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FEATURE ARTICLE

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Sequestration, Austerity And Terminations: Lions, Tigers And Bears—Oh My

By Mary Karen Wills and J. Andrew Stowe[1]

With the highest probability of sequestration since 1986, and the likelihood of an austerity period even if sequestration is avoided, a Government contractor's next logical step is to determine how budget cuts for existing programs may be enacted. Whether through sequestration or austerity, the Government's cuts will undoubtedly affect many programs and include both the Government workforce and that of contractors. Because of the need to support the industrial base, these cuts will likely hurt service contractors more than manufacturers.

Contractors should expect the Government to use three basic means to reduce spending on contracts: termination for default (T for D), termination for convenience (T for C) and deductive changes. The regulations and case law have defined, although not bright-line, usages for each of these mechanisms. The contractor does, however, have distinct rights and cost recoveries available under each mechanism—even under a T for D. This article provides an overview of each likely budget-cutting mechanism, the process entailed with each, and contractor recoveries available under each mechanism. Finally, the article will contrast partial terminations and deductive changes—the

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differences between the two and the comparison in cost recovery under each methodology. Contractors may face these two situations specifically, and should be well-armed to survive these most likely budget-reduction mechanisms.

Terminations and Deductive Changes—Addressing the Basics

The U.S. Government provides itself the unique contractual benefit under the Terminations clauses[2] of allowing itself to terminate contracts unilaterally, in full or in part, for both default and convenience. It also provides itself the authority under the Changes clauses[3] to modify terms authorized by the Changes clauses without the contractor's concurrence.[4] While on its face this seems unfair to the contractor, there are prescribed, albeit somewhat different, remedies available to make the contractor whole for costs resulting from a termination or change.

With the looming possibility of sequestration and the certainty of austerity, the Government will use T for D, T for C and deductive changes to reduce spending on programs that are underperforming or have already had money committed that the Government is no longer able to spend. As a general roadmap for contractors, the Federal Acquisition Regulation spells out the termination process in FAR pt. 49, from the contracting officer's perspective. As a contractor, it is important to know:

(1) which Government contract termination or change method is appropriate for your circumstances;

(2) what processes are followed under each termination or change method; and

(3) what contractor remedies are available under each termination or change method.

T for D

Overview

Default terminations can be full or partial. Regardless, they require the Government to show in a written notice of default to the contractor that:

(a) the contractor has failed to deliver products or services on time, or failed to perform the work specified under the contract within the time specified by the contract[5];

(b) the contractor is making progress in performing the work at a rate that endangers the performance of the contract[6]; or

(c) the contractor fails to perform any other provisions of the contract.[7]

Essentially, it is the remedy for a common law contract breach. When the contractor is deficiently performing some aspect of the contract and has not corrected the deficiency, the Government will issue a cure notice or a show cause notice. The difference between the notices issued is relatively straightforward:

(1) If a contract is to be terminated for default before the delivery date, then a cure notice is required by the Default clause.

(2) If there is not enough time remaining in the contract to permit a realistic cure (10 days or more), then the cure notice will not be used.[8] A show cause notice[9] will be used, requiring the contractor to show a realistic reason as to why it is not in default by demonstrating that it is able to meet a deadline, able to make sufficient progress as not to endanger the performance of the contract or providing quality products or services, or is following other contractual terms and conditions.

T for D Process

It is possible that the Government, in its budget-cutting goals, will attempt to terminate for default—in whole or in part—some contracts that really should be a T for C or treated as a deductive change. Using a T for D provides the Government with some similarities to and some distinct advantages over T for Cs and deductive changes. With a T for D, the Government:

(a) pays the contract price for supplies, products or services that have been delivered or accepted (same as a T for C or deductive change);

(b) negotiates a price for manufacturing supplies and partially completed work (same as a T for C or deductive change); and

(c) pays for the protection and preservation of the property it has accepted (same as a T for C or deductive change).

However, unlike a T for C or deductive change, the contractor may be held liable to the Government for the cost of completing the supplies, products and services.[10] Additionally, the contractor is not entitled to other cost recoveries allowed under a T for C or a deductive change and may have to return progress payments. This all pales in comparison to the T for D black mark on a contractor's past performance record that will affect its ability to obtain additional Government contract work.

Contractor Remedies

If a contractor has any questionable performance or contractual issues, it is to the Government's financial advantage in a sequestration or budget-cutting environment to use a T for D if possible. Aside from any litigation under the Disputes clause arising from T for D causes, the T for D is still a valid vehicle for the Government to eliminate contracts and cut budgets, if it can establish that the contractor was in default. However, since it may appear to be a lucrative, low-cost way to cut contracts, it may not always be used appropriately.

The contractor should be aware of the appropriate use of the T for D, document its version of key issues (like schedule slippage and subcontractor defaults), and then request the Government to excuse the default circumstances based on the contractor's documented chronology of events. If the default cause and circumstances can be shown to be excusable, the T for D will be converted to a T for C. In summary, it is only appropriate for the Government to use a T for D if there are material contract delinquency circumstances that cannot be cured—such as delivery schedule issues, project progress issues, or a contractor's unwillingness to follow contract provisions.

T for C

Overview

In a future world of budget cuts and sequestration, the one guarantee is that there will be T for Cs. As with the T for D, it is important to understand the underlying reasoning for a full or partial termination—both for cost recovery and for business purposes. The Government has the absolute right to terminate for convenience, any contract, in full or in part under the various T for C clauses when it is in the Government's interest.

There is a long and storied history of T for C, going back to *U.S. v. Corliss Steam-Engine Co.*[11] in 1875, in which the U.S. Supreme Court supported the Government's right to terminate a contract when completion of the contract was not in the Government's best interest—even though the contract had no termination clause and there was no statutory authority to terminate. Subsequent court decisions have narrowed the Government's right to terminate for convenience slightly,[12] but it remains a broad Government right that is substantially unaltered.

T for C Process

A CO initiates a T for C after determining that it is in the Government's best interest to terminate the contract and subsequently issuing a notice of termination. The notice of termination must specify the extent of the termination and the effective date of the termination. Immediately upon receiving a notice of termination a contractor must do several things,[13] including,

(1) stop work as specified in the notice;

(2) place no further subcontract orders, except as necessary to complete the continued portion of the contract in the case of a partial termination;

(3) terminate all subcontracts to the extent that they relate to the work terminated;

(4) assign to the Government, as directed by the CO, all right, title and interest of the contractor under the subcontracts terminated, in which case the Government shall have the right to settle or to pay any termination settlement proposal arising out of those terminations;

(5) with approval or ratification to the extent required by the CO, settle all outstanding liabilities and termination settlement proposals arising from the termination of subcontracts;

(6) as directed by the CO, transfer title and deliver to the Government—

(a) the fabricated or unfabricated parts, work in process, completed work, supplies, and other material produced or acquired for the work terminated; and

(b) the completed or partially completed plans, drawings, information and other property that, if the contract had been completed, would be required to be furnished to the Government;

(7) complete performance of the work not terminated;

(8) take any action that may be necessary, or that the CO may direct, for the protection and preservation of the property related to the contract that is in the possession of the contractor and in which the Government has or may acquire an interest; and

(9) use its best efforts to sell, as directed or authorized by the CO, any property of the types referred to in item (6) above, if the contractor

(a) is not required to extend credit to any purchaser; and

(b) may acquire the property under the conditions prescribed by, and at prices approved by, the CO.

The proceeds of any transfer or disposition will be applied to reduce any payments to be made by the Government under this contract, credited to the price or cost of the work, or paid in any other manner directed by the CO.

Although the CO issues the notice of termination, the termination is usually settled by a terminating CO.

Contractor Remedies

The next step in the process is contractor settlement. Settlement can occur in one of four ways[14]:

(1) negotiated agreement;

(2) determination by the TCO;

(3) costing-out under vouchers using SF 1034, Public Voucher for Purchases and Services Other Than Personnel; or

(4) a combination of these methods.

There are three bases for settlement proposals under T for Cs:

(a) no-cost settlement,

(b) the inventory basis, and

(c) the total cost basis.

Any other basis for settlement requires the approval of the chief of the contracting or contract administration office.[15] No-cost settlement is the preferred method for the Government if the contractor has not incurred costs (or is willing to waive costs incurred) under the contract, and if the Government is due no costs under the contract. If a no-cost settlement cannot be executed, then the other two approved bases for settlement (inventory or total cost) may be used. Of the two, the inventory basis is the method preferred by the Government.

Generally, under the total cost method, the contractor can recover its incurred cost (up to the total contract price) allowable under the FAR pt. 31 cost principles and allocable under the Cost Accounting Standards. Also, depending on the complexity of the settlement and the ability of the contractor's staff to perform the work, outside consultants may be retained to calculate the settlement cost and prepare the settlement proposal. The outside consultant's and attorneys' reasonable fees are allowable as part of the settlement proposal.

The basic difference between inventory basis and total cost basis settlements is that the inventory basis itemizes only those incurred costs attributable to the terminated portion of the contract, while the total cost basis itemizes the entire cost of the contract and allows for reimbursement of allowable costs up to the contract price.

