

McKenna Government Contracts,
continuing excellence at Dentons

DENTONS

Request for Equitable Adjustment (REA) and Claim Pricing

January 12, 2016

Agenda

- Disputes Process Overview
 - Claim v. REA
 - Basic Entitlement Theories
- Pricing Considerations
 - Methodologies
 - Application to REA/Claim Types
 - Pricing Added/Deleted Work
 - Overhead and Profit Issues
 - Special Situations (e.g., subcontractor pricing issues)
- Recent Developments
- Best Practices for Development, Pricing, Negotiating, and Resolving REAs and Claims

REA Overview

- Request for Equitable Adjustment (REA): a “Proposal” for Additional Compensation as a Result of Certain Circumstances or Government Conduct
 - Examples:
 - Changes Clause (FAR § 52.243-1): CO “Shall Make an Equitable Adjustment”
 - Differing Site Conditions (FAR § 52.236-2): “[A]n equitable adjustment shall be made” if differing site conditions increase Contractor’s cost.
 - Government Property (FAR § 52.245-1): For unsuitable government property, CO “shall consider an equitable adjustment.”
 - Suspension of Work (FAR § 52.242-14): “[A]n adjustment shall be made” for CO actions that delay and increase the cost of performance.
- DoD Requires Contractors to Certify REAs are Submitted “In Good Faith” and “Supporting Data are Accurate and Complete.” DFARS § 252.243-7002
- TINA Certification may be Required if REA Valued Above \$750,000, the Contract is Non-Commercial, and Contract Price will be Modified.

CDA Overview

- Contract Disputes Act (CDA), 41 U.S.C. § 7101 *et seq.*; FAR Subpart 33.2
 - Governs Disputes “Arising Under” or “Related to” a Government Contract
 - Certified Claim to the CO
 - A Non-Routine “Written Demand or Written Assertion”
 - “Seeking, as a Matter of Right”
 - “Payment of Money in a Sum Certain, the Adjustment or Interpretation of Contract Terms, or Other Relief”
- CDA Certifications:
 - FAR § 52.233-1, CDA Certification: Claims Exceeding \$100,000
 - Elements: Claim is made in good faith; supporting data is accurate and complete to the best of the Contractor’s knowledge and belief; the amount requested accurately reflects the contract adjustment for which the Contractor believes the Government is liable; the person submitting the claim is authorized to certify the claim on the Contractor’s behalf
 - Proper Certifying Official

REA/Claims—Legal Entitlement Theories

- Basic Legal Entitlement Grounds:
 - Constructive Changes/Scope Changes
 - Added or deleted work absent a change order
 - Improper contract interpretation
 - Defective specifications
 - Superior government knowledge
 - Interference/failure to cooperate/bad faith
 - Unreasonable inspection/acceptance
 - Stop Work Orders/Government Suspension of Work
 - Government Delay/Acceleration
 - Government Property
 - Differing site condition
 - Value Engineering

Contract Administration v. Prosecution of Claims

- CDA Claims v. REAs

CDA Claims	REAs
Four prong certification if over \$100K	Two Prong certification if over \$150K and submitted to DoD agency No certification if submitted to non-DoD
Must request CO decision	Should request negotiation
Must state sum certain	Should contain statement of basis for compensation and pricing logic
Costs of preparation are unallowable claim prosecution of costs	Costs of preparation are allowable contract administration costs
CDA interest starts to run where CO receives claim	CDA interest does not start to run
If CO issues decision, it can be appealed	If CO issues a decision, it is ordinarily not a final decision that may be appealed (but can be converted to a CDA claim)

Allowability of REA Costs v. Claim Costs

- General rule: REA costs may be allowable; Claim costs generally unallowable
 - REA Costs
 - *Tip Top Constr., Inc. v. Donahoe*, 695 F.3d 1276 (Fed. Cir. 2012)
 - Fees associated with “the realm of negotiation and genuine contract administration” are allowable, even if negotiations fail and result in a claim
 - *Moshe Safdie & Assocs., Inc. v. Gen. Servs. Admin.*, CBCA 1849, 14-1 BCA ¶ 35,564 (Mar. 13, 2014)
 - REA preparation costs are allowable
 - See also *Bill Strong Enterprises, Inc. v. Shannon*, 49 F.3d 1541, 1550-51 (Fed Cir. 1995) overruled on other grounds, *Reflectone, Inc. v. Dalton*, 60 F.3d 1572 (Fed. Cir., 1995).
 - Claim Costs
 - FAR § 31.205-47 disallows costs associated with both prosecution and defense of non-fraud CDA claims

