

## *Chapter 23*

# **Pricing of Contract Adjustments**



*2014 Contract Attorneys Deskbook*

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## CHAPTER 23

### PRICING OF CONTRACT ADJUSTMENTS

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## CHAPTER 23

### PRICING OF CONTRACT ADJUSTMENTS

**I. INTRODUCTION.** Following this block of instruction, students will understand:

- A. The circumstances that entitle a contractor to a contract price adjustment.
- B. The measurement of a price adjustment.
- C. The methods and burden of proving a price adjustment.
- D. The various special items that often comprise a price adjustment.
- E. Quantum Case Planning.

**II. REFERENCES**

- A. 41 U.S.C. §§ 1501-1506.
- B. Pricing of Adjustments, Chapter 8, Administration of Government Contracts, 4<sup>th</sup> Edition, Cibinic, Nash & Nagle, 2006.
- C. Federal Acquisition Regulation (FAR) 30, Cost Accounting Standards Administration; FAR 31, Contract Cost Principles and Procedures; FAR 43.2 Change Orders; FAR 52.243-1 to 52.243-7; 48 CFR 9903.202-1 to 5 (FAR Appendix); DFARS 243.205-70.
- D. DFARS 243.205-70 and 252.243-7001 Pricing of Contract Modifications, (Dec 1991); DFARS 243.205-71 and 252.243-7002 Requests for Equitable Adjustment (Mar 1998).
- E. Accounting Guide, Defense Contract Audit Agency Pamphlet No. 7641.90, Information for Contractors, <http://www.dcaa.mil>; OMB Circular A-122; OMB Circular No. A-21 Cost Principles for Education Institutions; OMB Circular No. A-87, Cost Principles for State and Local Governments.

### III. OVERVIEW

- A. Entitlement to More Money. There are three circumstances that entitle contractors to more than the original contract price:
1. Equitable adjustment. An equitable adjustment entitles the contractor to receive certain additional costs of performance **plus a reasonable profit** on those costs. Equitable adjustments are based on contract clauses granting that remedy, including:
    - a. FAR 52.243-1 thru -7, Changes.
    - b. FAR 52.245-1, -2, Government Furnished Property.
    - c. FAR 52.248-1 thru -3, Value Engineering.
    - d. FAR 52.242-15, Stop Work Order.
    - e. FAR 52.236-2, Differing Site Conditions.
  2. Adjustments. An adjustment entitles the contractor to recover certain additional performance costs, but not profit. The rationale for lack of profit is that there is no change in work and/or risk—only the period in which performance occurs. There are two types of adjustments:
    - a. Work stoppage adjustments. These adjustments allow the contractor to recover certain direct and indirect performance costs. Contract clauses providing for such adjustments are:
      - (1) FAR 52.242-14, Suspension of Work. See Thomas J. Papathomas, ASBCA No. 51352, 99-1 BCA ¶ 30,349;[No specific references to FAR, Part 52.242-14, just full text clause with substantially the same language. Negative treatment of the case has to do with an EAJA issue.] *see also GASA, Inc. v. United States, 79 Fed. Cl. 325, 347 (2007) Tom Shaw, Inc., ASBCA No. 28596, 95-1 BCA ¶ 27457* [Decision adhered to on reconsideration.].
      - (2) FAR 52.242-17, Government Delay of Work.
    - b. Labor standards adjustments. Adjustments under labor standards clauses include only the increased costs of direct labor (and do not include profit). See FAR 52.222-43, Fair Labor Standards Act and Service Contract Act – Price Adjustments (Multiple Year and

Option Contracts); FAR 52.222-44, Fair Labor Standards Act and Service Contract Act – Price Adjustments; All Star/SAB Pacific, J.V., ASBCA No. 50856, 98-2 BCA ¶ 29,958; U.S. Contracting, Inc., ASBCA No. 49713, 97-2 BCA ¶ 29,232. But see BellSouth Communications Sys., Inc., ASBCA No. 45955, 94-3 BCA ¶ 27,231 (holding that a price adjustment under FAR 52.222-6, Davis-Bacon Act, did not preclude profit).

3. Damages. The contractor can recover common law breach of contract damages in certain very narrow situations.
  - a. A contractor may not assert a claim for breach of contract damages when there is a remedy-granting contract clause. Information Sys. & Network Corp., ASBCA No. 42659, 99-1 BCA ¶ 30,665 (holding that claim for breach of damages barred by convenience termination clause); Hill Constr. Corp., ASBCA No. 49820, 99-1 BCA ¶ 30,327 (denying a breach claim for lost profits where the underlying changes were within the ambit of the Changes clause).
  - b. Situations where breach damages may be recovered include:
    - (1) Breach of a requirements contract. Bryan D. Highfill, HUDBCA No. 96-C-118-C7, 99-1 BCA ¶ 30,316.
    - (2) Bad faith termination for convenience. Praecomm, Inc. v. United States, 78 Fed. Cl. 5, 12 (2007); Torncello v. United States, 231 Ct. Cl. 20, 681 F.2d 756 (1982); but see Custom Printing v. United States, 51 Fed. Cl. 729, 734 (2002) (Questioned the level for standard of review for termination for convenience.).
    - (3) Government’s failure to disclose material information. Shawn K. Christensen, dba Island Wide Contracting, AGBCA No. 95-188-R, 95-2 BCA ¶ 27,724.
  - c. Damages are measured under common law principles (see Section V.E., *infra*), although cost principles may apply. Chevron, USA, Inc. v. United States, 71 Fed. Cl. 236 (2006); AT&T Tech., Inc. v. United States, 18 Cl. Ct. 315 (1989) (Decision later criticized on other, more specific grounds); Shawn K. Christensen, dba Island Wide Contracting, AGBCA No. 95-188-R, 95-2 BCA ¶ 27,724.

- (1) Consequential Damages. The general rule is that consequential damages are not recoverable unless they are foreseeable and caused directly by the government's breach. Prudential Ins. Co. of Am. v. United States, 801 F.2d 1295 (Fed. Cir. 1986); Land Movers Inc. and O.S. Johnson - Dirt Contractor (JV), ENG BCA No. 5656, 91-1 BCA ¶ 23,317 (no recovery of lost profits based on loss of bonding capacity; also no recovery related to bankruptcy, emotional distress, loss of business, etc.).
- (2) Compensatory Damages. A contractor whose contract was breached by the government is entitled to be placed in as good a position as it would have been if it had completed performance. White v. Delta Constr. Int'l, Inc., 285 F.3d 1040, 1043 (Fed. Cir. 2002); PHP Healthcare Corp., ASBCA No. 39207, 91-1 BCA ¶ 23,647 (the measure of damages for failure to order the minimum quantity is not the contract price; the contractor must prove actual damages). Compensatory damages include a reliance component (costs incurred as a consequence of the breach), and an expectancy component (lost profits). Keith L. Williams, ASBCA No. 46068, 94-3 BCA ¶ 27,196.