Allowable costs under a T for C generally include the actual, standard or estimated costs of the following:

(1) precontract costs, generally if they were incurred directly pursuant to the negotiation and in anticipation of the award of the contract, and where their incurrence was necessary to comply with the proposed delivery schedule[16];

(2) initial costs, such as abnormally high labor, material and administrative costs that are

incurred at the beginning of a contract to "ramp up" for performance[17];

(3) completed supplies or services, such as completed end items or deliverables to be delivered at the contract price under the contract, which have been accepted but not delivered[18];

(4) cost of facilities capital[19];

(5) termination inventory, if directed by the TCO[20];

(6) loss of useful value of special tooling, machinery and equipment[21];

(7) rental under unexpired leases, with some limitations[22];

(8) restorations of leased property (assuming the alterations were necessary under the contract)[23];

(9) post-termination costs in accordance with FAR 31.205-42(b)[24];

(10) settlement expenses, including,

(a) accounting, legal, clerical and similar costs necessary for the preparation and presentation of the settlement claim and the termination and settlement of subcontracts[25];

(b) reasonable costs for the storage, transportation, protection and disposition of property acquired or produced for the contract[26];

(c) indirect costs related to salary and wages incurred as settlement expenses in (a) and (b)—normally, such indirect costs shall be limited to payroll taxes, fringe benefits, occupancy costs and immediate supervision costs[27];

(11) subcontractor claims,[28] assuming that the contractor flowed down a terminations clause to the subcontractor, in accordance with the provisions at FAR pt. 49.108-1; and

(12) profit on the preparation for and work done on the terminated portion of the contract, *but not on the termination settlement expenses or the dollar value of the subcontractor settlement costs*.[29] Profit for the subcontractor costs will be taken into consideration based upon the contractor's efforts. Profit *is not allowed* if the contract, when completed, would have been in a loss position.[30] Anticipatory profits on the work not performed on the terminated portion of the contract are not permitted. Additionally, if the contract is in a loss position, the "loss ratio" is applied to reduce the contractor's recovery by a ratio equivalent to the percent loss it would have on the entire contract, if it had been completed.[31] The loss ratio is calculated as set forth in FAR pt. 49.203 and applies to both inventory basis and total cost basis settlements.

(a) The loss ratio is calculated by taking the total contract price and dividing it by the sum of the terminated contract's cost and estimated cost to complete. If a contract is in a loss position, the resulting quotient will be less than 100 percent. That percentage is then applied to settlement cost (exclusive of FAR pt. 31.205-42(g) settlement expenses) to calculate the allowable final settlement cost.

Also, under a partial termination, a contractor may request an equitable adjustment in the price of the continued work of a fixed-price contract. For example, if a contract is partially terminated and has incurred costs for expendable tools, dies or fixtures for the terminated portion of the contract and for which there is no other use, the contractor would be entitled to an equitable adjustment on those expendable tools, dies or fixtures.

The contractor has one year from the effective date of the termination to submit a final settlement proposal to the TCO. The contractor also has to certify a final settlement proposal as accurate, current and complete if it exceeds the Truth in Negotiations Act threshold[32] (currently $700,000). Once a settlement proposal has been submitted, the TCO is required to have an audit performed on any prime or subcontractor settlement proposals in excess of $100,000. Once all the required reviews have been performed and the contractor and Government agree upon the settlement proposal, a settlement

agreement is reached[33] and a settlement negotiation memorandum is prepared by the TCO. It is advisable for contractors to prepare their own settlement negotiation memorandum and keep it on file.

Deductive Changes

Overview

Work scope and deliveries may be eliminated from a contract by employing a deductive change under the Changes clause[34] appropriate for the contract. Under this method, the Government changes the specifications for minor portions of the work, and the contractor is theoretically left unharmed because deleted work cost and a reasonable profit are deleted from the contract.

Deductive Changes Process

The process for a deductive change is the same as for any contract change. The CO may, at any time, *by written order, and without notice to the sureties,* make changes within the general scope of a contract.[35] Specific Changes clauses are applicable to fixed-price, cost-reimbursement, and time-and-materials or labor-hours contracts. Each different clause (with or without alternate clauses) defines what can be changed by the Government under each contract type as enumerated. There are a number of clauses and alternate clause combinations addressing what can be changed, so it is important for a contractor to be cognizant of those applicable to its contracts.

Contractor Remedies

Contractors have the normal remedies available under the Changes clauses, including requests for equitable adjustment. However, in the case of deductive changes, there are generally no significant areas of cost that can be affected due to the presumed minor or non-identifiable nature of the work deleted. Three key legal distinctions are drawn as the line between a deductive change and a partial termination, and will be discussed in greater detail later in this article. Any request for equitable adjustment, if such exists, must be asserted within 30 days after the date of the receipt of the written order changing the contract.[36] One problem with deductive changes is that the contractor may or may not be able to recover significant costs that could be recovered as settlement expenses under a T for C. Also, with fixed-price contracts, a deductive change (as compared to a T for C) can be beneficial or harmful depending upon the contract profit/loss margins before the change.

Partial T for C vs. Deductive Changes

Case Law Contrast

The courts have held that judgment must be used in deciding between the use of a T for C or a deductive change. In *J.W. Bateson Co. v. U.S.*, the court stated,

> It is obvious that there can be no hard and fast line between a "termination" and a "change" in the sense of these contracts. By a shift of circumstances, the two words may be made to verge on each other, or, on the other hand, may be made to stand far apart.

However, the courts have also developed three legal distinctions/tests to help relieve some of the uncertainty between a partial T for C and a deductive change. The cases that led to these distinctions are:

(1) *J.W. Bateson Co. v. U.S.*[37]—major and minor variations;

(2) *Appeal of Celesco Indus., Inc.*[38]—elimination of identifiable work; and

(3) *Appeal of Skidmore, Owings, & Merrill*[39]—Government's continuing need for the work.

In *J.W. Bateson Co. v. U.S.*, the court decided,

> The long and short of it is that the proper yardstick in *judging between a change and a termination ... would best be found by thinking in terms of major and minor variations* in the plans.

(Emphasis added.)

In *Appeal of Celesco Indus., Inc.*, the board found,

> We conclude accordingly that the partial termination notice represented by Modification P00019 reduced appellant's obligations and tasks under the contract. However, such changes in the specifications or in the scope of work are usually treated as deductive changes rather than termination actions. *The latter are more appropriate for a reduction of the number of units or supplies to be delivered, elimination*

> *of identifiable items of work, reduction in the quantity of work required under the contract, or similar reductions in contract tasks.*

(Emphasis added.)

In *Appeal of Skidmore, Owings, & Merrill,* the board decided,

> Ordinarily termination for the convenience of the Government is used when the Government's need for the article or thing called for in the contract no longer exists.

It is to the contractor's advantage to know these distinctions. If there are major variations in the plan, elimination of identifiable work, or the Government's lack of a continuing need for the products or services, a partial termination appears more appropriate. Otherwise, if there are minor variations in the plan, elimination of non-identifiable work, or the Government has a continued need for the products or services, a deductive change appears in order. There are differences to recovery, discussed later, between a partial termination and a deductive change that make understanding the case law as it applies to the contractor's circumstances imperative.

Recovery Differences

There can be significant differences in recovery between a partial termination and a deductive change.

Profit

Because a deductive change is prospective, profit on the elimination of the service or product is lost—at the rate at which the profit was proposed. For example, if profit was proposed at five percent, the reduced portion of the work or product would include the cost of the work product plus five percent. The profit margin of the overall contract prior to the deductive change remains unchanged after the deductive change, except for the profit attributable to the deleted work.

Under a partial T for C, there is no allowance for recovery of anticipatory profits (only profit on any work actually performed under the terminated portion of the contract). Similar to a deductive change, the canceled work will not include any profit recovery, except for profit attributable to work performed under the terminated portion of the contract. The significant game changer for a partial T for C is whether or not that contract is in a loss position, which triggers the loss ratio requirements.

At a minimum, if actual profit is equal to the profit proposed on the contract, there is effectively no recovery difference in profit between a deductive change and a partial T for C. If the contract is in a significant profit position, a deductive change is preferred to a T for C because the deleted work is at a lower profit margin than may have actually been realized to date. This has the effect of shifting profit from the end of the contract to the beginning—including some of what would be anticipatory profit under a T for C; whereas under a T for C, there is no shift, and the anticipatory profit is not allowable or recovered.

However, if a contract is in a loss position and is a partial T for C, the loss ratio requirements of FAR 49.203(b)–(c) apply. These requirements effectively allocate a portion of the loss from the terminated portion of the work to the portion of the work not performed. Therefore, if the contract is in a loss position, a partial T for C is preferable to a deductive change, as the contractor bears only a portion of the loss.

Settlement Expenses

As previously discussed, in a T for C the contractor is in a position to recover reasonable contract settlement expenses. Thus, a T for C is preferable when the contract reduction requires substantial settlement expenses. Since a deductive change is prospective and just deletes a minor portion of the work, even if a request for equitable adjustment is appropriate for the change, it is likely to be so minor that settlement-type expenses may not be substantial or may be limited.

Conclusion

In conclusion, it is important for a contractor to know its contractual rights when it comes to a T for D, a T for C, or a deductive change. It is also important to know the allowability of the costs associated with each mechanism, and the ability to recover them. The coming sequestration and period

of austerity will make understanding the details of these rights important to contractors as they discuss with the Government whether to convert T for Ds to T for Cs, and deductive changes to T for Cs. Most importantly, knowing the processes and proper positions that come with each type of termination or deductive change will make a contractor ready to walk through the dark forest ahead.