Importance of REA/Claim Pricing

- Done Last/Reviewed First
- Pricing Drives the Decision-Making Process
- Government Often Ignores Entitlement and Defends Claim with Attack on the Amount Claimed
- Requires Coordinated Cross-Functional Team Effort
- Contractor Risks
 - False Claims/Fraud
 - Defective Pricing/TINA
 - Disapproval of Estimating System, Possibly Others

General Pricing Considerations

- Objective: Calculate the Increased Cost of the Changed Work
 - Place Contractor in Same Profit or Loss Position as If No Change Occurred
- Fundamentally Cost-Based Pricing
 - Generally broken out into four components:
 - Calculation of costs directly attributable to added work
 - Includes increased costs based on constructive changes
 - Calculation of costs directly attributable to eliminated work
 - Calculating overhead and profit for costs attributable to changed work
 - Contract administration costs
- Reasonable Cost, Not Value
- No Presumption of Reasonableness

General Pricing Considerations (Cont.)

- FAR § 15.408, Table 15-2 III(B) Provides Guidance Relating to Change Order, Modification and Claim Pricing
- FAR Part 31 Applies to Contract Modifications; However, Application Must Result in “Equitable Adjustment”
 - Reasonableness
 - Allocability
 - Conformity with Cost Accounting Standards (CAS), if applicable, GAAP and circumstances
 - Consistent with terms of the Contract
 - Conformity with limitations of FAR Subpart 31.2
- Contractor Burden of Proof: (1) Entitlement, (2) Causation, and (3) Amount/Quantum
- Amount: No Need for Absolute Certainty—“Reasonable Basis”:
 - *BPLW Architects & Engineers, Inc. v. United States*, 106 Fed. Cl. 521, 544 (2012) (“The amount of damages may be approximated, but only if a reasonable basis of computation is afforded.”) (internal quotation marks omitted).
 - Tension with fraud cases: when do a contractor’s unreasonably calculated damages constitute a false claim?

General Pricing Considerations (Cont.)

- Forfeiture

- Claim is forfeited if claimant attempts to defraud the government with the claim.
 - 28 U.S.C. § 2514. *See also Daewoo Engineering and Construction Co. Ltd. v. United States*, 557 F.3d 1332 (Fed. Cir. 2009) (entire claim can be forfeited when part of claim was fraudulently inflated as a “negotiating ploy”); *Horn & Associates, Inc. v. US*, 123 Fed. Cl. 728 (2015) (any fraudulent invoice submitted during contract performance may waive later claim).
- Jurisdiction
 - **Exclusive** jurisdiction vested in Court of Federal Claims to render judgment of forfeiture. 28 U.S.C. § 2514.
 - Board has no jurisdiction to hear the fraud case.
 - Board may – but need not – dismiss a claim pending resolution of the fraud case.
 - *Compare KBR, Inc.*, ASBCA No. 57530, 13 BCA ¶ 35,243 (Feb. 20, 2013) (substantial similarity between FCA and claim warranted dismissal of Board case without prejudice) *with ERKA Construction Co.*, 12-2 BCA ¶ 35,129 (Aug. 16, 2012) (fraud issues readily distinguishable from the issues in the Board case, case can go forward).

Pricing Methodologies

- Elements of Cost Method
 - Direct Labor
 - Direct Materials
 - ODCs (e.g., Subcontractors, Travel, IT)
 - Overhead/G&A
 - Profit
 - FAR § 15.404-4 Weighted Guidelines/Factors (Complexity, Risk, Capital Employed)
 - Contract Rate
 - Contract Exclusion—e.g., FAR 52.242-14, Suspension of Work
 - Contract Caps/Clauses

Pricing Methodologies (Cont.)