B. Pricing Formula.

1. General Rule.

- a. The basic adjustment formula is the difference between the reasonable cost to perform the work as originally required, and the reasonable cost to perform the work as changed. See B.R. Servs., Inc., ASBCA Nos. 47673, 48249, 99-2 BCA ¶ 30,397 (holding that the contractor must quantify the cost difference—not merely set forth the costs associated with the changed work); Buck Indus., Inc., ASBCA No. 45321, 94-3 BCA ¶ 27,061.
- b. Pricing adjustments should not alter the basic profit or loss position of the contractor before the change occurred. “An equitable adjustment may not properly be used as an occasion for reducing or increasing the contractor's profit or loss . . . for reasons unrelated to a change.” United States. ex rel Bettis v. Odebrecht, 393 F.3d 1321 (D.C. Cir. 2005); Pacific Architects and Eng'rs, Inc. v. United States, 203 Ct. Cl. 499, 508 491 F.2d 734, 739 (1974). See also Stewart & Stevenson Servs., Inc., ASBCA No. 43631, 97-2 BCA ¶ 29,252 modified by 98-1 BCA ¶ 29,653 (holding that a contractor

is entitled to profit on additional work ordered by the Army even though the original work was bid at a loss); Westphal Gmph & Co., ASBCA No. 39401, 96-1 BCA ¶ 28194 (Reversed, remanded, based on factual issue, not legal premises).

2. Pricing Additional Work. Agencies price additional work based on the reasonable costs actually incurred in performing the new work. CEMS, Inc. v. United States, 59 Fed. Cl. 168 (2003); Delco Elecs. Corp. v. United States, 17 Cl. Ct. 302 (1989), aff'd, 909 F.2d 1495 (Fed. Cir. 1990); The contractor should segregate and accumulate these costs.
3. Pricing Deleted Work.
  - a. Agencies price deleted work based on the difference between the estimated costs of the original work and the actual costs of performing the work after the change. Knights' Piping, Inc., ASBCA No. 46985, 94-3 BCA ¶ 27,026; Anderson/Donald, Inc., ASBCA No. 31213, 86-3 BCA ¶ 19,036. But see Condor Reliability Servs, Inc., ASBCA No. 40538, 90-3 BCA ¶ 23,254.
  - b. When the government partially terminates a contract for convenience, a contractor is generally entitled to an equitable adjustment on the continuing work for the increased costs borne by that work as a result of a termination. Deval Corp., ASBCA Nos. 47132, 47133, 99-1 BCA ¶ 30,182; Cal-Tron Sys., Inc., ASBCA Nos. 49279, 50371 97-1 BCA ¶ 28,986; Wheeler Bros., Inc., ASBCA No. 20465, 79-1 BCA ¶ 13,642.
    - (1) Convenience Termination Settlements. A contractor is not entitled to profit as part of a termination for convenience settlement proposal if the contractor would have incurred a loss had the entire contract been completed. FAR 49.203. The government has the burden of proving that the contractor would have incurred a loss at contract completion. R&B Bewachungs, GmbH, ASBCA No. 42214, 92-3 BCA ¶ 25,105. A contractor is not entitled to anticipatory profits as part of a convenience termination settlement proposal. Dairy Sales Corp. v. United States, 593 F.2d 1002 (Ct. Cl. 1979).
4. Responsibility. Where the parties share the fault, they share liability for the added costs. See Essex Electro Eng'rs, Inc., v. Danzig, 224 F.3d 1283 (Fed. Cir. 2000); Dickman Builders, Inc., ASBCA No. 32612, 91-2 BCA ¶ 23,989.

C. Recoverable Costs. The cost principles of FAR Part 31 apply to the pricing of contracts, subcontracts, and modifications whenever cost analysis is performed and when the determination, negotiation or allowance of costs is required by a contract clause. FAR 31.000. DoD requires the cost principles to be applied to all fixed price contracts when pricing any adjustment, such as a modification, under the contract. DFARS 243.205-70.

1. Allowability: When FAR Part 31 applies, contractors may claim only certain costs for adjustment purposes. The concept of allowability is ultimately a question of whether a particular item of cost should be recoverable as a matter of public policy. Boeing North American, Inc. v. Roche, 298 F.3d 1274, 1281 C.A. Fed. (2002).
  - a. A cost is allowable only when the cost complies with all the following requirements:
    - (1) Reasonableness. See discussion below.
    - (2) Allocability. See discussion below.
    - (3) Standards promulgated by the Cost Accounting Standards (CAS) Board, if applicable, or generally accepted accounting principles (GAAP) and practices appropriate to the circumstances. Cross-reference with Section C.4., infra.
    - (4) Terms of the contract. See discussion below on advance agreements.
    - (5) Any limitations set forth in FAR part 31. See discussion below. FAR 31.201-2(a).
2. Reasonable. To be allowable, a cost must be reasonable. A cost is reasonable if, in its nature and amount, it does not exceed that which a prudent person would incur in the conduct of a competitive business. FAR 31.201-3.
  - a. Cost held unreasonable in amount. TRC Mariah Assocs., Inc., ASBCA No. 51811, 99-1 BCA ¶ 30,386; Kelly Martinez d/b/a Kelly Martinez Constr. Servs., IBCA Nos. 3140, 3144-3174, 97-2 BCA ¶ 29,243, 1997 IBCA LEXIS 12. But see Raytheon STX Corp., GSBCA No. 14296-COM, 00-1 BCA ¶ 30,632, 1999 GSBCA LEXIS 252 (holding that salaries paid key employees during a shutdown were reasonable in amount).

- b. Nature of cost held unreasonable. Lockheed-Georgia Co., Div. of Lockheed Corp., ASBCA No. 27660, 90-3 BCA ¶ 22,957 (air travel to the Greenbrier resort for executive physicals unreasonable because competent physicians were available in Atlanta).
  - c. No presumption of reasonableness is attached to contractor costs. If an initial review of the facts causes the Contracting Officer to challenge a specific cost, the Contractor bears the burden of showing the cost is reasonable. FAR 31.201-3. Reasonableness depends on a variety of considerations and circumstances, including:
    - (1) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance;
    - (2) Generally accepted sound business practices, arm's length bargaining, and Federal and State laws and regulations;
    - (3) The contractor's responsibilities to the Government, other customers, the owners of the business, employees, and the public at large; and
    - (4) Any significant deviations from the contractor's established practices. FAR 31.201-3(b).
  - d. Profit. In determining the reasonableness of profit as part of an equitable adjustment, profit is calculated as:
    - (1) The rate earned on the unchanged work;
    - (2) A lower rate based on the reduced risk of equitable adjustments; or
    - (3) The rate calculated using weighted guidelines. See Doyle Constr. Co., ASBCA No. 44883, 94-2 BCA ¶ 26,832.
3. Allocable. To be allowable, a cost must be allocable to the contract.
- a. A cost is allocable if:
    - (1) Incurred specifically for the contract (direct cost); **or**

- (2) The cost benefits both the contract and other work, and is distributed to them in reasonable proportion to the benefits received; **or**
  - (3) Is necessary for the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown. FAR 31.201-4.
- b. Generally, allocability is a subset of allowability. A cost is not allowable if the cost cannot be allocated to a government contract. However, a cost may be allocable to a contract, but be unallowable because it failed another element of allowability – such as reasonableness. Boeing North American, Inc. v. Roche, 298 F.3d 1274, 1280 (Fed. Cir. 2002).
- (1) The concept of allocability is addressed to the question of whether a sufficient “nexus” exists between the cost and a government contract. Lockheed Aircraft Corp. v. United States, 179 Ct. Cl. 545, 375 F.2d 786, 794 (1967); Boeing North American, Inc. v. Roche, 298 F.3d 1274, 1280 (Fed. Cir. 2002).
  - (2) “Allocability is an accounting concept involving the relationship between incurred costs and the activities or cost objectives (e.g., contracts) to which those costs are charged. Proper allocation of costs by a contractor is important because it may be necessary for the contractor to allocate costs among several government contracts or between government and non-government activities.” Boeing North American, Inc. v. Roche, 298 F.3d 1274, 1280 (Fed. Cir. 2002).
  - (3) **Benefit to the government.** For a period of time, under the Caldera case, the courts held that a cost is not allocable to a government contract if there is no reasonable benefit to the government. That principle is no longer good law.
    - (a) Currently, “the word “benefit” is used in the allocability provisions to describe the nexus required for accounting purposes between the cost and the contract to which it is allocated.”
    - (b) The term is not designed to send the government into an “amorphous inquiry into whether a particular