❖ Endnotes

1 Mary Karen Wills, CPA, is a Director with the Berkeley Research Group and the head of its Government Contracts Advisory Services practice. J. Andrew Stowe is a Senior Managing Consultant with the Berkeley Research Group.

2 FAR 52.249-1, Termination for Convenience of the Government (Fixed Price) (Short Form); FAR 52.249-2, Termination for Convenience of the Government (Fixed Price); FAR 52.249-3, Termination for Convenience of the Government (Dismantling, Demolition, or Removal of Improvements); FAR 52.249-4, Termination for Convenience of the Government (Services) (Short Form); FAR 52.249-5, Termination for Convenience of the Government (Educational and Other Nonprofit Institutions); FAR 52.249-6, Termination (Cost Reimbursement); FAR 52.249-7, Termination (Fixed-Price Architect-Engineer); FAR 52.249-8, Default (Fixed-Price Supply and Service); FAR 52.249-9, Default (Fixed-Price Research and Development); FAR 52.249-10, Default (Fixed-Price Construction); FAR 52.249-12, Termination (Personal Services).

3 FAR 52.243-1, Changes—Fixed-Price; FAR 52.243-2, Changes—Cost-Reimbursement; FAR 52.243-3, Changes—Time-and-Materials or Labor-Hours; FAR 52.243-4, Changes; FAR 52.243-5, Changes and Changed Conditions.

4 FAR 2.101 "Change order" means a written order, signed by the contracting officer, directing the contractor to make a change that the Changes clause authorizes the CO to order without the contractor's consent.

5 FAR 52.249-8(a)(1)(i); FAR 52.249-9(a)(1)(i); FAR 52.249-10(a).

6 FAR 52.249-8(a)(1)(ii); FAR 52.249-9(a)(1)(ii); FAR 52.249-10(a).

7 FAR 52.249-8(a)(1)(iii); FAR 52.249-9(a)(1)(iii); FAR 52.249-10(a).

8 FAR 49.607(a), Cure notice.

9 FAR 49.607(b), Show cause notice.

10 FAR 52.249-8(b); FAR 52.249-9(b); FAR 52.249-10(a).

11 91 U.S. 321, 23 L.Ed. 397 (1875).

12 The two limitations to this broad authority to T for C are bad faith and a clear abuse of discretion.

13 FAR 52.249.

14 FAR 49.103.

15 FAR 49.206-2(c).

16 FAR 31.205-32.

17 FAR 31.205-42(c).

18 FAR 49.205(a).

19 FAR 31.205-10.

20 FAR 52.249-2(b)(8)–(9).

21 FAR 31.205-42(d).

22 FAR 31.205-42(e).

23 FAR 31.205-42(f).

24 FAR 31.205-42(b), Costs continuing after termination. Despite all reasonable efforts by the contractor, costs that cannot be discontinued immediately after the effective date of termination are generally allowable. However, any costs continuing after the effective date of the termination due to the negligent or willful failure of the contractor to discontinue the costs shall be unallowable.

25 FAR 31.205-42(g)(i).

26 FAR 31.205-42(g)(ii).

27 FAR 31.205-42(g)(iii).

28 FAR 31.205-42(h).

29 FAR 49.202(a).

30 FAR 49.203(a).

31 FAR 49.203(b)–(c).

32 FAR 49.105(c)15.

33 FAR 49.109.

34 FAR 52.243-1; FAR 52.243-2; FAR 52.243-3; FAR 52.243-4; FAR 52.243-5.

35 FAR 52.243 (a).

36 FAR 52.243 (c), (e).

37 *J.W. Bateson Co. v. U.S.*, 308 F.2d 510.

38 *Celesco Indus., Inc.*, ASBCA 22251, 79-1 BCA ¶ 13604.

39 *Skidmore, Owings, & Merrill*, ASBCA 5115, 60-1 BCA ¶ 2570.

CASES OF SPECIAL NOTE

By Karen L. Manos

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Consultant And Attorney Costs Recoverable Under Changes Clause

Reversing the Postal Service Board of Contract Appeals, the U.S. Court of Appeals for the Federal Circuit held in *Tip Top Constr., Inc. v. Donahoe*, 2012 WL 4094851 (Fed. Cir. Sept. 12, 2012), that consultant and attorneys' costs associated with negotiations relating to a price increase for changed work are recoverable under the Changes clause. The PSBCA held that costs incurred after the Postal Service approved the underlying change were not recoverable because the consultant and outside counsel "had nothing to do with performance of the changed work or genuine contract administration and were solely directed at trying to convince the contracting officer to accept [Tip Top Construction Inc.'s] figure for the change and maximizing [Tip Top's] monetary recovery."

The Government made three principal arguments in support of the PSBCA's decision: (1) the attor-

ney fees were incurred in the filing of a claim and were therefore not recoverable; (2) the consultant's invoices did not provide sufficient detail to determine the work he performed, and the declarations of the consultant and attorney were after-the-fact and of dubious value; and (3) the attorney's costs were unreasonable because of the ratio between his costs and the costs of the change. The Federal Circuit rejected all three arguments.

Reaffirming its decision in *Bill Strong Enters., Inc. v. Shannon*, 49 F.3d 1541 (Fed. Cir. 1995), overruled on other grounds by *Reflectone, Inc. v. Dalton*, 60 F.3d 1572 (Fed. Cir. 1995) (en banc), the Federal Circuit held that costs incurred for the genuine purpose of materially furthering the negotiation process are allowable as contract administration costs, even if the negotiation fails; whereas costs incurred in the prosecution of a Contract Disputes Act claim are unallowable. The court concluded that "the PSBCA erred in holding that the consultant costs and attorney fees which are at issue were not 'genuine contract administration costs' because they were 'solely directed at … maximizing [Tip Top's] monetary recovery.' " The price adjustment is part of the change order process, the Federal Circuit explained,

> [s]imply because the negotiations related to the price of the change does not serve to remove the associated costs from the realm of negotiation and genuine contract administration costs. Consideration of price is a legitimate part of the change order process. In holding otherwise, the Board, we believe, erred.

The Federal Circuit gave short shrift to the Government's other two arguments. The court found that Tip Top adequately supported its claim with time sheets, attorney billing records, and declarations from the consultant and attorney describing the work they performed. "This evidence was unrebutted," the court noted. Regarding the reasonableness of the consultant and attorney's costs—$12,400 as compared to $22,133.77 for the changed work—the Federal Circuit stated simply, "those costs were reasonable in light of the course of the price negotiations."

The Federal Circuit therefore reversed and remanded with instructions to grant Tip Top's appeal in its entirety.

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Fed. Cir. Finds No Breach In Timber Sales Contract Dispute

The dispute in *Scott Timber Co. v. U.S.*, 692 F.3d 1365 (Fed. Cir. 2012), arose out of three Forest Service contracts for the sale of timber on public lands. The contracts were awarded to Scott Timber Co. in 1999, but were suspended before performance began due to an injunction issued by the U.S. district court in *Ore. Natural Res. Council Action v. U.S. Forest Serv.,* 59 F. Supp. 2d 1085 (W.D. Wash. 1999). In accordance with the *Oregon Natural* court's order, the Forest Service began conducting surveys under the Northwest Forest Plan for protected species in September 1999, and continued the surveys pursuant to the settlement agreement. Although the surveys for two of Scott's contracts were completed in 2000, the Forest Service continued the suspension of those contracts until 2003 due to a different litigation. Meanwhile, the surveys for Scott's third contract were completed in August 2001, but the suspension was not lifted until 10 months later. Scott subsequently harvested the total amount of timber covered by the three contracts between 2004 and 2008.

The three tracts of land for Scott's contracts were not identified as being at risk in any public filings in the *Oregon Natural* case, but the environmental organizations that brought suit had informed the Government during confidential settlement negotiations that they believed the three sales, among others, had been made in contravention of the Northwest Forest Plan. The Forest Service intentionally withheld this information from Scott, acting on the basis that they were obliged by attorney-client privilege *not* to disclose the inclusion of the tracts on the list of "at risk" sales.

Scott submitted three claims under the Contract Disputes Act for the Forest Service's suspension and breach of the three contracts. The Forest Service contracting officer granted Scott's claims for interest on its deposits on the three sales contracts, but denied Scott's claims for lost market opportunity and other costs. Scott filed suit in the U.S. Court of Federal Claims seeking damages for the Government's breach of the three contracts. Following separate trials on

liability and damages, the COFC found the Government liable for breaching each of the contracts, and entered judgment for Scott of $6.9 million, plus CDA interest. See *Scott Timber Co. v. U.S.*, 97 Fed. Cl. 685 (2011) (damages); *Scott Timber Co. v. U.S.*, 86 Fed. Cl. 102 (2009) (liability).

The COFC found that the Forest Service's award of the three contracts without informing Scott of the risks to those contracts posed by the *Oregon Natural* litigation amounted to a breach of the Government's implied duty of good faith and fair dealing. In addition, the COFC found that, while acting pursuant to the settlement agreement, the Forest Service unreasonably delayed completing the surveys for Scott's three tracts of land, which unduly lengthened the contract suspension periods. The COFC found that all of the required surveys could have been completed by the spring of 2000, but the surveys for two of the tracts were not completed until the fall of 2000, and the surveys for the third tract were not completed until August 2001. The COFC also found that the Forest Service unreasonably continued the suspensions of two of the contracts even after the surveys were complete because of other litigation in which no injunction was ever issued.