- Actual Cost Method
 - Preferred Method
 - Requires Early Recognition/Establishment of Separate Job Cost Codes
 - Certain Entitlement Theories Present Difficulties (e.g., interference)
 - Establish Connection to Government Conduct
 - Cumulative Impact of Multiple Changes
 - Change Order Accounting Requirement
 - FAR § 52.243-6: For changes over \$100,000, CO “may require change order accounting,” which requires the contractor to maintain separate accounts or otherwise segregate changes allocable to the change. Applies “until the parties agree to an equitable adjustment for the charges...or the matter is conclusively disposed of.”
 - Applies when CO issues change order and may apply to constructive changes. See, e.g., *Svc. Engineering Co.*, ASBCA No. 40274, 93-1 BCA ¶ 25,520 (Oct. 13, 1992).

Pricing Methodologies (Cont.)

- Estimated Cost Method
 - Claims/REAs Often Require Some Type of Estimate(s)
 - Actuals unavailable/lack of segregation
 - Future impacts
 - Methods Include:
 - Buildup through studies, use of Subject Matter Experts (SMEs)
 - Analogy/Actual cost of single event
 - Parametric/Cost Estimating Relationship (CER)—“top-down” [e.g., number of work-stations]
 - Weighted average—3 or more similar projects
 - Engineering build-up
 - Keys:
 - Detail of analysis
 - Ability to tie directly to impact
 - Validity of any comparison
 - Experience/Training of personnel

Pricing Methodologies (Cont.)

- Total Cost Method
 - Difference Between the Bid Cost/Price and Actual Cost
 - Disfavored, Because it Assumes the Entire Cost Overrun is the Government's Fault
 - Elements—Contractor Must Show:
 - The impracticability of proving its actual costs
 - The reasonableness of its bid
 - The reasonableness of its actual costs
 - A lack of responsibility for the added costs
- Modified Total Cost Method
 - Total Cost Method
 - Adjusted for any *Deficiencies* in the Contractor's Proof in Satisfying the Requirements of the Total Cost Method
- Jury Verdict
 - Least Favored
 - Requires clear proof of injury, no more reliable method for calculating damages, sufficient evidence for a fair and reasonable approximation

Pricing Deleted Work

- Price Adjustment Should Equal the Amount of Cost the Contractor Would Have Incurred Had the Work Been Performed (“Would-Have-Cost” Rule)
 - See, e.g., *EJB Facilities Servs.*, ASBCA No. 57547, 13 BCA ¶ 35,399 (Aug. 28, 2013); *Celesco Indust., Inc.*, ASBCA No. 22251, 79-1 B.C.A. ¶ 13,604 (Nov. 30, 1978).
- If contractor is in a loss position, contractor must bear loss that it would have incurred had the change not been issued.
 - See, e.g., *Fox Constr. Inc.*, ASBCA No. 55265 *et al.*, 08-1 BCA ¶ 33,810 (Mar. 5, 2008); *S. N. Nielson Co. v. United States*, 141 Ct. Cl. 793 (1958).
- On the other hand, a contractor is permitted to show that it could have performed the work for less than its original estimate – entitled to retain excess amount.
 - See, e.g., *Dan G. Trawick III Contractors*, ASBCA No. 47779, 98-2 BCA ¶ 29,781 (May 13, 1998); *Admiral Corp.*, ASBCA No. 8634, 1964 B.C.A. ¶ 4161 (Mar. 24, 1964).

Pricing Deleted Work (Cont.)

- Exception to “Would-Have-Cost” Rule: “Severable” Deletion:
 - Where separately priced item of work is deleted, adjustment measured by the stated contract item price v. “would-have-cost”
 - Government Burden
 - Can deprive contractor of high profit it would have earned if it had performed the deleted work; or save the contractor from the loss it would have incurred if it had to perform the work
 - Key test: whether deleted work is actually severable from other line items, or whether award was made on “aggregate” basis. See *EJB Facilities Servs.*, ASBCA No. 57547 (2013)

Overhead and Profit

- Contractor entitled to overhead and profit as part of an equitable adjustment that increases performance costs
 - May be limited by contract terms
 - Conversely, government can reduce overhead and profit amounts on changes that delete work

Overhead

- For changed work with minor cost increases, use of ordinary overhead rates may be appropriate
- For changed work with significant cost increases, parties may negotiate specific overhead rates/costs
 - Treatment of overhead costs for changed work must not violate contractor's established accounting practices
 - E.g., Contractor cannot treat site overhead as both a time cost and as a percentage add-on cost.
M.A. Mortenson Co., ASBCA No. 40750, 98-1 B.C.A. ¶ 29,658.

