do not have to produce originals during an audit if the contractor
  - Has established procedures to ensure that the imaging process preserves accurate images
  - Maintains an effective indexing system to efficiently access the imaged records
  - Retains the original records for a minimum of one year after imaging to permit periodic validation of the imaging system
- Guidance requires DCAA field audit offices to test contractors' scanned images annually as part of an on-going audit

Notable DCAA Audit Guidance

Guidance on Reliance on Scanned Images

- Auditors should
  - Require the contractor to provide a demonstration of the scanning and document management system
  - Determine if a transfer from one electronic medium to another will or has taken place
  - Test a sample of images to original documentation
  - Test the transfer process to ensure integrity, reliability, and security
- These reviews are required for all contractors with over $100M in auditable dollar value ("ADV") and select contractors with ADV below $100M

Notable DCAA Audit Guidance

Guidance on Access to Contractor Employees

- DCAA asserts that the FAR audit clause (52.215-2) gives DCAA the right to access contractor employees during an audit.
- Guidance indicates that DCAA should have access to
  - management personnel with information pertinent to successful planning of the audit
  - personnel who actually perform the duties being audited in a system audit walkthrough/demonstration
  - relevant personnel for labor-related audits
- DCAA will treat a denial of access to personnel as an access to records issue

Notable DCAA Audit Guidance

Guidance on Detecting Instances of Fraud

- DCAA directs that audits should be designed to detect fraud and legal/regulatory non-compliances
- Auditors should refer to the DoD Inspector General Handbook of Fraud Indicators and look for such indicators during a contract audit
  - E.g., lack of segregation of duties, inadequate monitoring by management for compliance with policies, laws and regulations, and lack of asset accountability or safeguarding procedures
- If such indicators are found, DCAA auditors should design additional audits to determine whether fraud is occurring
- Guidance alerts auditors that "management has the unique ability to perpetrate fraud by overriding controls"

Notable DCAA Audit Guidance

Updated Guidance on Access to Contractor Internal Audit Reports

- DCAA had previously issued guidance encouraging its auditors to request internal audit reports
- This guidance states that to gain access, DCAA must
  - Prepare a written determination that access to such reports is necessary to complete the required evaluations of contractor business systems
  - Maintain a copy of any request to a contractor for access
  - Maintain a copy of the contractor's response

Notable DCAA Audit Guidance

Updated Guidance on Access to Contractor Internal Audit Reports

- The guidance states that DCAA should handle internal audits in accordance with general procedures for handling proprietary data
  - Auditors should not include internal audit reports as part of the working papers
  - Auditors should safeguard the reports and provide them for use in other audits only when the need arises

Questions?

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