Most of the damages awarded by the COFC were for lost profits of Scott's affiliate, Roseburg Forest Products. The COFC determined that the contracts required Scott to process the logs and that Roseburg was a subcontractor for that purpose. Therefore, the COFC concluded, Scott was entitled to recover Roseburg's losses through a pass-through claim.

The Government appealed the judgment to the U.S. Court of Appeals for the Federal Circuit, which reversed both the liability and damages decisions, and ruled against Scott on every one of its arguments.

The Federal Circuit held that the Forest Service did not—and could not—breach its implied duty of good faith and fair dealing by failing to notify Scott that contracts on which it was bidding were at risk of being suspended "because the covenant did not exist until the contract was signed." Scott argued unsuccessfully that the COFC's holding on this point should be sustained under the doctrine of superior knowledge, even though the COFC did not rely on the doctrine. Citing *Hercules Inc. v. U.S.*, 24 F.3d 188 (Fed. Cir. 1994), the Federal Circuit stated that the doctrine applies only if "the government was aware the contractor had no knowledge of and had no reason to obtain such information," and "any contract specification supplied misled the contractor or did not put it on notice to inquire." The Federal Circuit found that the Forest Service satisfied any duty it might have had under the superior knowledge doctrine because its general pre-award notice to all of the bidders was sufficient to put Scott on notice of the risk that the contracts would be suspended.

The Federal Circuit held that the Forest Service did not breach the implied duty of good faith and fair dealing after the contracts were awarded by unreasonably delaying completion of the surveys. The Federal Circuit stated,

> This issue is directly controlled by *Precision Pine & Timber, Inc. v. United States*, 596 F.3d 817 (Fed. Cir. 2010). As in this case, the Forest Service in *Precision Pine* had suspended timber-harvesting under contracts with identical suspension clauses in order "to comply with a court order." *Id.* at 828. "Because the suspensions were authorized, the only remaining question [wa]s whether the Forest Service's actions during the suspensions violated the implied duty of good faith and fair dealing." *Id.* We concluded that the Forest Service did not breach its implied duty of good faith and fair dealing because its actions during the suspensions "were (1) not 'specifically targeted,' and (2) did not reappropriate any 'benefit' guaranteed by the contracts, since the contracts contained no guarantee that ... performance would proceed uninterrupted." *Id.* at 829.
>
> Here too, Scott has not established specific targeting because there is no evidence that any delays in completing the surveys were incurred "for the purpose of delaying or hampering [Scott's] contracts." *Id.* at 830. Here too, the suspension clauses expressly qualified Scott's bargained-for harvesting rights, and uninterrupted performance cannot be considered a " 'benefit' guaranteed by the contracts." *Id.* As in *Precision Pine*, the Forest Service's actions while conducting the required surveys did not breach its implied duty of good faith and fair dealing.

Dissenting Circuit Judge Wallach took the panel to task for finding *Scott Timber Co. v. U.S.*, 333 F.3d 1358 (Fed. Cir. 2003) ("*Scott I*"), and *Precision Pine* reconcilable, and *Scott I* inapplicable to the instant

case. Circuit Judge Wallach stated, "These cases are irreconcilable, and therefore this court should take the case en banc to resolve the conflict the two cases present or the panel should hold that *Scott I* is the earlier, and therefore precedential, decision over *Precision Pine*."

The Federal Circuit further held that the COFC erred in awarding damages based on Scott's pass-through claim for Roseburg. The Federal Circuit found that Roseburg was not a subcontractor under the contracts and had no legitimate pass-through claim because Scott's contracts did not require Scott to provide for the processing of the harvested timber. Moreover, the Federal Circuit found, "[e]ven if Roseburg were a subcontractor, Scott's passthrough claim would nonetheless fail" because Scott did not establish that it was liable to Roseburg. Noting that Scott simply agreed to use its "best efforts" to supply Roseburg with timber, the Federal Circuit stated, "Even if the Forest Service's suspensions of the harvesting contracts were unauthorized, Scott did not breach its 'best efforts' contract with Roseburg by abiding by the suspensions." Thus, the Federal Circuit concluded, "[b]ecause Scott has not established that it is liable to Roseburg, Scott cannot assert a pass-through claim for Roseburg's alleged damages."

Finally, the Federal Circuit found that Scott did not incur any costs resulting from delays caused by a harvesting suspension, as required for Scott to be entitled to lost profits. The Federal Circuit reasoned that Scott chose to harvest the three tracts after the suspensions were lifted and thereby elected to treat the suspensions as a partial breach. Accordingly, the Federal Circuit found that Scott was precluded from recovering damages on a theory of material breach.

¶ 64

Claim Preclusion Bars Later Claim Arising From Same Transactional Facts

Affirming a decision by the U.S. Court of Federal Claims, the U.S. Court of Appeals for the Federal Circuit held in *Bowers Inv. Co., LLC v. U.S.*, 695 F.3d 1380 (Fed. Cir. 2012), that the plaintiff landlord's claims against the Federal Aviation Administration for rent due for January–March 1994 was barred by claim preclusion because it was based on the same transactional facts, and should have been resolved in an earlier appeal to the Civilian Board of Contract Appeals on a claim for rent due in September 2006.

On Oct. 1, 1993, Bowers and FAA entered into a lease agreement for office and warehouse space in South Fairbanks, Alaska. The lease was renewable annually at FAA's option, and the parties modified the lease eight times until the termination date of Sept. 30, 2006. On Feb. 25, 2008, Bowers submitted a claim to the contracting officer for the final month's rent, arguing that because the lease provided for payment "in arrears," the FAA payment made on Sept. 13, 2006 was for the August 2006 rent, not the September 2006 rent. Bowers appealed the CO's final decision to the CBCA. During the CBCA proceedings, FAA produced records of its historical payments to Bowers, which according to Bowers, demonstrated that FAA had not paid rent for January, February and March 1994. However, the CBCA refused to allow Bowers to amend its complaint to incorporate the three additional months.

After the CBCA proceedings concluded, Bowers submitted two claims for rent under the lease: one for unpaid rent for January, February and March 1994, and the second for alleged underpayments for Oct. 1, 1998–Oct. 1, 2006. The CO denied both claims, and Bowers appealed to the COFC. The COFC granted the Government's motion to dismiss under Rule 12(b)(6), holding that the claims were precluded because they arose "from the same set of transactional facts" as the claims previously before the CBCA. The Federal Circuit agreed.

The Federal Circuit provided the following explanation of the claim preclusion doctrine:

> Claim preclusion requires (1) an identity of parties or their privies, (2) a final judgment on the merits of the first suit, and (3) the later claim to be based on the same set of transactional facts as the first claim such that the later claim should have been litigated in the prior case. Cases that meet these criteria preclude later litigation of issues that could have and should have reasonably been brought in the earlier case. In essence, the preclusion doctrine operates to give a party one, and only one,

> full and fair opportunity to litigate its matter. [Internal citations omitted.]

The Federal Circuit further observed, "[i]n contract disputes, the rule has been refined to create a presumption that all claims arising from the same contract should be brought together." The court concluded that the COFC "did not err in holding that it had jurisdiction of the subject matter, and correctly held that the claims now raised arose from the same transactional facts and the same Lease contract, and could have been and should have been raised in the prior proceeding." The Federal Circuit therefore affirmed.

¶ 65

Government Delay Waives Deliberative Process Privilege

In *Sikorsky Aircraft Corp. v. U.S.*, 2012 WL 4018026 (Fed. Cl. Sept. 13, 2012), the Defense Contract Audit Agency established a new procedure and asserted the deliberative process privilege (apparently for the first time) to protect an e-mail exchange between a DCAA auditor and his supervisor, only to have the privilege waived by the Government trial attorney's lack of diligence in asserting the privilege. The e-mails in question were produced as part of a Government discovery response in February 2011, and are relevant to Sikorsky's statute of limitations defense against the Government's claim for a Cost Accounting Standard 418 noncompliance. In the e-mail exchange, DCAA auditor Robert Boyer discusses a CAS 410 issue with DCAA supervisory auditor Janice Berardi, and uses his opinion of a past event, Sikorsky's alleged violation of CAS 418 some years earlier, to convey his opinion about what action DCAA should take in an ongoing CAS 410 audit. Sikorsky used the e-mails, without any contemporaneous objection by the Government's counsel, during a deposition of Boyer on July 20, 2011. At the end of the deposition, the Government's counsel informed Sikorsky that the exhibit might be the subject of deliberative process privilege, and asked to have the deposition transcript sealed until the issue could be determined. Sikorsky agreed to the Government's request.

At the time, DCAA had not adopted specific procedures for asserting the deliberative process privilege. On Dec. 19, 2011, DCAA Director Patrick Fitzgerald formally delegated authority to assert the privilege to the regional directors. Acting pursuant to the newly delegated authority, DCAA Northeastern Regional Director Ronald Meldonian on Jan. 19, 2012 asserted the deliberative process privilege over, among other documents, the disputed e-mails. However, the Government failed to inform Sikorsky of this assertion of the privilege until May 14, 2012, *after* Sikorsky filed the e-mails as an exhibit in support of its opposition to the Government's motion to dismiss Sikorsky's statute of limitations defense. The Government asked Sikorsky to return or destroy all copies of the e-mails in its possession and remove all references to the exhibit in its briefing. Sikorsky refused, but proposed redacting the exhibit to include only the language relevant to its statute of limitations defense. The Government rejected this proposal and filed a motion to strike the exhibit.