cost sufficiently ‘benefits’ the government so that the cost should be recoverable by the government. The question whether a cost should be recoverable as a matter of policy is to be undertaken by applying the specific allowability regulations, which embody the government’s view, as a matter of ‘policy,’ as to whether the contractor may permissibly change particular costs to the government (if they are otherwise allocable.)” Boeing North American, Inc. v. Roche, 298 F.3d 1274, 1284 (Fed. Cir. 2002)(holding that the CAS do not require that a cost directly benefit the government’s interests for the cost to be allocable). Caldera v. Northrop Worldwide Aircraft Servs., Inc., 192 F.3d 962 (Fed. Cir. 1999) (holding that attorneys fees incurred unsuccessfully defending wrongful termination actions resulted in no benefit to the contract and were not allocable).

- (c) The contractor does not, however, have to demonstrate that the incurrence of the cost benefits the government in order for the cost to be allocable. Rumsfeld v. United Techs Corp., 315 F.3d 1361 (Fed. Cir. 2003) (holding that the concept of “benefit” within the provisions dealing with allocability merely require a nexus for accounting purposes between the cost and the contract to which it is allocated); Info. Sys. & Network Corp., ASBCA No. 42659, 00-1 BCA ¶ 30,665; P.J. Dick, Inc., GSBCA No. 12415, 96-2 BCA ¶ 28,307 (finding that accounting fees were costs benefiting the contract);

- c. In certain instances (i.e., impact on other work), the contract appeals boards may ignore the principle of allocability. See Clark Concrete Contractors, Inc. v. Gen. Servs. Admin., GSBCA No. 14340, 99-1 BCA ¶ 30,280 (holding that costs incurred on an unrelated project were recoverable because they were “equitable and attributable” by-products of agency design changes).

- 4. Accounting Standards. Costs must be measured in accordance with standards promulgated by the Cost Accounting Standards Board (CASB), if applicable. Otherwise, Contractors can determine costs by using any

generally accepted cost accounting principles and practices appropriate to the circumstances. FAR 31.201-2.

- a. Introduction to Cost Accounting Standards (CAS). CAS are administrative cost rules promulgated by the Cost Accounting Standards Board (CASB), which is an office within the Office of Federal Procurement Policy (OFPP). The regulations are codified at 48 CFR, Chapter 99.
  - (1) The CASB is an independent statutorily-established board consisting of five members. 41 U.S.C. § 1502 (2011). The Board has exclusive authority to make, promulgate, and amend cost accounting standards and interpretations. The CASB's goal is to achieve uniformity and consistency in the cost accounting practices governing the measurement, assignment, and allocation of costs to contracts with the United States. See [http://www.whitehouse.gov/omb/procurement\\_casb/](http://www.whitehouse.gov/omb/procurement_casb/) (last visited June 29, 2014).
  - (2) CAS grew out of criticism of accounting and pricing practices of the defense industry in the 1960s. In turn, Congress called for and GAO confirmed the feasibility of applying uniform cost accounting standards to all negotiated prime contract and subcontract defense procurements of \$100,000 or more. In 1988, a more permanent and independent CASB was established within the OFPP. See Pub.L.No. 100-679, 102 Stat. 4055 (1988); Boeing North American, Inc. v. Roche, 298 F.3d 1274, 1282-83 (Fed. Cir. 2002)(detailing some of the history of the CASB).
- b. If there is any conflict between the CAS and the FAR as to an issue of allocability, the CAS governs. United States v. Boeing Co., 802 F.2d 1390, 1395 (Fed. Cir. 1986); Rice v. Martin Marietta Corp., 13 F.3d 1563, 1565 n.2 (Fed. Cir. 1993).
- c. CAS do not apply to sealed bid contracts or to any contract with a small business concern. 48 CFR 9903.201-1(b)(FAR Appendix) and FAR 30.000.
- d. CAS are mandatory for contractors and subcontractors in estimating, accumulating, and reporting costs in connection with pricing and administration of and settlement of disputes concerning

all negotiated prime contract and subcontract procurements with the United States in excess \$700,000<sup>1</sup>, **except:**

- (1) Contracts or subcontracts for the acquisition of commercial items.
- (2) Contracts or subcontracts where the price negotiated is based on prices set by law or regulation.
- (3) Firm, fixed-price contracts or subcontracts awarded on the basis of adequate price competition without submission of certified cost or pricing data.
- (4) A contract or subcontract with a value of less than \$ 7,500,000 if, at the time the contract or subcontract is entered into, the contractor or subcontractor that will perform the work has not been awarded at least one contract or subcontract with a value of more than \$ 7,500,000 that is covered by the cost accounting standards.
- (5) The term "subcontract" includes a transfer of commercial items between divisions, subsidiaries, or affiliates of a contractor or subcontractor. 41 U.S.C. §1502(b)(1).
- (6) Waiver Authority. In certain situations, when CAS is required, it can be waived. 41 U.S.C. §1502(b)(2); FAR 30.201-5; DFARS 230.201-5:
  - (a) The head of an executive agency may waive CAS in writing for contracts less than \$ 15,000,000 where the contractor primarily sells commercial items and would not otherwise be subject to CAS.
  - (b) The head of an executive agency may waive CAS under exceptional circumstances when necessary to meet the needs of the agency. A written J&A will address certain questions listed in the FAR & DFARS.

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<sup>1</sup> The statute refers to 10 U.S.C. § 2306a, the Truth in Negotiations Act (TINA) threshold. This threshold adjusts for inflation every five years. See also, Contract Pricing for threshold information.

- (c) The head of an executive agency may not delegate the authority under subparagraphs (A) or (B) to any official in the executive agency below the senior policymaking level in the executive agency.
- (d) A list of all waivers is forwarded to the CASB on an annual basis. 41 USC §1502(b)(3)(E).

5. Terms of the Contract. **Advance Agreements.**

- a. The reasonableness, allocability, and allowability of certain costs may be difficult to determine. Contracting officers and contractors should seek advance agreement on the treatment of special or unusual costs. Advance agreements are not required but may be negotiated before or during a contract as long as the costs involved have not been incurred.
- b. A contracting officer may not agree to a treatment of costs inconsistent with FAR Part 31. FAR 31.109.
- c. Advance agreements may be particularly important for:
  - (1) Compensation of personal services;
  - (2) Fully depreciated assets;
  - (3) Precontract costs;
  - (4) Independent research and development and bid and proposal costs;
  - (5) Royalties and costs for use of patents;
  - (6) Costs of idle facilities and idle capacity;
  - (7) See FAR 31.109(h) for more examples.

6. **Limitations set forth in FAR 31.205 – Limited allowable costs and unallowable costs.** The government does not pay certain costs even if they are actually incurred, reasonable, allocable, and properly accounted for. FAR Part 31 sets forth specific costs that are disallowed. Similarly, the parties may specify in the contract that certain costs will not be allowable.