Profit

- Contractor entitled to fair profit for changed work.
 - Even if contractor was not going to recover profit on the unchanged work (see e.g., *Stewart & Stevenson Svcs, Inc.*, ASBCA No. 43631, 97-2 B.C.A. ¶ 29,252 (Sept. 23, 1997))
- Contractor generally required to reduce profit relating to changes that reduce costs (see e.g., *Keco Indust., Inc.*, ASBCA No. 15131, 72-1 B.C.A. ¶ 9,262 (Dec. 3, 1971))
 - If, however, the contractor is not earning any profit, there is no requirement to reduce profit related to deleted work (see e.g., *States Roofing Corp.*, ASBCA No. 55507, 09-1 B.C.A. ¶ 34,094 (Mar. 4, 2009))
- Amount of profit to be added or deducted as part of equitable adjustment is a matter of negotiation
 - For minor changed work, contracting parties can use profit rate in original contract (or other reasonable amount)
 - For major changed work, parties negotiate profit based on weighted factors (FAR § 15.404-4(b)(1)-(d); DFARS § § 215.404-4(b), 215.404-71-1): work complexity, effort, contractor risk, etc.
 - Profit for changed work may be limited by special contract clauses/caps

Special Situations—Pricing Delays

- Changes
 - Government Delay v. Concurrent Delay (e.g., FAR § 52.242-17)
 - Excusable Delay v. Compensable Delay (e.g., FAR § 52.249-8)
 - Excusable Delays (e.g., FAR 52.249-8): Acts of God, Acts of Government in Sovereign or Contractual Capacity, Fires, Floods, Epidemics, Strike, Unusually Severe Weather
 - Beyond Control and Without Fault of Contractor
 - Subcontractors: (1) Without Sub Fault; (2) No Other Source
 - Cost Elements: Idle Labor and Equipment, Rental Equipment, Loss of Efficiency (“Measured Mile”), Escalation of Labor Costs; Performance in Later/ Costlier Time Period, Other (e.g., Storage, Additional Bond Premium Amounts)
- Acceleration:
 - Contractor Effort to Make Up for Excusable Delays
 - Cost Elements: Excess Labor, Overtime Premiums, Material Cost (expediting), Adverse Conditions, Loss of Efficiency
 - Impact on Other Work
 - Profit Generally Not Permitted

Special Situations—Pricing Delays (Cont.)

- Unabsorbed Overhead—*Eichleay Corp.*, ASBCA No. 5183, 60-2 BCA ¶ 2688 (July 29, 1960):
 - Three Conditions:
 - Government-caused delay
 - Contractor was on “Standby” (Delay=Uncertain, Indefinite Duration)
 - Accordingly, if actual overhead is allocable to the project, then *Eichleay* is inapplicable. See *Shirley Contracting Corp.*, ASBCA No. 29848, 1984 WL 582414 (Dec. 27, 1984); *Excavation-Construction, Inc.*, ENGBCA No. 3858, 82-1 BCA ¶ 15,770 (Apr. 30, 1982).
 - Contractor could not have taken on additional work
 - Calculation Method:
 - $(\text{Total Contract Billings} / \text{Total Company Billings}) \times \text{Total Home Office Overhead During Contract} = \text{Overhead Allocable to the Contract}$
 - $(\text{Allocable Overhead} / \text{Days of Contract Performance}) = \text{Daily Contract Overhead}$
 - $\text{Daily Contract Overhead} \times \text{Number of Days of Delay} = \text{Unabsorbed Overhead}$
 - Still commonly used formula.
 - *Nicon, Inc. v. United States*, 331 F.3d 878, 888 (Fed. Cir. 2003); *Tulsa Mid-W. Constr. Co.*, ASBCA No. 55173, 07-2 BCA ¶ 33,646 (Aug. 2, 2007).