The court began its analysis with an explanation of the deliberative process privilege. The U.S. Supreme Court has held that the deliberative process privilege protects "documents reflecting advisory opinions, recommendations and deliberations comprising part of a process by which governmental decisions and policies are formulated." *Dep't of the Interior v. Klamath Water Users Protective Ass'n*, 121 S. Ct. 1060 (2001) (internal citation and quotation marks omitted). The court explained that there are both procedural and substantive requirements for asserting the privilege:

> Procedurally, the privilege can only be invoked by an agency head or his or her subordinate after careful, personal review, and that head or designee must identify the specific information that is subject to the privilege and provide reasons for maintaining the confidentiality of the pertinent record.... Substantively, the government must demonstrate that the allegedly privileged material is both pre-decisional and deliberative. Material is pre-decisional if it addresses activities "antecedent to the adoption of an agency policy."... Material is deliberative if it addresses "a direct part of the deliberative process in that it makes recommendations or expresses opinions on legal or policy matters." [Internal citations omitted.]

However, the court continued,

> A claim of deliberative process privilege, even when properly established, is not absolute. The deliberative process privilege is qualified, requiring the court to balance the interests of the parties for and against disclosures. Additionally, the privilege may be waived if the government produces documents related to the subject matter of the privileged matter or produces the privileged matter in other litigation. [Internal citations omitted.]

The court found that DCAA properly invoked the deliberative process privilege as a procedural matter, and the exhibit was both predecisional and deliberative. The court further found that Sikorsky had not shown its need for the exhibit outweighed the Government's interest in preserving the confidentiality of the exhibit. Turning to the issue of waiver, the court observed that "[i]n this jurisdiction, there is limited precedent on the question of whether the deliberative process privilege may be waived simply by the passage of time." After reviewing the available precedents, the court held that "invocation of the deliberative process privileges, as with other privileges, is subject to a timeliness requirement."

Finding no binding precedent as to the criteria for determining whether such a waiver has occurred, the court applied by analogy the portion of Fed. R. Evid. 502 pertaining to inadvertent disclosure of privileged material. "Applying the three-part test in Fed. R. Evid. 502(b)," the court stated, "the court must determine whether the government's disclosure of Exhibit P was inadvertent, whether the government took reasonable steps to prevent its disclosure, and whether the government promptly took reasonable steps to rectify the error." The court concluded that the Government had not acted "with sufficient alacrity to claw back the records produced in this case." Although recognizing that "the formalities attendant to assertion of the deliberative process privilege may require more time than an attorney's typical assertion of attorney-client privilege or attorney work-product protection," the court found that 10 months was "simply too long a time to try now to resuscitate the privilege." Accordingly, the court denied the Government's motion to strike the exhibit.

¶ 66

Contractor Entitled To Attorneys' Fees, Despite Fee Arrangement

In *SUFI Network Servs., Inc. v. U.S.*, 105 Fed. Cl. 184 (2012), the U.S. Court of Federal Claims granted SUFI Network Services Inc.'s motion for summary judgment on its claim for attorneys' fees, expenses and interest that it incurred following the Government's material breach of a non-appropriated funds contract for telephone services in Germany. Although the contract was not subject to either the Contract Disputes Act or Federal Acquisition Regulation, it incorporated the standard FAR Changes clause.

SUFI notified the contracting officer that it intended to cancel the contract as a result of the Government's material breach. Thereafter, the parties reached a partial settlement agreement, pursuant to which SUFI stopped work under the contract. SUFI then submitted 28 monetary claims to the CO under both the contract and the partial settlement agreement.

After waiting more than six months for the CO to issue a final decision, SUFI appealed the deemed denial of its claims to the Armed Services Board of Contract Appeals. The ASBCA awarded SUFI damages on 22 of its 28 claims, as well as the costs and expenses of SUFI's employees and the non-legal consultants incurred as a result of the Government's material breach. SUFI then submitted a claim to the CO for its attorneys' fees through the last full month before SUFI submitted its 28 claims. SUFI appealed the deemed denial of its claim for attorneys' fees by filing a complaint in the COFC. Both parties moved for summary judgment.

The Government argued, among other things, that the attorneys' fees were unallowable under FAR 31.205-33(b) because SUFI was represented on a one-third contingency fee basis. The COFC noted that "the FAR and its cost principles provide only guidance here; they do not control the parties' non-appropriated funds contract." "However," the court continued, "even if the FAR were controlling, SUFI's contingent fee arrangement with outside counsel would 'not preclude the award of reasonable attorney's fees.' " (Internal citation omitted.) The COFC concluded,

> The better interpretation of FAR § 33.205-33(b) is that it merely provides guidance as to fee recovery, setting attorneys' fees at 'the "lodestar" amount of the hours worked at the normal hourly rate.' " [Internal citations omitted.] While FAR § 33.205-33(b) may preclude the payment of attorneys' fees as a percentage of recovery against the Government, that cost principle does not prevent the payment of fees calculated on an hourly basis at reasonable hourly rates. Even if outside counsel provided services to a client on a contingency basis, counsel and the represented party still may recover fees if they are claimed on an hourly basis rather than a contingency basis. Thus, SUFI's contingency fee arrangement with counsel poses no obstacle to it prevailing on the merits of its attorneys' fees claim.

Analyzing SUFI's claim under the U.S. Court of Appeals for the Federal Circuit's seminal decision in *Bill Strong Enters., Inc. v. Shannon*, 49 F.3d 1541 (Fed. Cir. 1995), overruled on other grounds by *Reflectone, Inc. v. Dalton*, 60 F.3d 1572 (Fed. Cir. 1995) (en banc), the COFC held that the attorneys' fees were incurred for the purpose of contract administration, as opposed to claim prosecution, and were therefore recoverable as a direct and foreseeable consequence of the Government's breach.

¶ 67

District Court Action Filed After COFC Complaint Does Not Trigger § 1500

In yet another case, *Halim v. U.S.*, 2012 WL 4356211 (Fed. Cl. Sept. 24, 2012), the U.S. Court of Federal Claims rejected the Government's argument that 28 USCA § 1500 bars the COFC from exercising judgment if "regardless of filing order … a plaintiff files complaints based upon the same operative facts in both the Court of Federal Claims and another court." Section 1500 provides that the COFC

> shall not have jurisdiction of any claim for or in respect to which the plaintiff or his assignee has pending in any other court any suit or process against the United States or any person who, at the time when the cause of action alleged in such suit or process arose, was, in respect thereto, acting or professing to act, directly or indirectly under the authority of the United States.

In *Tecon Eng'rs, Inc. v. U.S.*, 343 F.2d 943 (Ct. Cl. 1965), the U.S. Court of Claims interpreted a "pending" action as one filed *before* the plaintiff filed its complaint in the Court of Claims. However, the following language in *U.S. v. Tohono O'Odham Nation*, 131 S. Ct. 1723 (2011), calls into question the continuing viability of *Tecon*'s "order of filing" rule:

> The panel of the Court of Appeals could not identify "any purpose that § 1500 serves today," in large part because it was bound by Circuit precedent that left the statute without meaningful force. For example, the panel cited *Tecon Engineers, Inc. v. United States,* 170 Ct.Cl. 389, 343 F.2d 943 (1965), which held that § 1500 does not prohibit two identical suits from proceeding so long as the action in the CFC, or at that time the Court of Claims, is filed first. The *Tecon* holding is not presented in this case because the CFC action here was filed after the District Court suit.
>
> Still, the Court of Appeals was wrong to allow its precedent to suppress the statute's aims. Courts should not render statutes nugatory through construction. In fact the statute's purpose is clear from its origins with the cotton claimants—the need to save the Government from burdens of redundant litigation—and that purpose is no less significant today. The conclusion that two suits are for or in respect to the same claim when they are based on substantially the same operative facts allows the statute to achieve its aim. Developing a factual record is responsible for much of the cost of litigation. Discovery is a conspicuous example, and the preparation and examination of witnesses at trial is another. The form of relief requested matters less, except insofar as it affects what facts parties must prove. An interpretation of § 1500 focused on the facts rather than the relief a party seeks preserves the provision as it was meant to function, and it keeps the provision from becoming a mere pleading rule, to be circumvented by carving up a single transaction into overlapping pieces seeking different relief. [Internal citations omitted.]

