

A CONTRACTOR'S GUIDE TO...

MAXIMIZING RECOVERY ON CERTIFIED CLAIMS & REQUESTS FOR EQUITABLE ADJUSTMENT DURING THE COVID-19 PANDEMIC

PRESENTED BY:



CARES Act

- ▶ In one of its first major responses to the pandemic, the Government initiated the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), which was signed by President Trump on March 27, 2020. The CARES Act provides some guidance on and public policy considerations for how a government agency might respond to its contractors and what assistance may be available to them.

OTHER KEY DOCUMENTS

- ▶ March 20, 2020, Office of Management and Budget, MEMORANDUM TO THE HEADS OF EXECUTIVE DEPARTMENT AND AGENCIES, SUBJECT: Managing Federal Contract Performance Issues Associated with the Novel Coronavirus (COVID-19)
- ▶ March 30, 2020, Office of the Under Secretary of Defense Memorandum, SUBJECT: Managing Defense Contracts Impacts of the Novel Coronavirus
- ▶ April 8, 2020, Office of the Under Secretary of Defense Memorandum, SUBJECT: Class Deviation - CARES Act Section 3610 Implementation

POTENTIAL AREAS OF RECOVERY UNDER THE CARES ACT AND RELATED GOVERNMENT GUIDANCE

- ▶ Changes (FAR 52.243-1 or 52.243-2)
 - ▶ Contractor directed to perform additional or out-of-scope work
- ▶ Others include:
 - ▶ Contract Terms and Conditions for Commercial Items (FAR 52.212-4)
 - ▶ Excusable Delays (FAR 52.249-14)
 - ▶ Stop work orders (FAR 52.242-15)
 - ▶ “The Contracting Officer shall make an equitable adjustment in the delivery schedule or contract price, or both, and the contract shall be modified, in writing, accordingly ...”

Other Common Theories of Recovery

- ▶ Suspension due to bid protest (FAR 52.233-3)
 - ▶ Same as FAR 52.242-15
- ▶ Revision to technical data (FAR 52.227-21)
 - ▶ “The Contractor may submit a request for an equitable adjustment to the terms and conditions of this contract for any revisions to technical data made pursuant to this paragraph.”
- ▶ Differing site condition (FAR 52.236-2)
 - ▶ “If the conditions do materially so differ and cause an increase or decrease in the Contractor’s cost of, or the time required for, performing any part of the work under this contract, whether or not changed as a result of the conditions, an equitable adjustment shall be made under this clause and the contract modified in writing accordingly.”
- ▶ Failure to include Service Contract Act wage determination (FAR 22.1015)
 - ▶ “The contracting officer shall equitably adjust the contract price to reflect any changed cost of performance resulting from incorporating a wage determination or revision.”

Claims vs. Requests for Equitable Adjustment (REA)

▶ Claims

- 4-prong certification if claim is over \$100K
- Must request CO decision
- Must state sum certain
- Costs of preparation are unallowable
- CDA interest starts to accrue when CO receives claim
- CO decision may be appealed by contractor.

▶ REAs

- 2-prong certification if claim is over \$150K (DOD agency)
- Request negotiation
- Contain statement of basis for compensation and pricing logic
- Costs of preparation are allowable contract administration costs
- Does not trigger CDA interest
- If CO issues a decision, it is ordinarily not a final decision that may be appealed, but may be converted to a CDA claim

Request for Equitable Adjustment (REA)

- ▶ FAR 52.243-1, Changes - Fixed-Price
- ▶ Unilateral changes - authorizes the contracting officer to make changes within general scope of contract
 - ▶ Drawings, designs, or specifications
 - ▶ Method of shipment or packing
 - ▶ Place of delivery
- ▶ Right to equitable adjustment
 - ▶ “(b) If any such change causes an increase or decrease in the cost of, or the time required for, performance of any part of the work under this contract, whether or not changed by the order, the Contracting Officer shall make an equitable adjustment in the contract price, the delivery schedule, or both, and shall modify the contract.”
- ▶ Must assert right to adjustment within 30 days of written order
- ▶ REA is matter of contract administration
- ▶ Based on FAR clause/order
 - ▶ Generally entitlement to some amount not in dispute
- ▶ Costs preparing REA are allowable whereas costs of pursuing or defending a claim are expressly unallowable
 - ▶ Interest based on the guidance of the Contract Disputes Act accrues under a claim whereas interest does not accrue under a REA