- a. The following list of potential **disallowed costs** is non-exclusive:

- (1) Bad debts. FAR 31.205-3.
- (2) Costs related to contingencies are generally unallowable, but some categories are allowable. FAR 31.205-7.
- (3) Contributions or Donations, including cash, property and services, regardless of recipient. FAR 31.205-8.
- (4) Depreciation costs that significantly reduce the book value of a tangible capital asset below its residual value. FAR 31.205-11(b).
- (5) Entertainment costs, including amusement, diversions, social activities, gratuities and tickets to sports events. FAR 31.205-14.
- (6) Specific Lobbying and Political Activities. FAR 31.205-22.
- (7) Excess of costs over income under any other contract. FAR 31.205-23.
- (8) Costs of Alcoholic Beverages. FAR 31.205-51
- (9) Excessive Pass-Through charges by contractors from sub-contractors, which add no or negligible value, are unallowable. If a contractor sub-contracts at least 70 percent of the work, the contracting officer must make a determination that pass-through charges at the time of award are not excessive and add value. FAR 15.408(n)(2) and FAR 52.215-23.

b. What if a cost is not expressly listed in FAR 31.205?

- (1) FAR 31.205 does not cover every element of cost. Failure to include any item of cost does not imply that it is either allowable or unallowable. In that case, the determination of allowability shall be based on the principles and standards in FAR 31 and the treatment of similar or related selected items. FAR 31.204(d).
- (2) There are several cases analyzing allowability based on whether a particular cost is similar or related to selected items in FAR 31.

- (a) Boeing North American, Inc. v. Roche, 298 F.3d 1274, 1285-86 (Fed. Cir. 2002). This case involved a claim for the cost of settling a private shareholder lawsuit against 14 directors of a company (later bought by Boeing). The shareholder suit sought damages for the failure of the company directors to establish internal controls that would have prevented the company from committing fraud against the government. The fraud led to subsequent convictions, fines and penalties against the company. The court first held that costs of shareholder suits are not “similar” to costs incurred in connection with criminal convictions or any other disallowed cost in the FAR. Then the court held that such costs were “related” to the convictions with a sufficiently direct relationship to the disallowed costs of the criminal convictions to disallow the cost of defending against the adverse judgment in the shareholder suit.
- (b) Southwest Marine, Inc. v. United States, 535 F.3d 1012 (9<sup>th</sup> Cir. 2008). The court held that legal costs associated with citizen suits against Southwest Marine under the Clean Water Act were not allowable costs because they were “similar” to costs disallowed in the FAR in False Claims Act proceedings.
- (c) Geren v. Tecom, Inc. (“Tecom II”), 566 F.3d 1037, (Fed. Cir. 2009). The court stated that when the cost of an adverse judgment on an underlying suit would be unallowable (and thus in breach of the contract), the settlement of such a private suit is “similar” to the FAR provisions concerning private suits under the False Claims Act. Thus, attorneys’ fees defending against the lawsuit would not be an allowable cost. The court held that the settlement costs may still be allowable if the contracting officer determines that there was ‘very little likelihood that the third party plaintiffs would have been successful on the merits.’”
- (3) A cost is unallowable if it is associated with the contractor breaching the government contract. See cases below.

- (a) Geren v. Tecom, Inc. (“Tecom II”), 566 F.3d 1037 (Fed. Cir. 2009). This case examined the allowability of legal costs associated with Title VII violations. Rather than conduct a “similar or related” analysis (see discussion above), the court held that if an adverse judgment would cause the contractor to breach its contract with the government, the cost is unallowable. In this case, the contract contained a clause stating the contractor would not discriminate based on sex, among other factors. The court found that an adverse judgment in a Title VII suit would breach the contract clause, thus any defense costs and judgment costs would be unallowable. See also NAACP v. Federal Power Commission, 425 U.S. 662, 668, 96 S. Ct. 1806, 48 L.Ed.2d 284 (1976)(holding that the Federal Power Commission had authority to disallow the costs of unlawful discriminatory employment practices as the costs were unreasonable and contrary to public policy).
- (b) Dade Brothers, Inc., v. United States, 163 Ct. Cl. 485, 325 F.2d 239, 240 (1963). This case holds that costs resulting from a breach of a contractual obligation are not allowable costs under the contract. The case dealt with allowability of the legal cost of defending a union suit and the subsequent cost of satisfying the adverse judgment. Specifically, 54 employees sued the contractor for denying them seniority rights. The court found all the costs unallowable because the contract specifically stated the contractor would abide by the union agreement.

D. Certification Requirements. The Federal Acquisition Streamlining Act of 1994 (FASA), Pub. L. 103-355, § 2301, 108 Stat. 3243 (1994) amended by 10 U.S.C. § 2410, Requests for Equitable Adjustment or Other Relief: Certification.

- 1. In DOD, a request for equitable adjustment that exceeds the simplified acquisition threshold (currently, \$150,000) may not be paid unless a person authorized to certify the request on behalf of the contractor certifies, at the time that the request is submitted, that:

- a. The request is made in good faith, and
- b. The supporting data is accurate and complete to the best of that person's knowledge. 10 U.S.C. § 2410.

#### IV. MEASUREMENT OF THE ADJUSTMENT

A. Costs. "Costs" for adjustment formula purposes are the sum of allowable direct and indirect costs, incurred or to be incurred, less any allowable credits, plus cost of money. FAR 31.201-1. If it is an equitable adjustment, one must also calculate the profit on the allowable costs.

1. Direct Costs.

- a. A direct cost is any cost that is identified specifically with a particular contract. Direct costs are not limited to items that are incorporated into the end product as material or labor. All costs identified specifically with a claim are direct costs of that claim. FAR 31.202.
- b. Direct costs generally include direct labor, direct material, subcontracts, and other direct costs.

2. Indirect Costs.

- a. Indirect costs are any costs not directly identified with a single final cost objective, but identified with two or more final cost objectives, or with at least one intermediate cost objective. FAR 31.203. There are two types of indirect costs:
  - (1) Overhead. Allocable to a cost objective based on benefit conferred. Typical overhead costs include the costs of personnel administration, depreciation of plant and equipment, utilities, and management.
  - (2) General and administrative (G&A). Not allocable based on benefit, but necessary for overall operation of the business. See FAR 31.201-4(c).
- b. Calculating indirect cost rates. The total indirect costs divided by the total direct costs equals the indirect cost rate. For example, if a contractor has total indirect costs of \$100,000 in an accounting period, and total direct costs of \$1,000,000 in the same period, the indirect cost rate is 10%.

- c. Some agencies limit the recoverable overhead through contract clauses. Reliance Ins. Co. v. United States, 931 F.2d 863 (Fed. Cir. 1991) (court upheld clause that limited recoverable overhead for change orders).
- B. Profit and Loss. An equitable adjustment includes a reasonable and customary allowance for profit. United States v. Callahan Walker Constr. Co., 317 U.S. 56 (1942); Rumsfeld v. Applied Companies, Inc., 325 F.3d 1328 (Fed. Cir. 2003). Adjustments under FAR 52.242-14, Suspension of Work and FAR 52.242-17, Government Delay of Work, expressly do not include profit. Profit is calculated as:
1. The rate earned on the unchanged work;
  2. A lower rate based on the reduced risk of equitable adjustments; or
  3. The rate calculated using weighted guidelines. See Doyle Constr. Co., ASBCA No. 44883, 94-2 BCA ¶ 26,832.