Because *Tecon*'s "order of filing" rule was not before the Court in *Tohono*, the language in *Tohono* is plainly dicta. Nevertheless, since *Tohono* was decided last year, the Department of Justice has repeatedly cited it in motions to dismiss filed at the COFC. The *Halim* decision is the most recent in a long

line of cases to reject DOJ's argument expressly. The *Halim* court stated,

> Defendant argues that "regardless of filing order, if a plaintiff files complaints based upon the same operative facts in both the Court of Federal Claims and another court, this [c]ourt is bound to dismiss the action pending before it." *Id.* at 10. Defendant references the order-of-filing rule established by *Tecon Eng'rs, Inc. v. United States* (*Tecon*), *see id.* at 8, in which the United States Court of Claims (Court of Claims) held that section 1500 bars this court from exercising jurisdiction over "any claim for or in respect to which plaintiff has pending, in any other court any suit against the United States, only when the suit shall have been commenced in the other court *before* the claim was filed in this court," 170 Ct.Cl. 389, 399, 343 F.2d 943, 949 (Ct.Cl. 1965) (emphasis added); *see Tohono*, 131 S.Ct. at 1729 (stating that *Tecon* "held that [section] 1500 does not prohibit two identical suits from proceeding so long as the action in the [COFC] ... is filed first"). According to defendant, the [U.S.]Supreme Court "has recently expressed its disagreement with the order-of-filing exception established in *Tecon.*" Def.'s Mot. 8 (referencing *Tohono*). As support for its position, defendant points to language in *Tohono* in which the Supreme Court refers to *Tecon* as " 'precedent that left [§ 1500] without meaningful force.' " *Id.* at 9 (quoting *Tohono*, 131 S.Ct. at 1729).
>
> The Supreme Court made clear, however, that the *Tecon* order-of-filing rule was not before it: "The *Tecon* holding is not presented in this case because the [COFC] action here was filed after the District Court suit." *Tohono*, 131 S.Ct. at 1729–30; *see also id.* at 1735 (Sotomayor, J., concurring) ("[T]he validity of the Court of Claims' holding in *Tecon* ... is not presented in this case. This Court has never considered that holding."). And, as this court stated in *Kaw Nation of Okla. v. United States* (*Kaw Nation*), 103 Fed. Cl. 613, 617 (2012). "the [COFC] is powerless to disregard binding ... precedent on the mere belief that a subsequent Supreme Court opinion casts doubt on a prior decision of the Court of Claims or [United States Court of Appeals for the] Federal Circuit." 103 Fed. Cl. at 618. Accordingly, the court agrees with other judges of this court and holds that *Tohono* does not disturb the order-of-filing rule set forth in *Tecon. See, e.g., Starr Int'l Co. v. United States* (*Starr Int'l*), No. 11-779C, 2012 WL 2512920, at *8 (Fed. Cl. July 2, 2012) (rejecting the government's argument that the *Tecon* order-of-filing rule "is no longer controlling authority in light of dicta from *Tohono O'odham*"); *Otoe-Missouria Tribe of Indians, Okla. v. United States*, No. 06-937L, 2012 WL 1959437, at *3 (Fed. Cl. May 31, 2012) ("The Court rejects Defendant's argument once again ... and holds that *Tecon* is still good law and has not been overturned."); *Nez Perce Tribe v. United States*, 101 Fed. Cl. 139, 145 (2011) (finding that *Tohono* left "undisturbed" *Tecon*'s order-of-filing rule); *Coeur d'Alene Tribe v. United States*, 102 Fed. Cl. 17, 25 (2011) (stating that *Tohono* "declined to either overrule or explicitly endorse *Tecon*'s order-of-filing rule, and it did not indicate otherwise that *Tecon* is no longer good law"); *Yakama Nation Hous. Auth. v. United States*, 102 Fed. Cl. 478, 484 (2011) ("[T]he *Tohono O'Odham* Court neither considered nor overruled *Tecon* in its application of § 1500.").

Although DOJ's argument has not met with any success at the COFC, the fact that DOJ continues to raise it suggests that the department intends to appeal the issue and see if it can obtain a different result at the Federal Circuit. Thus, § 1500 has the potential to become even more of a "monumental trap for the unwary," as the COFC observed in *Lan-Dale Co. v. U.S.*, 85 Fed. Cl. 431 (2009).

¶ 68

COFC Finds Subcontract Costs Unreasonable

In *Kellogg Brown & Root Servs., Inc. v. U.S.*, 2012 WL 4461270 (Fed. Cl. Sept. 27, 2012), the U.S. Court of Federal Claims held that Kellogg Brown & Root Services Inc. (KBR) failed to prove that the negotiated, fixed price it paid to a dining facility (DFAC) subcontractor was reasonable as defined by Federal Acquisition Regulation § 31.201-3(a). This is the second COFC decision involving the reasonableness of the price KBR paid for a dining facility subcontract under its cost-reimbursement Logistics Civil Augmentation Program (LOGCAP III) contract. See *Kellogg Brown & Root Servs., Inc. v. U.S.*, 103 Fed. Cl. 714 (2012) ("*KBR I*"); 7 CP&A Rep. ¶ 41. Both cases were heard by Judge Christine Miller.

KBR competitively awarded a subcontract to ABC International Group for DFAC services for the U.S. Army at Camp Anaconda, one of the largest U.S.

military bases in Iraq during the troop buildup following the March 2003 invasion. As with its other DFAC subcontracts, KBR was compelled to award a fixed-price subcontract because its Middle Eastern subcontractor did not have a Government-approved cost accounting system. In response to force protection concerns, after the subcontract was awarded, the Army administrative contracting officer directed KBR to stop construction of the prefabricated metal DFAC and construct a larger, reinforced concrete DFAC at a different location. The Army also increased the statement of work base-camp population from 2,573 persons to more than 6,200. Because of the location and sense of urgency, KBR decided to retain ABC rather than solicit new bids for the work.

KBR's DFAC subcontract administrator, Jamal Nasery, and ABC negotiated a fixed-price modification, CO 1, which increased the total subcontract price from nearly $13.8 million to more than $33.8 million. Although Nasery requested additional information from ABC to support its proposed price, he did not attempt to negotiate a lower price for CO 1. In addition, his price negotiation memorandum determining that the price was fair and reasonable contained an analytical flaw that was not discovered until later: Since the Army had doubled the head count, Nasery doubled the originally competed per-person rates, which had the effect of justifying a quadrupling of the price because he doubled not only the number of troops to be served, multiplied by the rate per person, but also the per-person rate.

The Defense Contract Audit Agency issued a DCAA Form 1 disapproving more than $12.5 million in DFAC costs billed under the LOGCAP III contract for ABC. DCAA found that the costs were unreasonable under FAR 31.201-3 because, according to DCAA, KBR performed an inadequate analysis related to (a) the prices for the higher head-count bands, and (b) the costs of building a new DFAC facility. KBR filed a certified claim challenging the Government's withholding of the amount disapproved by DCAA, and subsequently filed suit in the COFC.

In contrast to *KBR I*, in this case, KBR argued that the standard for reasonableness of costs must be considered in the context of a cost-reimbursement contract, under which the Government bears the entire cost risk associated with contract performance, and the contractor is required only to exert its best efforts. KBR argued that it had satisfied its burden under FAR 31.201-3 by showing that (1) it incurred the questioned costs in connection with its performance of the task order, (2) the prices in CO 1 were the result of its best efforts to perform under the task order in wartime circumstances, and (3) the incurred costs were not the product of management's gross disregard or willful misconduct. The Government argued—and the court agreed—that FAR 31.201-3 alone provides the standard for determining reasonableness of costs, namely, "A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business." The COFC found that KBR had not met its burden in this regard, and stated,

> The court finds that KBR has not shown that it employed sound business practices and acted as a reasonably prudent business in accepting ABC's proposed prices for CO 1. The court accepts KBR's decision not to hold a competition upon receiving the [Army's directive] as reasonable, given the urgency conveyed by [the ACO] and the Army. That urgency, however, is insufficient to justify the acceptance of unreasonable prices.

Moreover, the court held, reasonableness of a price can be judged only by comparison to some other price, which KBR failed to establish. The court stated,

> The court lacks a reliable contemporaneous benchmark against which to assess the CO 1 prices to determine if they are in fact reasonable. Accordingly, the court finds that plaintiff has failed to demonstrate the reasonableness of the costs incurred for pricing elements—not including facility costs—that were questioned by DCAA in its Revised Form 1.

Lacking a "reliable contemporaneous benchmark," the court turned instead to a demonstrative exhibit prepared by the Government's expert that showed per-item prices from ABC's original, competitively awarded subcontract. After making adjustments for two items that the court ruled were not in dispute, the court determined that KBR was entitled to $4.2 million—the difference between the Government expert's questioned amount, ostensibly representing reasonable adjustments that KBR could not overcome, and the $12.5 million questioned by DCAA.

The court found that the cost KBR incurred for the construction of the DFAC was reasonable based on KBR's after-the-fact price reasonableness analysis supported by its expert at trial. The court also ruled in KBR's favor on the interpretation of the payment terms for a different modification of the ABC subcontract.

The court directed the parties to submit a joint stipulation reflecting the judgment to be awarded to KBR.

¶ 69

Contractor's Claim Barred By Statute Of Limitations

The U.S. Court of Federal Claims granted the Government's motion to dismiss one count of the complaint in *Uniglobe Gen. Trading & Contracting Co., W.L.L. v. U.S.*, 2012 WL 4467230 (Fed. Cl. Sept. 27, 2012), because the contractor's claim was submitted to the contracting officer more than six years after it accrued. The dispute arose out of three contracts between the Army and Uniglobe General Trading and Contracting Co., W.L.L., for the lease of various types of vehicles to be used in support of Operation Iraqi Freedom. In May 2003, the Army informed Uniglobe that it was canceling the "442 contract," but did not return two vehicles leased under the contract until Oct. 29, 2003. One vehicle was severely damaged. In March 2004, Uniglobe submitted a claim for the cost of repairing the damaged vehicle.

In September 2005, the CO issued a final decision finding that Uniglobe was entitled to only a fraction of the amount claimed. In October 2005, the CO issued a revised final decision, decreasing the amount to be paid to Uniglobe. For the next few years, Uniglobe and different Army COs communicated intermittently—and ultimately unsuccessfully—regarding payment of the amount determined by the revised final decision.