Claims

- ▶ Definition of a “claim”
 - ▶ A “claim” is “a written demand or written assertion by one of the contracting parties, seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to a contract.” FAR 2.101
 - ▶ Note that a claim seeking payment in excess of \$100,000 must be certified to qualify as a “claim.”
- ▶ What is not a claim?
 - ▶ Routine requests for payment (invoices, vouchers, etc.)
 - ▶ Request for Equitable Adjustment (REA) (can be converted into a claim)

Claims

- ▶ Who can be a claimant?
 - ▶ Normally, only parties to the contract (the prime contractor and the government)
 - ▶ Subcontractors, sureties, financial institutions, and others may not bring claims
 - ▶ While a subcontractor cannot file a claim directly with the government, a prime contractor can sponsor claims on behalf of its subcontractors

Claims

- ▶ What must a claim include:
 - ▶ The demand or assertion must be in writing
 - ▶ Seeking as a matter of right:
 - ▶ Payment of money in a sum certain
 - ▶ Adjustment or interpretation of contract terms
 - ▶ Other relief arising under or relating to the contract
 - ▶ Has been submitted to the contracting officer for a decision
 - ▶ Contain explicit request for the contracting officer's final decision, although implicit requests may prove sufficient
 - ▶ Contain CDA Certification (language in 41 U.S.C. § 7103(b))

After Submission of a Claim

- ▶ After submitting a claim while awaiting a COFD (and after!), a contractor still has a continuing duty to perform, pending resolution of a dispute
 - ▶ If work stops, the contractor risks termination for default
 - ▶ Best practice is for the contractor to continue performance under protest and seek a declaratory judgment that it is entitled to suspend performance

Statute of Limitations for Filing a Claim under the CDA

▶ Statute of limitations

- ▶ A contractor must submit a proper claim to the contracting officer within six years of accrual

▶ “Accrual” Analysis

- ▶ “Accrual of a claim means the date when all events that fix the alleged liability of either the government or the contractor and permit assertion of the claim, were known or should have been known. For liability to be fixed, some injury must have occurred. However, monetary damages need not have been incurred.” (FAR 33.201)
- ▶ Analysis turns on what facts are objectively and reasonably knowable, not what a party subjectively understood

What Constitutes a Sum Certain?

- ▶ A claim states a “sum certain” if the government can determine the amount of the claim using a simple mathematical formula
- ▶ Best practice is to expressly demand payment of a specific amount
- ▶ Claims based on estimates are acceptable if the contractor identifies what part of the claim relies on estimates and explains how the contractor arrived at those estimates using actual cost data
- ▶ Generally, best practice is to exercise caution when using estimates to avoid a government counterclaim for fraud or misrepresentation
- ▶ Under the enlarged claim doctrine, a BCA or the COFC may exercise jurisdiction over a dispute that involves a sum in excess of that presented to the contracting officer for a final decision if:
 - ▶ The increase is based on the same set of operative facts previously presented to the contracting officer; and
 - ▶ The contractor neither knew nor reasonably should have known, at the time when the claim was presented, of the factors justifying an increase in the amount of the claim.

Effect of a Change Order

- ▶ Subject to LOC / LOF clauses and ceiling price of T&M contract, contractor is obligated to perform changed work
- ▶ If there is a change in the cost of performance or time required to perform as a result of a Change Order, contract is to be equitably adjusted
- ▶ Adjustment may be additive or deductive
- ▶ Adjustment covers total impact of Change Order, not just impact on changed work

Pricing of Change Orders

- ▶ Except for construction contracts, contractor must assert right to adjustment within 30 days of receipt of Change Order and before final payment
- ▶ Change order accounting (FAR 52.243-6)
- ▶ Pricing of adjustments clauses in agency supplements makes cost principles applicable to change orders

Change Order Accounting Procedures. FAR 43.203

- ▶ The contracting officer should advise offerors of the possible need to revise their accounting procedures.
- ▶ The following direct costs normally are segregable and accountable:
 - ▶ Non-recurring costs (e.g., engineering costs and costs of obsolete or re-performed work).
 - ▶ Costs of added distinct work caused by the change order (e.g., new subcontract work, new prototypes or new retrofit or backfit kits).
 - ▶ Cost of recurring work (e.g., labor and material costs).