## V. PROVING THE AMOUNT OF THE ADJUSTMENT

- A. Burden of Proof.
1. The burden is on the party claiming the benefit of the adjustment. Wilner v. United States, 24 F.3d 1397 (Fed. Cir. 1994); Lisbon Contractors, Inc. v. United States, 828 F.2d 759, 767 (Fed. Cir. 1987) (moving party “bears the burden of proving the amount of loss with sufficient certainty so that the determination of the amount of damages will be more than mere speculation”); B&W Forest Prod., AGBCA Nos. 96-180, 96-198-1, 98-1 BCA ¶ 29,354.
  2. What must the party prove?
    - a. Entitlement (Liability)—the government did something that changed the contractor’s costs, for which the government is legally liable. T.L. James & Co., ENG BCA No. 5328, 89-2 BCA ¶ 21,643.
    - b. Causation—there must be a causal nexus between the basis for liability and the claimed increase (or decrease) in cost. Hensel Phelps Constr. Co., ASBCA No. 49270, 99-2 BCA ¶ 30,531; Stewart & Stevenson Servs., Inc., ASBCA No. 43631, 98-1 BCA ¶ 29,653, modifying 97-2 BCA ¶ 29,252; Oak Adec, Inc. v. United States, 24 Cl. Ct. 502 (1991).

- c. Resultant Injury—that there is an actual injury or increased cost to the moving party. Servidone Constr. Corp. v. United States, 931 F.2d 860 (Fed. Cir. 1991); Cascade Gen., Inc., ASBCA No. 47754, 00-2 BCA ¶ 31,093, 2000 ASBCA LEXIS 138 (holding that a contractor claim was deficient when it failed to substantiate what specific work and/or delays resulted from the defective government specifications).

B. Methods of Proof.

1. Actual Cost Method. The actual cost method is the preferred method for proving costs. North Star Alaska Hous. Corp. v. United States, 76 Fed. Cl. 158 (2007).
  - a. A contractor must prove its costs using the best evidence available under the circumstances. The preferred method is actual cost data. Cen-Vi-Ro of Texas, Inc. v. United States, 210 Ct. Cl. 684, (1976); Deval Corp., ASBCA Nos. 47132, 47133, 99-1 BCA ¶ 30,182.
  - b. The contracting officer may also include FAR 52.243-6, Change Order Accounting, in a contract. This clause permits the contracting officer to order the accumulation of actual costs. A contractor must indicate in its proposal, which proposed costs are actual and which are estimates.
  - c. Failure to accumulate actual cost data may result in either a substantial reduction or total disallowance of the claimed costs. Delco Elecs. Corp. v. United States, 17 Cl. Ct. 302 (1989), aff'd, 909 F.2d 1495 (Fed. Cir. 1990) (recovery reduced for unexcused failure to segregate); Togaroli Corp., ASBCA No. 32995, 89-2 BCA ¶ 21,864 (costs not segregated despite the auditor's repeated recommendation to do so; no recovery beyond final decision); Assurance Co., ASBCA No. 30116, 86-1 BCA ¶ 18,737 (lack of cost data prevented reasonable approximation of damages for jury verdict, therefore, the appellant recovered less than the amount allowed in the final decision).
2. Estimated Cost Method.
  - a. Good faith estimates are preferred when actual costs are not available. Lorentz Bruun Co., GSBCA No. 8505, 88-2 BCA ¶ 20,719 (estimates of labor hours and rates admissible). Estimates are generally required when negotiating the cost of a change in

advance of performing the work. Estimates are an acceptable method of proving costs where they are supported by detailed substantiating data or are reasonably based on verifiable cost experience. J.M.T. Mach. Co., ASBCA No. 23928, 85-1 BCA ¶ 17,820 (1984), aff'd on other grounds, 826 F.2d 1042 (Fed. Cir. 1987).

- b. If the contractor uses detailed estimates based on analyses of qualified personnel, the government will not be able to allege successfully that the contractor used the disfavored total cost method of adjustment pricing. Illinois Constructors Corp., ENG BCA No. 5827, 94-1 BCA ¶ 26,470.
- c. Estimates based on Mean's Guide must be disregarded where actual costs are known. Anderson/Donald, Inc., ASBCA No. 31213, 86-3 BCA ¶ 19,036.

3. Total Cost Method.

- a. The total cost method is not preferred because it assumes the entire overrun is solely the government's fault. The total cost method calculates the difference between the bid price on the original contract and the actual total cost of performing the contract as changed. Servidone v. United States, 931 F.2d 860 (Fed. Cir. 1991); Raytheon Co. v. White, 305 F.3d 1354 (Fed. Cir. 2002); Stewart & Stevenson Servs., Inc., ASBCA No. 43631, 98-1 BCA ¶ 29,653, modifying 97-2 BCA ¶ 29,252; Santa Fe Eng'rs, Inc., ASBCA No. 36682, 96-2 BCA ¶ 28,281; Concrete Placing Inc. v. United States, 25 Cl. Ct. 369 (1992).
- b. To use the total cost method, the contractor must establish four factors:
  - (1) The nature of the particular cost is impossible or highly impracticable to determine with a reasonable degree of certainty;
  - (2) The contractor's bid was realistic;
  - (3) The contractor's actual incurred costs were reasonable; and
  - (4) The contractor was not responsible for any of the added costs. Raytheon Co. v. United States, 305 F.3d 1354 (Fed.

Cir. 2002), WRB Corp. v. United States, 183 Ct. Cl. 409 (1968).

4. Modified total cost method. The court or board of contract appeals allows the contractor to adjust the total cost method to account for other factors, usually because the bid was not realistic or because there were other causes for the extra costs. Olsen v. Espy, 1994 U.S. App. LEXIS 11840, 26 F.3d 141 (Fed. Cir. 1994); River/Road Constr. Inc., ENG BCA No. 6256, 98-1 BCA ¶ 29,334; Hardrives, Inc., IBCA No. 2319, 94-1 BCA ¶ 26,267; Servidone Constr. Corp., ENG BCA No. 4736, 88-1 BCA ¶ 20,390; Teledyne McCormick-Selph v. United States, 218 Ct. Cl. 513 (1978).

C. Jury Verdicts.

1. Jury verdicts are not a method of proof, but a means of resolving disputed facts. Northrop Grumman Corp. v. United States, 47 Fed. Cl. 20 (2000); Delco Elecs. Corp. v. United States, 17 Cl. Ct. 302 (1989), aff'd, 909 F.2d 1495 (Fed. Cir. 1990); River/Road Constr. Inc., ENG BCA No. 6256, 98-1 BCA ¶ 29,334; Cyrus Contracting Inc., IBCA Nos. 3232, 3233, 3895-98, 3897-98, 98-2 BCA ¶ 29,755; Paragon Energy Corp., ENG BCA No. 5302, 88-3 BCA ¶ 20,959. Before adopting a jury verdict approach, a court must first determine three things:
  - a. That clear proof of injury exists;
  - b. That there is no more reliable method for computing damages. See Azure v. United States, 129 F.3d 136 (Table), 1997 WL 665763 (Fed. Cir., Oct. 24, 1997)(actual costs are preferred; where contractor offers no evidence of justifiable inability to provide actual costs, then it is not entitled to a jury verdict); Service Eng'g Co., ASBCA No. 40274, 93-2 BCA ¶ 25,885; and
  - c. That the evidence is sufficient for a fair and reasonable approximation of the damages. Northrop Grumman Corp. v. United States, 47 Fed. Cl. 20 (2000).

## VI. SPECIAL ITEMS

A. Unabsorbed Overhead.

1. Generally. A type of cost associated with certain types of claims is “unabsorbed overhead.” Unabsorbed overhead has been allowed to compensate a contractor for work stoppages, idle facilities, inability to use available manpower, etc., due to government fault. In such delay

situations, fixed overhead costs, e.g., depreciation, plant maintenance, cost of heat, light, etc., continue to be incurred at the usual rate, but there is less than the usual direct cost base over which to allocate them. Therm-Air Mfg. Co., ASBCA No. 15842, 74-2 BCA ¶ 10,818.