On Nov. 5, 2009, Uniglobe submitted a claim in connection with all three contracts, including the costs of repairing the damaged vehicle from the 442 contract, which were the subject of Uniglobe's 2004 claim and the CO's 2005 final decisions. The CO had not yet rendered a decision on the November 2009 claim when Uniglobe filed suit on April 6, 2010.

The Government moved to dismiss the count of Uniglobe's complaint relating to the costs of repairing the damaged vehicle, arguing that it was barred by (1) the general six-year statute of limitations set forth in 28 USCA § 2501, (2) the six-year presentment period in § 605 of the Contract Disputes Act, and (3) the 12-month statute of limitations in CDA § 609. The court rejected the first reason, noting that the U.S. Court of Appeals for the Federal Circuit held in *Pathman Constr. Co. v. U.S.*, 817 F.2d 1573 (Fed. Cir. 1987), that the six-year statute of limitations in 28 USCA § 2501 does not apply to suits brought under the CDA. However, the court agreed with the Government that Uniglobe failed to meet the six-year presentment requirement of the CDA, as well the 12-month appeal period.

The court found that Uniglobe's "claim for breach of the 442 contract accrued no later than October 29, 2003, when Uniglobe recovered the last remaining vehicle from the Army." "At that time," the court continued, "the full extent of the government's alleged liability under that contract would have been apparent." Uniglobe argued unsuccessfully that the claim did not accrue until November 2007, when the Army reversed its earlier decision to make a settlement payment. Agreeing with the Government, the court noted that Uniglobe's complaint was based, in part, on breach of the 442 contract, not on the breach of a settlement agreement. The court also rejected Uniglobe's argument that the six-year presentment period should be equitably tolled because the Army misled Uniglobe into believing that a final decision on its claim had not yet been rendered. Although agreeing that the six-year presentment period is subject to equitable tolling, the court found "no evidence that Uniglobe was 'induced or tricked' by any misconduct on the part of the government." Accordingly, because Uniglobe's November 2009 claim was submitted more than six years after it accrued, the court held that it was time-barred.

The court further found that Uniglobe failed to file a complaint within 12 months after receiving the CO's revised final decision. Uniglobe argued that

neither CO decision was a "final decision" because subsequent negotiations with the Army called into question their finality. Although acknowledging that the finality of a CO's final decision may be suspended in certain limited circumstances, the court found that rule inapplicable in this instance because none of the documented communications between the parties suggested that the CO was reconsidering the earlier decision. Rather, the communications were limited to Uniglobe's attempts to secure payment of the amount the CO had agreed to pay and the Army's attempts to make that payment.

Uniglobe also argued that its claim should not be barred under the 12-month appeal period for two reasons. First, according to Uniglobe, the Government waived any arguments based on that provision because they were not raised in the initial motion to dismiss. Second, because the Army offered to make a settlement payment and Uniglobe promptly accepted, any applicable statutes of limitation were equitably tolled until the Army reversed its initial offer and informed Uniglobe in November 2007 that it was now denying the claim.

The court rejected both arguments. Regarding the waiver argument, the court stated that jurisdictional defects cannot be waived. Regarding the equitable tolling argument, the court observed that the COFC "has not squarely addressed whether the twelve-month limitations period of the CDA is subject to equitable tolling." The court found no need to address that issue in this case, however, because the court found no evidence that Uniglobe was "induced or tricked" by any Government conduct. The court therefore granted the Government's motion for partial dismissal.

¶ 70

District Court Sanctions Government In FCA Case

In *U.S. ex rel. Baker v. Cmty. Health Sys., Inc.*, No. 05-279 WJ/ACT, slip op. (D. N.M. Oct. 3, 2012), the U.S. District Court for the District of New Mexico affirmed the magistrate judge's imposition of sanctions against the Government for its failure to issue a timely and adequate litigation hold for evidence crucial to the defendant's affirmative defense. The court agreed with the magistrate's finding that the Government implemented its litigation hold well after litigation was or should have been "reasonably anticipated," and that the Government implemented the litigation hold with a "lackadaisical attitude." Specifically, the attorney responsible for implementing the litigation hold at the Government agency "took no steps to contact specific individuals to ensure that appropriate measure[s] were in fact being taken." The court noted that "Counsel must take affirmative steps to monitor compliance so that all sources of discoverable information are identified and searched."

The court stated, "Spoliation sanctions are proper when (1) a party has a duty to preserve evidence because it knew, or should have known, that litigation was imminent, and (2) the adverse party was prejudiced by the destruction of the evidence." Community Health Systems Inc. (CHS) showed prejudice by linking the lost evidence to its affirmative defense that the "Government's knowledge of an alleged 'false' claim contradicts a defendant's intent to knowingly submit a false claim." In deciding on the appropriate sanctions for the Government's "woefully inadequate" and "beyond mere negligence" prelitigation attempts to preserve electronically stored information and other documents, the court considered the degree of culpability of the party who lost or destroyed the evidence and the degree of actual prejudice to the other party.

Finding both culpability on the part of the Government and actual prejudice to CHS, the court imposed spoliation sanctions. However, the court rejected the defendant's request for (a) an adverse inference that the destroyed documents would have been exculpatory, and (b) dismissal of claims arising prior to the date that the Government issued its belated litigation hold. Instead, the court adopted the magistrate judge's sanctions requiring:

- the Government to produce related documents withheld under a claim of ordinary work product or deliberative process privilege;
- the Government to produce related e-mails from or to certain recently retired employ-

ees whose electronically stored information was not preserved;

- the Government to show cause why additional discovery from Government servers is not necessary at Government expense; and
- the Government to pay CHS' attorneys' fees and costs for the motion for sanctions.

¶ 71

Contractor Not Entitled To More Compensation For Extension

The Armed Services Board of Contract Appeals held in *APAC-Se. Inc. n/k/a Oldcastle S. Group*, ASBCA 58057, 2012 WL 4793744 (Sept. 27, 2012), that Oldcastle Southern Group was not entitled to additional costs for work performed during two three-month extensions under Federal Acquisition Regulation clause 52.217-8, Option to Extend Services, even though the extensions exceeded the maximum contract period specified in FAR 52.217-9, Option to Extend the Term of the Contract. The dispute arose out of a firm-fixed-price requirements contract for the construction of concrete targets. The contract provided for a base year and two option years, and incorporated both FAR 52.217-8 and FAR 52.217-9. The contracting officer's choice of which of these two clauses to use can make a significant difference in the amount paid to the contractor. FAR 52.217-8 states,

> The Government may require continued performance of any services within the limits and at the rates specified in the contract. These rates may be adjusted only as a result of revisions to prevailing labor rates provided by the Secretary of Labor. The option provision may be exercised more than once, but the total extension of performance hereunder shall not exceed 6 months. The Contracting Officer may exercise the option by written notice to the Contractor within 30 days before contract expiration.

FAR 52.217-9, as modified to include the maximum term of Oldcastle's contract, provides,

> (a) The Government may extend the term of this contract by written notice to the Contractor within 30 days before contract expiration; provided that the Government gives the Contractor a preliminary written notice of its intent to extend at least 60 days before contract expiration. The preliminary notice does not commit the Government to an extension.
>
> (b) If the Government exercises this option, the extended contract shall be considered to include this option clause.
>
> (c) The total duration of this contract, including the exercise of any options under this clause, shall not exceed 36 months.

After exercising both option years, the CO extended the period of performance by six months. Oldcastle performed under protest, arguing that FAR 52.217-9 limited the duration of the contract to 36 months, and contending that it was entitled to recover increased costs for targets provided after Jan. 21, 2007. Oldcastle appealed to the ASBCA after the CO denied its claim for additional compensation for the extra six months.

Relying on *Arko Exec. Servs., Inc. v. U.S.*, 553 F.3d 1375 (Fed. Cir. 2009), the ASBCA granted summary judgment in the Government's favor. *Arko* involved a contract for security guard services at the U.S. embassy in Cyprus; the controversy centered on how to apply FAR 52.217-8 and 52.217-9. The State Department had exercised the contract's four option years, which extended the contract to March 31, 2005. In early November 2004, the Government issued a solicitation for a new contract. Because the new contract could not be finalized by March 31, 2005, the Government extended Arko's contract for 60 days under FAR 52.217-8. After completing its contract under protest, Arko submitted a claim and later brought suit in the U.S. Court of Federal Claims asserting that the CO improperly extended the contract beyond March 31, 2005. On appeal, the U.S. Court of Appeals for the Federal Circuit affirmed the COFC's grant of summary judgment for the Government. It differentiated limits on contract duration (base plus any option years) in FAR 52.217-9 from the Government's right to add short extensions outside that period in accordance with FAR 52.217-8.

The ASBCA found "no reason to ignore the language of FAR 52.217-8, its purpose, or to not apply the precedential interpretation of this clause by

the United States Court of Appeals for the Federal Circuit." Accordingly, the ASBCA held that the Government properly extended the contract under FAR 52.217-8, and Oldcastle was not entitled to additional compensation as a result of the extensions.