Importance of REA and Claim Pricing

- ▶ Done last and reviewed first
- ▶ Pricing drives the decision-making process
- ▶ Government often ignores entitlement and defends claim with attack on quantum
- ▶ Requires coordinated cross-functional team effort
- ▶ Contractor risks
 - ▶ False Claims, fraud
 - ▶ Defective pricing under TCPD/TINA
 - ▶ Disapproval of estimating system and possibly others

A Swing and a Miss: Recent Decisions Where Contractors Failed to Prove Entitlement

- ▶ *Sang Kash Co.*, ASBCA No. 62148 (March 9, 2020)
 - ▶ Claim dismissed where contractor did not first submit it to the contracting officer for final decision.
 - ▶ FAR 2.101 defines “claim,” in relevant part, as “a written demand or written assertion by one of the contracting parties seeing, as a matter of right, the payment of a sum certain.”
- ▶ *NVS Techs., Inc. v. Dept’ Homeland Security*, CBCA No. 4775 (March 5, 2020)
 - ▶ Board denied a claim for bad faith termination for convenience.
 - ▶ Contractor failed to present evidence to overcome presumption that government officials act conscientiously in discharging their duties.
- ▶ *Korea Eng’g Consultants Corp.*, ASBCA No. 61724 (Feb. 24, 2020)
 - ▶ Appeal alleging breach of contract denied where contractor failed to meet its burden of proof.
 - ▶ Generally, government not liable for damages resulting from action of third parties.

Recent Decisions Regarding Quantification And Proof Of Damages

- ▶ *King Aerospace*, ASBCA No. 60933 (Apr. 15, 2019)
 - ▶ Appeal sustained, but Board took contractor to task for its quantum analysis.
 - ▶ Board noted that contractor’s quantum case “paints with too broad a brush.”
 - ▶ “It is not the case that King ‘could not have contemporaneously identified and quantified every discrete impact of each of the many thousands of deficient aircraft conditions and parts through change order accounting’ or could not have ‘after the fact, waded through the hundreds of thousands of aircraft records.’” (quoting contractor’s brief).
 - ▶ “Rather than identify specific deficiencies and cost them directly, King estimates that the aircraft and inventory conditions are responsible for most of its El Paso labor costs above its average labor costs during a ‘measured mile’ that was unaffected by those conditions. That estimate is unconvincing.” (citations omitted)

Where to Start From a Cost Perspective

- ▶ Objective is to calculate the increased cost of the changed work
 - ▶ Contractor should be in the same profit or loss position as if no change occurred
- ▶ Generally broken out into four components:
 - ▶ Calculating costs directly attributed to added work
 - ▶ Calculating costs directly attributable to eliminated work
 - ▶ Calculating overhead and profit for costs attributable to changed work
 - ▶ Contract administration costs

Where to Start From a Cost Perspective

- ▶ FAR 15.408, Table 15-2(III)(B), provides the format for change orders, modifications, and claims
 - ▶ Recently increased \$2 million in 2018 NDAA
- ▶ Seven components:
 - ▶ Cost elements (materials, services, direct labor, indirects, other costs)
 - ▶ Estimated costs of all work deleted
 - ▶ Cost of deleted work already performed
 - ▶ Net cost to be deleted
 - ▶ Estimate for cost of work added by the change
 - ▶ Net cost of change
 - ▶ References--documentation supporting specific cost elements

Where to Start From a Cost Perspective

- ▶ FAR Part 31, Contract Cost Principles and Procedures, applies to modifications, but its application must result in an “equitable adjustment”
- ▶ FAR 31.201-2, allowability requirements:
 - ▶ Reasonableness - No presumption of reasonableness
 - ▶ Allocability
 - ▶ CAS (if applicable), GAAP as appropriate
 - ▶ Terms of the contract
 - ▶ FAR Subpart 31.2 limitations

Where to Start From a Cost Perspective

- ▶ Consistent Accounting Practices
 - ▶ By Cost Element
 - ▶ CASB DS-1 (if applicable)
 - ▶ Estimated and/or Actuals. Actuals are preferred over estimates
 - ▶ Consistent to policies

Impact by Cost Element

Direct Labor	Materials, Subcontracts & ODCs	Indirect Costs	Profit
<ul style="list-style-type: none">• Added Work• Larger Crews• Overtime• Idle Time or Layoffs• Detection or Correcting of Problem• Discussions with Government• Coordination with Subcontractors• Loss of Efficiency & Learning• Impact on Labor Rates	<ul style="list-style-type: none">• Material Prices• Pricing Inventory• Scrap, Spoilage, Rework, Obsolete Materials, etc.• Storage• Market Conditions• Supplier Terms	<ul style="list-style-type: none">• Consistency with Current Accounting Practices• Application of Forecasted Rates due to Timing of Scope• Shifting of work between years• Corporate Allocations• Change in Sales• Impact on Other Costs	<ul style="list-style-type: none">• Not Precluded• But Not for Suspension of Work or Government Delay• Generally Consistent with Proposal and Company practices

Impact on Profit

- ▶ Not precluded
 - ▶ But not for Suspension of Work or Government Delay
- ▶ Consistent with Proposal and Company practices
 - ▶ Weighted Guidelines
 - Not required for a Contractor but a good tool to identify the Government's position
 - ▶ Historical Data
 - ▶ Policy