2. Contracts Types. Most unabsorbed overhead cases deal with recovery of additional overhead costs on construction and manufacturing contracts. The qualitative formula adopted in Eichleay Corp., ASBCA No. 5183, 60-2 BCA ¶ 2688, aff'd on recons., 61-1 BCA ¶ 2894, is the exclusive method of calculating unabsorbed overhead for both construction contracts (Wickham Contracting Co. v. Fischer, 12 F.3d 1574 (Fed. Cir. 1994)) and manufacturing contracts (West v. All State Boiler, Inc., 146 F.3d 1368 (Fed. Cir. 1998); Genisco Tech. Corp., ASBCA No. 49664, 99-1 BCA ¶ 30,145, mot. for recons. den., 99-1 BCA ¶ 30,324; Libby Corp., ASBCA No. 40765, 96-1 BCA ¶ 28,255).
  - a. Under this method, calculate the daily overhead rate during the contract period, then multiply the daily rate by the number of days of delay.
  - b. To be entitled to unabsorbed overhead recovery under the Eichleay formula, the following three elements must be established:
    - (1) A government-caused or government-imposed delay;
    - (2) The contractor was required to be on “standby” during the delay; and
    - (3) While “standing by,” the contractor was unable to take on additional work. Melka Marine, Inc. v. United States, 187 F.3d 1370 (Fed. Cir. 1999); West v. All State Boiler, 146 F.3d 1368 (Fed. Cir. 1998); Satellite Elec. Co. v. Dalton, 105 F.3d 1418 (Fed. Cir. 1997); Altmayer v. Johnson, 79 F.3d 1129 (Fed. Cir. 1995).
  - c. If work on the contract continues uninterrupted, albeit in a different order than originally planned, the contractor is not on standby. Further, a definitive delay precludes recovery “because ‘standby’ requires an uncertain delay period where the government can require the contractor to resume full-scale work at any time.” Melka Marine, Inc. v. United States, 187 F.3d 1370 (Fed. Cir. 1999); American Renovation & Constr. Co., Inc. v. United States, 45 Fed. Cl. 44 (1999).

- d. A contractor's ability to take on additional work focuses upon the contractor's ability to take on replacement work during the indefinite standby period. Replacement work must be similar in size and length to the delayed government project and must occur during the same period. Melka Marine, Inc. v. United States, 187 F.3d 1370 (Fed. Cir. 1999); West v. All-State Boiler, 146 F.3d 1368, 1377 n.2 (Fed. Cir. 1998).
3. Proof Requirements.
    - a. Recovery of unabsorbed overhead is not automatic. The contractor should offer credible proof of increased costs resulting from the government-imposed delay. Beaty Elec. Co., EBCA No. 403-3-88, 91-2 BCA ¶ 23,687. But see Sippial Elec. & Constr. Co. v. Widnall, 69 F.3d 555 (Fed. Cir. 1995) (allowing Eichleay recovery with proof of actual damages).
    - b. A contractor must prove only the first two elements of the Eichleay formula. Once the contractor has established that the Government caused the delay and that it had to remain on "standby," it has made a prima facie case that it is entitled to Eichleay damages. The burden of proof then shifts to the government to show that the contractor did not suffer or should not have suffered any loss because it was able to either reduce its overhead or take on other work during the delay. Satellite Elec. Co. v. Dalton, 105 F.3d 1418 (Fed. Cir. 1997); Mech-Con Corp. v. West, 61 F.3d 883 (Fed. Cir. 1995).
    - c. When added work causes a delay in project completion, the additional overhead is absorbed by the additional costs and Eichleay does not apply. Community Heating & Plumbing Co. v. Kelso, 987 F.2d 1575 (Fed. Cir. 1993) (Eichleay recovery denied because overhead was "extended" as opposed to "unabsorbed"); accord C.B.C. Enters., Inc. v. United States, 978 F.2d 669 (Fed. Cir. 1992).
  4. Subcontractor Unabsorbed Overhead. Timely completion by a prime contractor does not preclude a subcontractor's pass-through claim for unabsorbed overhead. E.R. Mitchell Constr. Co. v. Danzig, 175 F.3d 1369 (Fed. Cir. 1999).
  5. Multiple Recovery. A contractor may not recover unabsorbed overhead costs under the Eichleay formula where it has already been compensated for the impact of the government's constructive change on performance

time and an award under Eichleay would lead to double recovery of overhead. Keno & Sons Constr. Co., ENG BCA No. 5837-Q, 98-1 BCA ¶ 29,336.

6. Profit. A contractor is not entitled to profit on an unabsorbed overhead claim. ECC Int'l Corp., ASBCA Nos. 45041, 44769, 39044, 94-2 BCA ¶ 26,639; Tom Shaw, Inc., ASBCA No. 28596, 95-1 BCA ¶ 27,457; FAR 52.242-14, Suspension of Work; FAR 52.242-17, Government Delay of Work.

B. Subcontractor Claims.

1. The government consents generally to be sued only by parties with which it has privity of contract. Erickson Air Crane Co. of Wash. v. United States, 731 F.2d 810, 813 (Fed. Cir. 1984); E.R. Mitchell Constr. Co. v. Danzig, 175 F.3d 1369 (Fed. Cir. 1999).
2. A prime contractor may sue the government on a subcontractor's behalf, in the nature of a pass-through suit, for the extra costs incurred by the subcontractor only if the prime contractor is liable to the subcontractor for such costs. When a prime contractor is permitted to sue on behalf of a subcontractor, the subcontractor's claim merges into that of the prime, because the prime contractor is liable to the subcontractor for the harm caused by the government. Absent proof of prime contractor liability, the government retains its sovereign immunity from pass-through suits. Severin v. United States, 99 Ct. Cl. 435 (1943), cert. denied, 322 U.S. 733 (1944)); E.R. Mitchell Constr. Co. v. Danzig, 175 F.3d 1369 (Fed. Cir. 1999).
3. The government may use the Severin doctrine as a defense only when it raises and proves the issue at trial. If the government fails to raise its immunity defense at trial, then the subcontractor claim is treated as if it were the prime's claim and any further concern about the absence of subcontractor privity with the government is extinguished. Severin v. United States, 99 Ct. Cl. 435 (1943), cert. denied, 322 U.S. 733 (1944)); E.R. Mitchell Constr. Co. v. Danzig, 175 F.3d 1369 (Fed. Cir. 1999).

C. Loss of Efficiency. The disruption caused by government changes and/or delays may cause a loss of efficiency to the contractor.

1. Burden of Proof. A contractor may recover for loss of efficiency if it can establish both that a loss of efficiency has resulted in increased costs and that the loss was caused by factors for which the Government was responsible. Luria Bros. & Co. v. United States, 177 Ct. Cl. 676, 369 F.2d

701 (1966). See generally Thomas E. Shea, Proving Productivity Losses in Government Contracts, 18 Pub. Cont. L. J. 414 (March 1989).

2. Applicable Situations. Loss of efficiency has been recognized as resulting from various conditions causing lower than normal or expected productivity. Situations include: disruption of the contractor's work sequence (Youngdale & Sons Constr. Co. v. United States, 27 Fed. Cl. 516 1993)); working under less favorable weather conditions (Charles G. Williams Constr., Inc., ASBCA No. 42592, 92-1 BCA ¶ 24,635); the necessity of hiring untrained or less qualified workers (Algernon-Blair, Inc., GSBCA No. 4072, 76-2 BCA ¶ 12,073); and reductions in quantity produced.