Special Situations—Subcontractor Claims

- Subs Typically Cannot File Claims Directly with the Government—No Privity of Contract
 - Prime must “Sponsor” sub claims to Government and there must be “line of privity” between the subcontractor and the government
 - *Severin v. United States*, 99 Ct. Cl. 435 (1943) (Prime cannot sue Government on behalf of a sub unless the Prime is itself liable to the sub)
 - Any Sub Claim Exceeding \$100K Must Include Proper CDA Certification Language from 41 U.S.C. § 7103(b)(1)
 - Sub REAs arising from DoD Contracts must include DFARS § 252.243-7002 certification language
 - Prime should reject any deviations to certification language in sub claims/REAs
 - Prime Certification of sub claims can be based on “Good Grounds,” see *Transamerica Ins. Corp. for and on behalf of Sharp Sheet Metal Works v. United States*, 973 F.2d 1572 (Fed. Cir. 1992), *overruled on other grounds by Reflectone v. Dalton*, 60 F.3d 1572 (Fed. Cir. 1995).

Special Situations—Subcontractor Claims (Cont.)

- Apply Prime's Overhead and Profit to Sub Claims
- Understand and Vet Sub's Claim/REA Pricing Method
 - Pricing methodology
 - Factual support
 - Flow-down audit clauses to facilitate Prime's review of sub's financial data
- Obtain, Review, and Submit Sub Cost or Pricing Data if the REA Exceeds the TINA Threshold (\$750,000) if applicable
 - Non-commercial
 - Will result in modification
 - Agreement on price
- Obtain Sub's Agreement to be Bound to Result of Final Amount Determined Due under Claim

Recent Developments

- *DMS Imaging, Inc. v. United States*, 123 Fed. Cl. 645 (2015)
 - Government liable for MRI machine leased after it was destroyed in a fire.
 - Cost elements:
 - Fair market value of machine
 - Lease payments due after destruction of equipment
 - Contractual late fees and service fees
 - Attorney's fees
 - CDA interest
- *SUFI Network Servs., Inc. v. United States*, ___ Fed. Cl. ___, 2015 WL 7954529 (2015).
 - COFC denied the contractor's claims for overhead and profit on the attorneys' fees previously awarded because there was no contractual basis for the recovery.
 - Contractor equitably estopped from changing the method used to calculate its attorneys' fees from the traditional lodestar method to an approach based on the amount it was required to pay the law firm under the contingent fee agreement.
 - Though not technically a CDA case, "the parties likely would accept such a result as being typical in federal procurement law."
 - May be persuasive in future cases.

Best Practices

- Be Proactive/Start Early
- Cross-function Cooperation and Communication (Legal/Contract/Pricing)
- Identify Potential Changes and Initiate Segregation of Increased Costs Immediately
 - Assign separate cost accounting number
 - Contract may require change order accounting (FAR § 52.243-6)
- Document Estimates in Sufficient Detail and Verify Bases of Estimate
- Delays: Regularly Update Schedule to Reflect Changes as They Occur
- Cost Allowability: Clearly Draw Lines between Negotiations and Contract Administration and Certified Claims
- Manage/Avoid Broad Release Language (“known or unknown”) May Have Unintended Consequences
 - Preserve Delays, Cumulative Impact

Best Practices (Cont.)

- Scrub Carefully for Unallowables
- Anticipate DCAA Challenges to Estimates:
 - Relevance/Causation/Reliability of Increased Costs Data
 - Unallowables
 - Reasonableness of Labor Hours
 - Attorney/Accountant Fees
 - Profit
 - Interest on Claim

Questions?



Steven M. Masiello

Partner
Government Contracts

303.634.4355
steve.masiello@dentons.com



Joel M. Pratt

Associate
Government Contracts

303.634.4324
joel.pratt@dentons.com

Thank you

The Dentons logo consists of the word "DENTONS" in white, uppercase, sans-serif font, centered within a dark purple arrow-shaped graphic pointing to the right.

Dentons US LLP
1400 Wewatta Street
Suite 700
Denver, CO 80202-5548
United States

Dentons is the world's first polycentric global law firm. A top 20 firm on the Acritas 2015 Global Elite Brand Index, the Firm is committed to challenging the status quo in delivering consistent and uncompromising quality and value in new and inventive ways. Driven to provide clients a competitive edge, and connected to the communities where its clients want to do business, Dentons knows that understanding local cultures is crucial to successfully completing a deal, resolving a dispute or solving a business challenge. Now the world's largest law firm, Dentons' global team builds agile, tailored solutions to meet the local, national and global needs of private and public clients of any size in more than 125 locations serving 50-plus countries. www.dentons.com.