Pricing Methodologies: Actual Cost Method

- ▶ Actual cost data is the preferred method for proving costs
- ▶ Requires early recognition and establishment of separate job cost codes
- ▶ Best evidence available under the circumstances
- ▶ Key point: establish connection to government conduct
- ▶ Cumulative impact of multiple changes
- ▶ FAR 52.243-6, Change Order Accounting
 - Permits CO to order the accumulation of actual costs
 - Contractor must indicate in its proposal which proposed costs are actual and which are estimates

Pricing Methodologies: Estimated Cost Method

- ▶ REAs/claims often require some type of estimates
 - Cost of deleted work
 - Actuals are unavailable for added work
 - Lack of segregation
 - Future impacts
- ▶ Good faith estimates are preferred when actual costs are not available
- ▶ Support: detailed substantiating data or reasonably verifiable cost experience
- ▶ Methods include:
 - Buildup through studies, use of subject matter experts (SMEs)
 - Analogy/actual cost of single event
 - Parametric/cost estimating relationship
 - Engineering build-up

Pricing Methodologies: Total Cost Method

- ▶ Difference between the bid cost/price and actual cost
- ▶ Disfavored; assumes entire cost overrun is government's fault
 - Fails to identify specific extra costs caused by changes, differing site conditions, or delays
- ▶ Four factors the contractor must show:
 - Impracticality of proving actual costs
 - Contractor's bid was realistic
 - Reasonableness of its actual costs
 - Lack of responsibility for added costs

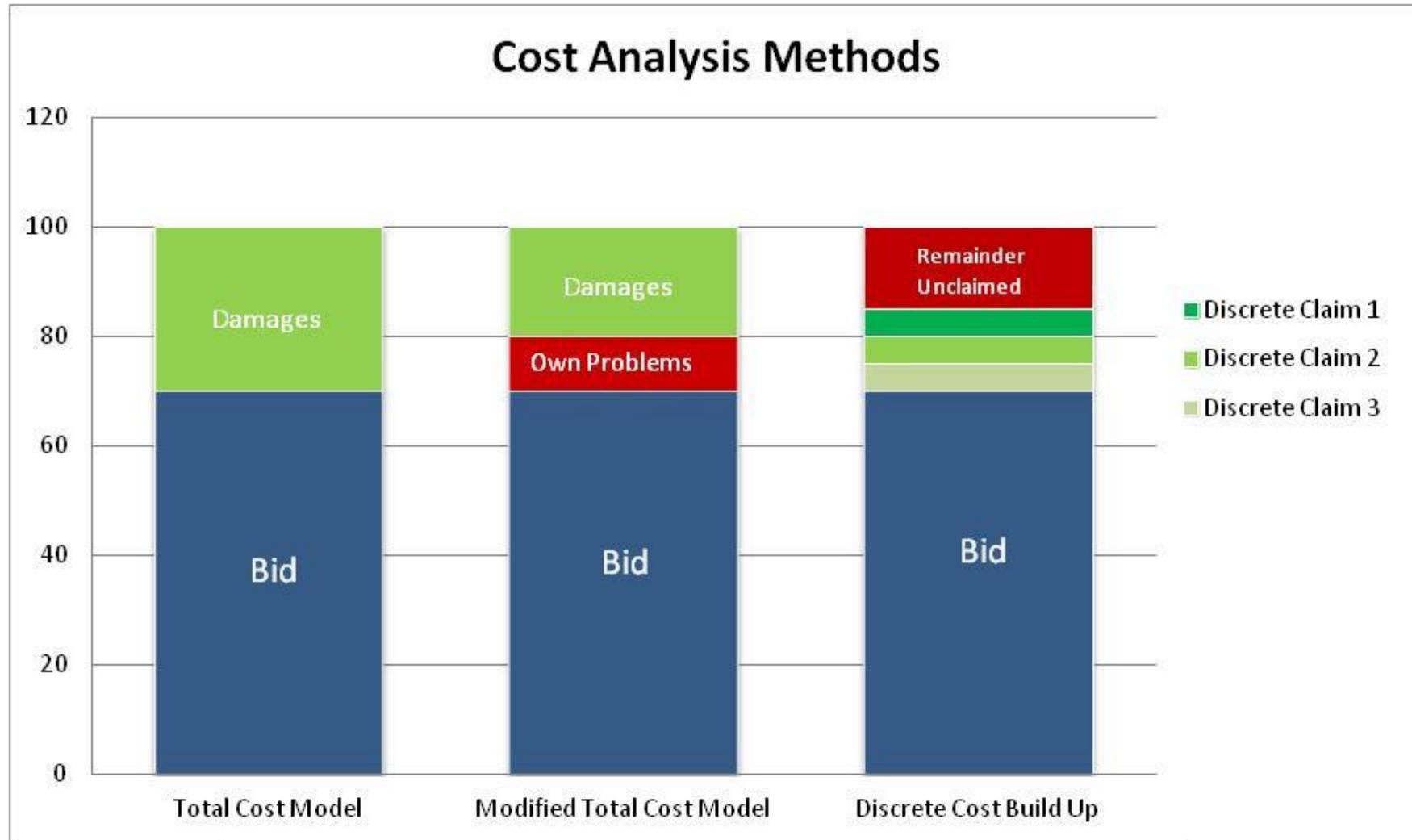
Pricing Methodologies: Modified Total Cost Method