D. Impact on Other Work.

1. General Rule. A contractor is generally prohibited from recovering costs under the contract in which a Government change, suspension, or breach occurred, when the impact costs are incurred on other contracts. Courts and boards usually consider such damages too remote or speculative, and subject to the rule that consequential damages are not recoverable under Government contracts. See General Dynamics Corp. v. United States, 218 Ct. Cl. 40, 585 F.2d 457 (1978); Defense Sys. Co., ASBCA No. 50918, 2000 ASBCA LEXIS 100, 00-2 BCA ¶ 30,991 (holding the loss of sales on other contracts was too remote and speculative to be recoverable); Sermor, Inc., ASBCA No. 30576, 94-1 BCA ¶ 26,302; Ferguson Mgmt. Co., AGBCA No. 83-207-3, 83-2 BCA ¶ 16,819.
2. Exceptions. In only exceptional circumstances, especially when the impact costs are definitive in both causation and amount, have contractors recovered for additional expenses incurred in unrelated contracts. See Clark Concrete Contractors, Inc. v. Gen. Servs. Admin., GSBCA No. 14340, 99-1 BCA ¶ 30,280 (allowing recovery of additional costs incurred on an unrelated project as a result of government delays and changes).

E. Attorneys' Fees.

1. Legal Expenses are addressed by two FAR provisions, listed below. Such expenses are commonly an indirect expense in a contractor's G&A expense pool. However, in some situations, legal expenses are specifically incurred for a particular contract and counted as a direct cost. Government Contract Costs & Pricing, Karen Manos, 2<sup>nd</sup> Edition, 2009.
  - a. FAR 31.205-33 covers professional and consultant service costs.

- b. FAR 31.205-47 discusses costs related to legal and other proceedings. It defines costs as including, but are not limited to, administrative and clerical expenses; the costs of legal services, whether performed by in house or private counsel; the costs of the services of accountants, consultants, or others retained by the contractor to assist it; cost of employees, officers, and directors; and any similar costs incurred before, during, and after commencement of a judicial or administrative proceeding which bears a direct relationship to the proceeding. FAR 31.205-47.
2. Costs incurred in connection with any proceeding brought by a Federal, State, local, or foreign government for violation of, or a failure to comply with, law or regulation by the contractor are unallowable if the result is an adverse judgment. This includes costs involved in a final decision to (a) debar or suspend the contractor, (b) rescind or void the contract, or (c) terminate a contract for default for violation or failure to comply with the law. FAR 31.205-47(b).
  - a. Costs incurred in connection with any Qui Tam proceeding brought against the contractor are unallowable if the result is an adverse judgment. FAR 31.205-47(b); See False Claims Act, 31 U.S.C. § 3730.
3. Costs related to prosecuting and defending claims and appeals against the federal government are unallowable. FAR 31.205-47(f)(1). See Stewart & Stevenson Servs., Inc., ASBCA No. 43631, 97-2 BCA ¶ 29,252 modified by 98-1 BCA ¶ 29,653 (finding that claimed legal expenses related to counsel's preparation of a certified claim and so are disallowed); Marine Hydraulics Int'l, Inc., ASBCA No. 46116, 94-3 BCA ¶ 27,057 (finding that legal costs to prepare a request for equitable adjustment were unallowable costs to prepare a claim because the parties were not working together, the contract work had already been performed, and the issues had been in dispute for months); P&M Indus., Inc., ASBCA No. 38759, 93-1 BCA ¶ 25,471 (finding that consultant fees for post termination administration costs were unallowable in the preparation of a claim). This is consistent with the general rule that attorneys' fees are not allowed in suits against the United States absent an express statutory provision allowing recovery. Piggly Wiggly Corp. v. United States, 112 Ct. Cl. 391, 81 F. Supp. 819 (1949).
4. The Equal Access to Justice Act, 5 U.S.C. § 504, authorizes courts and boards to award attorneys' fees to qualifying prevailing parties unless the

government can show that its position was “substantially justified.” See, e.g., Midwest Holding Corp., ASBCA No. 45222, 94-3 BCA ¶ 27,138.

5. Costs incurred incident to contract administration, or in furtherance of the negotiation of the parties’ disputes, are allowable. FAR 31.205-33 (consultant and professional costs may be allowable if incurred to prepare a demand for payment that does not meet the Contract Disputes Act definition of a “claim”).
  - a. “There must be a ‘beneficial nexus’ between effort for which the cost is incurred and performance or administration of the contract.” Appeal of Marine Hydraulics Intern., Inc., 94-3 BCA ¶ 27057 (1994). “Contract administration normally involves ‘the parties . . . working together.’” *Id.*
  - b. Example: SAB Constr., Inc. v. United States, 66 Fed. Cl. 77 (Fed. Dist. 2005) (holding that when the genuine purpose of incurred legal expenses is that of materially furthering a negotiation process, such cost should normally be allowable);
  - c. Example: Submittal of a proposal in aid of determining how a specification could be met. Prairie Wood Products, AGBCA No. 91-197-1, 94-1 BCA ¶ 26,424.
6. Legal fees unrelated to presenting or defending claims against the government are generally allowable. But see the earlier discussion entitled “What if a cost is not expressly listed in FAR 31.205?” for cases where legal costs to defend 3<sup>rd</sup> party suits have been found to be unallowable. See section III.C.6.b. supra.
  - a. Boeing North American, Inc. v. United States, 298 F.3d 1274 (Fed. Cir. 2002); Information Sys. & Networks Corp., ASBCA No. 42659, 00-1 BCA ¶ 30,665 (holding that legal expenses incurred in lawsuits against third-party vendors were allowable as part of convenience termination settlement); Bos’n Towing and Salvage Co., ASBCA No. 41357, 92-2 BCA ¶ 24,864 (holding that costs of professional services, including legal fees, are generally allowable, except where specifically disallowed).
  - b. 3<sup>rd</sup> Party Settlement Agreements. When a third party has sued a government contractor and the contractor has settled the lawsuit, the question becomes whether the legal costs associated with the settlement agreement are allowable. The courts and boards

conduct a two-step inquiry to determine the allowability of costs associated with such a settlement.

- (1) The two-step test is:
  - (a) If an adverse judgment were reached, would the damages, costs, and attorneys' fees be allowable? (See earlier discussion under the heading 'What if costs are expressly discussed in FAR 31?')
  - (b) If yes, the cost of the settlement is allowable.
  - (c) If no, then the cost of the settlement is disallowed unless the contractor can prove that the private suit has very little likelihood of success on the merits. Geren v. Tecom, Inc., 566 F.3d 1037, 1046 (Fed. Cir. 2009), rehearing and rehearing en banc denied, (Oct. 2, 2009).
  - (d) The rationale behind the "very little likelihood of success" test is two-fold. The court noted that the FAR's policy was to disallow the cost of settling suits that were likely to have been meritorious and therefore disallowed if not settled. The reason is a policy judgment that assumes that suits brought by government entities are in most situations "likely to be meritorious." However, the same bright line assumption is not appropriate for suits brought by a private party. Geren v. Tecom, Inc., 566 F.3d 1037, 1046 (Fed. Cir. 2009), rehearing and rehearing en banc denied, (Oct. 2, 2009).