¶ 72

Costs Are Not Unreasonable Just Because The CO Says So

The dispute in *Shaw Areva MOX Servs., LLC v. Dep't of Energy*, CBCA 2407, 2012 WL 4803264 (Sept. 28, 2012), involved the allowability of costs paid by Shaw Areva MOX Services LLC to its employees to encourage them to accept long-term assignments to Aiken, S.C. The contracting officer issued a final decision determining that the costs were unreasonable and therefore unallowable, and MOX Services appealed to the Civilian Board of Contract Appeals.

The Department of Energy moved for summary judgment, arguing that "because the contracting officer made a thoughtful determination that the costs in question are not allowable, the Board must deny MOX Services' appeal of what the agency characterizes as a discretionary act." In making this argument, DOE relied on *Planning Research Corp. Sys. Servs. Co.*, NASA BCA 680-11, 81-2 BCA ¶ 15179, which held,

> In the absence of an express contract provision or established practice between the parties controlling the allocability of the costs in question, this Board will not substitute its judgment for that of the Contracting Officer in the reasonable exercise of his discretionary authority. Appellant assumed the risk and responsibility of being wrong when it substituted its judgment for the Contracting Officer's.

Not surprisingly, the CBCA rejected DOE's argument. The CBCA noted that "if this formulation of the law was ever correct, it has not been so since enactment of the Contract Disputes Act in 1978." The CBCA denied the Government's motion, finding that it was "premised on an incorrect legal standard" and that there were material facts in dispute.

¶ 73

CBCA Rules On Appropriate CO In Contract Dispute

Determining the contracting officer for submission of a claim arising under a General Services Administration schedule contract is often challenging, and because submission of the claim to the correct CO is a jurisdictional requirement, making the wrong choice can have significant consequences.

Federal Acquisition Regulation § 8.406-6(a)(1) states that under the Disputes clause of a schedule contract, the ordering activity CO may issue final decisions on disputes arising from performance of an order or refer the dispute to the schedule CO. On the other hand, FAR 8.406-6(b) requires the ordering activity CO to "refer all disputes that relate to the contract terms and conditions to the schedule contracting officer for resolution under the Disputes clause of the contract and notify the schedule contractor of the referral." FAR 8.406-6(c) states that "[c]ontractors may appeal final decisions to either the Board of Contract Appeals servicing the agency that issued the final decision or the U.S. Court of Federal Claims."

The contractor in *GTSI Corp. v. Equal Employment Opportunity Comm'n*, CBCA 2718 et al., 2012 WL 4195335 (Sept. 14, 2012), hedged its bets by submitting identical claims to both the GSA CO responsible for administering its schedule contract and the Equal Employment Opportunity Commission CO responsible for administering the delivery order. The claim sought termination costs as a result of the EEOC's decision not to exercise an option year of the delivery order because of a lack of funds. The EEOC CO issued a final decision denying the claim, but the GSA CO did not respond. GTSI appealed both the EEOC CO's final decision and the GSA CO's deemed denial of its claim to the Civilian Board of Contract Appeals. Predictably, both agencies moved to dismiss, each arguing that it was not the proper party respondent.

After discussing the history of the FAR 8.406-6 revisions and noting the problems inherent in its interpretation, the CBCA concluded that the EEOC CO had authority to issue the final decision, and

thus the EEOC was the proper respondent. The CBCA explained that it "reach[ed] this conclusion because the terms and operation of the [schedule contract's] termination for non-appropriations clause are not at issue." Rather, the CBCA stated, "[t]he issue is purely factual and the facts are solely relevant to the EEOC: was the status of the EEOC's appropriations sufficient to invoke the termination for non-appropriations clause." The CBCA concluded that this issue was more appropriately addressed by the EEOC CO than the GSA CO, who had no knowledge of the EEOC's appropriations. The CBCA therefore granted GSA's motion and dismissed the appeal against GSA, but held that it had jurisdiction over the appeal against the EEOC.

DEVELOPMENTS

By Karen L. Manos

¶ 74

In Brief

(a) **Class Deviations to Accelerate Payment to Small Business Subcontractors**. The Director of Defense Procurement and Acquisition Policy August 15 issued a class deviation directing Department of Defense contracting officers to use a new clause that requires prime contractors that receive accelerated payments from the Government to pay their small business subcontractors on an accelerated timetable to the maximum extent practicable. The new clause, Federal Acquisition Regulation 52.232-99, Providing Accelerated Payment to Small Business Subcontractors (DEVIATION 2012-O0014) (August 2012), implements the temporary one-year policy provided by Office of Management and Budget Policy Memorandum M-12-16, dated July 11, 2012. COs must include the clause in all new solicitations and resultant contracts issued after the date of the deviation and, to the extent feasible, should modify existing solicitations and contracts to insert it. The DPAP memo states that "[t]o assist in expediting contractor payments to small business subcontractors, DoD will provide accelerated payments to all prime contractors after receipt of a proper invoice and all proper documentation while also maintaining necessary DoD internal controls." DOD subsequently published notice that it has taken steps to accelerate federal payments to prime contractors, with the goal of making payment within 15 days, so that prime contractors can expedite payments to their small business subcontractors. The notice states that accelerated payments will remain in effect through July 10, 2013, unless otherwise rescinded or extended. See 77 Fed. Reg. 63298 (Oct. 16, 2012). Separately, the Civilian Agency Acquisition Counsel August 16 issued Civilian Agency Acquisition Letter 2012-03, allowing civilian agencies to authorize a class deviation, in accordance with FAR 1.404, for COs to insert the same clause in new solicitations and resultant contracts and, to the extent feasible, to modify existing solicitations and contracts to insert it.

(b) **FAR Proposed Rule on Positive Law Codification of Title 41**. The Department of Defense, General Services Administration and NASA have published a proposed rule to amend the Federal Acquisition Regulation to conform references to the new positive law codification of title 41, U.S. Code. "Positive law codification" is an ongoing project, required by 2 USCA § 285b(1), to prepare and enact, one title at a time, all general and permanent U.S. laws. Title 41 was enacted into positive law by P.L. 111-350, which was signed into law Jan. 4, 2011. Because title 41 governs public contracts, and the new law changed all of the section numbers, almost every statutory citation in the FAR must be changed. The proposed rule would also make updates to complete the FAR implementation of the recodification of title 40. See 77 Fed. Reg. 57950 (Sept. 18, 2012).

(c) OMB Guidance on Allowable Costs Associated with WARN Act. The Worker Adjustment and Retraining Notification (WARN) Act, 29 USCA § 2101–2109, generally requires employers with at least 100 employees to provide written notification 60 calendar days before plant closings and mass layoffs. Violations of the WARN Act may subject the employer to liability for back pay and benefits, civil penalties of up to $500 per day, and attorneys' fees. Affected employees, their representatives and units of local government may bring individual or class action suits against employers believed to be in violation of the Act. With the looming threat of sequestration—scheduled to occur on Jan. 2, 2013 if Congress fails to act—some contractors have publicly announced their intent to issue WARN Act notices. Seeking to dissuade contractors from doing so, the Department of Labor issued guidance on July 30, 2012, stating that it is neither necessary nor appropriate for federal contractors to provide WARN Act notices to employees 60 days in advance of the potential sequestration because of the uncertainty about whether sequestration will occur and, if it does, what effect it will have on particular contracts, among other factors. See DOL Training and Employment Guidance Letter No. 3-12 (July 30, 2012). Despite DOL's guidance, some contractors have indicated that they are still considering issuing WARN Act notices. On September 28, the Office of Management and Budget issued guidance regarding the allowability of liability and litigation costs associated with WARN Act (non)compliance. The guidance memorandum states,

> [I]f (1) sequestration occurs and an agency terminates or modifies a contract that necessitates the contractor order a plant closing or mass layoff of the type subject to WARN Act requirements, and (2) that contractor has followed a course of action consistent with DOL guidance, then any resulting employee compensation costs for WARN Act liability as determined by a court, as well as attorneys' fees and other litigation costs (irrespective of the litigation outcome), would qualify as allowable costs and be covered by the contracting agency, if otherwise reasonable and allocable.

However, the guidance memo also makes clear that it "does not alter existing rights, responsibilities, obligations, or limitations under individual contract provisions or the governing cost principles set forth in the Federal Acquisition Regulation (FAR) and other applicable law." See Office of Management and Budget Memorandum for the Chief Financial Officers and Senior Procurement Executives of Executive Departments and Agencies, "Guidance on Allowable Contracting Costs Associated with the Worker Adjustment and Retraining Notification (WARN) Act" (Sept. 28, 2012).

(d) DCAA Audit Guidance on Denial of Access to Privileged Records. The Defense Contract Audit Agency has issued audit guidance to inform its auditors of new procedures to follow if a contractor asserts attorney-client privilege or attorney work product doctrine. Under the new procedures, if a contractor denies access to requested information and does not provide alternative, non-privileged information, the field audit office should pursue access to records until such time as a high-level executive from the company asserts the privilege in writing. Upon receipt of a written assertion, the issue should be elevated to the regional office for coordination with top-level contractor management. If the auditor still cannot obtain the data needed to establish allowability, allocability or reasonableness, the field audit office should coordinate with headquarters so that the access to records issue may be reviewed with DCAA counsel. These new procedures have been added to Defense Contract Audit Manual ¶ 1-504.4g. See DCAA Memorandum for Regional Directors, "Audit Guidance—Denial of Access to Records Due to Contractor Assertion of Attorney-Work-Product Doctrine or Attorney-Client Privilege" (12-PPS-018(R)) (July 25, 2012).

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by Karen L. Manos

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