F. Interest.

1. Pre-Claim Interest.

- a. Generally. Contractors are not entitled to interest on borrowings, however represented, as part of an equitable adjustment. FAR 31.205-20; Servidone Constr. Corp. v. United States, 931 F.2d 860 (Fed. Cir. 1991); D.E.W. & D.E. Wurzbach, A Joint Venture, ASBCA No. 50796, 98-1 BCA ¶ 29,385; Superstaff, Inc., ASBCA Nos. 48062, et al., 97-1 BCA ¶ 28,845; Tomahawk Constr. Co., ASBCA No. 45071, 94-1 BCA ¶ 26,312. This is consistent with the general rule that the United States is immune

from interest liability absent an express statutory provision allowing recovery. Library of Congress v. Shaw, 478 U.S. 310 (1986).

- b. Lost Opportunity Costs. The damages for the “opportunity cost of money” are unrecoverable as a matter of law. Adventure Group, Inc., ASBCA No. 50188, 97-2 BCA ¶ 29,081; Environmental Tectonics Corp., ASBCA No. 42540, 92-2 BCA ¶ 24,902 (not only interest on actual borrowings, but also the economic equivalent thereof, are unallowable); Dravo Corp. v. United States, 219 Ct. Cl. 416, 594 F.2d 842 (1979).
  - c. Cost of Money. Contractors may recover facilities capital cost of money (FCCM) (the cost of capital committed to facilities) as part of an equitable adjustment. FAR 31.205-10. Among the various allowability criteria, a contractor must specifically identify FCCM in its bid or proposal relating to the contract under which the FCCM cost is then claimed. FAR 31.205-10(a)(2). See also McDonnell Douglas Helicopter Co. d/b/a McDonnell Douglas Helicopter Sys., ASBCA No. 50756, 98-1 BCA ¶ 29,546.
2. Prompt Payment Act Interest. Under the Prompt Payment Act, 31 U.S.C. §§ 3901-3907, the contractor is entitled to interest if the contractor submits a proper voucher and the government fails to make payment within 30 days.
  3. Contract Disputes Act Interest.
    - a. Generally. A contractor is entitled to interest on its claim based upon the rate established by the Secretary of the Treasury, as provided by the Contract Disputes Act, 41 U.S.C. §§ 7101-7109.
    - b. Timing. Interest begins to run when the contracting officer receives a properly certified claim. Raytheon Co. v. White, 305 F.3d 1354 (Fed. Cir. 2002), or upon submission of a defectively certified claim that is subsequently certified. Federal Courts Administration Act of 1992, Title IX, Pub. L. No. 102-572, 106 Stat. 4506, 4518. Interest runs regardless of whether the claimed costs have actually been incurred at the date of submission of a claim. Servidone Constr. Co. v. United States, 931 F.2d 860 (Fed. Cir. 1991).
    - c. Convenience Termination Settlements. A termination for convenience settlement proposal, FAR 49.206, is not initially considered a CDA claim, as it is generally submitted for purposes of negotiation. James M. Ellett Constr. Co. v. United States, 93 F.3d

1537 (Fed. Cir. 1996). Accordingly, a contractor is not entitled to interest on the amount due under a settlement agreement or determination. FAR 49.112-2(d); James M. Ellett Constr. Co. v. United States, 93 F.3d 1537 (Fed. Cir. 1996). If a termination settlement proposal matures into a CDA claim (once settlement negotiations reach an impasse), then a contractor is entitled to interest.

4. Payment of Interest. When the contracting officer pays a claim, the payment is applied first to accrued interest. Then the payment is applied to the principal amount due. Any unpaid principal continues to accrue interest. Paragon Energy Corp., ENG BCA No. 5302, 91-3 BCA ¶ 24,349.

## VII. QUANTUM CASE PLANNING

### A. The Philosophy.

1. It is necessary to approach pricing of adjustments with a guiding philosophy. To do otherwise renders your litigation efforts half-hearted. The elements of quantum litigation planning are two-fold:
  - a. The fact that a contractor prevails on entitlement is meaningless in your quantum case.
  - b. Your game plan for the contractor's claim is a simple one: First you are going to cut it up, and then you are going to defeat it.

### B. The Prerequisites.

1. There exist two essential prerequisites to your efforts.
  - a. You must have a thorough understanding of the law on pricing adjustments.
  - b. Facts are king, and getting all the facts will take hard work.

### C. The Methodology: DAMS.

1. Divide the contractor's claim into component parts.
2. Apply Cost/Cost Accounting Standards (CAS) principles.
3. Make the contractor prove the amount claimed.

4. See what really happened.

## **VIII. APPLYING THE DAMS METHODOLOGY**

- A. Divide the Contractor's Claim into Component Parts.
  1. A contractor claim is really a series of smaller claims all added together. Each piece must stand on its own, in terms of being both legally permitted and factually supported.
  2. Quantum case litigation requires analyzing each section of the contractor's claim separately. This leads to a more thorough examination and prevents overpayment regardless if the case is settled or litigated.
- B. Apply Cost/CAS Principles. Generally. The government does not pay all the costs actually incurred and/or claimed by a contractor. Applying Cost/CAS principles entails analyzing each part of the total claim for allowability, allocability, reasonableness, and CAS compliance.
- C. Make the contractor prove the amount claimed.
- D. See What Really Happened (Seize the Offensive).
  1. A contractor's cost data will tell you what really happened. Accordingly, you must seize the initiative/go on the offensive. This allows you to develop the "real story" of how the contractor incurred extra costs.
  2. Determine the true root causes of the contractor's extra costs.
    - a. Was the job as a whole underbid?
    - b. Did the contractor change planned facilities?
    - c. Did the contractor purchase cheap and unworkable component parts?
    - d. Did the contractor select subcontractors that were unable to perform?
    - e. Was there reliance upon less competent vendors?
    - f. Were there increases in material costs?
    - g. Did the contractor change components for cost reasons? Did this in turn result in engineering problems? Did prior design work

- become worthless? Did this in turn cause the need for redesign work, with more time and effort?
- h. Was there an overall lack of efficient organization?
  - i. Did the contractor waste time recompeting components and vendors?
  - j. What expenses were unrelated to the claimed causation?
  - k. Did the contractor order surplus material (for potential options and possible commercial jobs)?
3. Important Documents. There are many important contractor documents that will assist you in determining what really happened.
- a. As-Bid Bill of Materials (BOM), and Final BOM.
  - b. Production Schedules
  - c. As-Bid Bid Rates (Overhead Rates).
  - d. Actual Overhead Rates.
  - e. Expected and Actual Direct Costs—for the specific contract and plant-wide.
  - f. Expected and Actual Labor Amounts—for the specific contract and plant-wide.
  - g. Material Invoices for Major Component Parts.
  - h. CAS Disclosure Statement.
4. The Quantum Case Litigation Team. It is necessary to enlist the support of many individuals in both your defensive and offensive quantum case litigation efforts. These individuals will help you decipher the contractor's accounting documentation, as well as explain relevance in relation to contract performance.
- a. DCAA Auditor.
  - b. Contracting Officer.
  - c. Program Manager/End User.

- d. Contracting Officer's Representative (COR).
- e. Project Managers, Site Inspectors, Project Engineers, Quality Assurance Representatives.

## **IX. CONCLUSION**

- A. The various circumstances that entitle a contractor to a contract price adjustment (equitable adjustments, adjustments, damages) result in different types/amounts of recovery.
- B. The basic measurement of a price adjustment is the difference between the reasonable costs of the original and changed work.
- C. The burden of proving a price adjustment is on the moving party, and the method of proving a price adjustment is to use the best evidence available.
- D. The various special items that often comprise a price adjustment demand special attention.