- ▶ Contractor may adjust the total cost method to account for other factors
- ▶ Two elements of the total cost method computation are adjusted:
 - Original costs in the contract price
 - Total costs of performance
- ▶ Goal of adjustments: eliminate amounts for which the government is not responsible
- ▶ May occur in situations where the bid was not realistic or there were other causes for the extra costs

Pricing Methodologies: Discrete Cost Build

- ▶ Provides for direct quantification of any increased costs
- ▶ Ties increased costs to contract changes (i.e., claim elements)
- ▶ Most precise method; generally preferred
- ▶ Often used for termination settlement proposals

Pricing Methodologies



Audit Process

- ▶ Audits should be expected on substantial claims and terminations
- ▶ REAs are often audited prior to negotiations
- ▶ Post-completion audits typically occur prior to close-out on contracts with multiple, major change orders
- ▶ Expect the auditor to find something - be prepared
- ▶ Proper documentation to support the claimed costs is key
 - ▶ Review supporting documentation prior to the audit and identify any potential gaps - leave no surprises for your company to the audit itself
 - ▶ Organize the support documentation and make available to the auditor
 - ▶ Make sure your company is leading the narrative of the audit

Best Practices for Claim Package

- ▶ Well-supported claims can achieve quicker and more favorable settlements.
- ▶ Provide a narrative that tells your story and justifies each claim element
- ▶ Include all records to substantiate claim elements For example:
 - ▶ Accounting/ Job cost records
 - ▶ Timekeeping or Equipment Usage records
 - ▶ Narrative - Entitlement and Quantum
- ▶ Keep claim and support materials in digestible pieces/easy to understand
- ▶ Be conscious of organizational impact: Technical, Accounting, Legal
- ▶ Claim elements should be credible to avoid additional scrutiny and slowing the process
- ▶ Submissions should be easy to understand
- ▶ Remember preparation costs may be directly recoverable depending on the vehicle
- ▶ May consider separating your claim into two where you know CO agrees with only certain pieces
- ▶ Ensure the cost workbook is realistic and well organized
 - ▶ Best practice is to start with the proposal and work from there
 - ▶ Charts and attachments
- ▶ Dealing with the auditors
 - ▶ It's a negotiation

Sources of Supporting Documentation

- ▶ Accounting Records
- ▶ Engineering Log Books
- ▶ Time Records
- ▶ Travel Records
- ▶ Visitor Logs
- ▶ Meeting Documentation
- ▶ Correspondence
- ▶ Program Status Reports
- ▶ Activity Reports

Maximizing Your Recovery: Best Practices

- ▶ Be proactive, and start early.
- ▶ Document, document, document
- ▶ Know your contract.
 - Need to be able to recognize that a change has been made to the contract
 - Provide government with timely notice of the change
- ▶ Identify potential changes, and segregate increased cost immediately.
 - Use a unique project code to separately accumulate these increased costs.
 - Project may require change order accounting.
- ▶ Leverage cross-functional cooperation and communication (i.e. engagement of contractor's legal, contracts, and pricing teams)
- ▶ Support estimates with sufficient levels of detail; any bases of estimate used to calculate costs should be documented and verified.

Maximizing Your Recovery: Best Practices

- ▶ Regularly update contract schedules to reflect changes as they occur, especially in the case of any performance delays.
- ▶ Be cognizant of cost allowability under certified claims and REAs:
 - Negotiations/contract administration costs should be segregated from claim costs.
 - Costs should be scrubbed for unallowable costs.
- ▶ Manage/avoid broad release language (“known or unknown”) due to unintended consequences.
- ▶ Anticipate DCAA challenges to estimates used and prepare justifications for use of such estimate for items like:
 - Relevance, causation, reliability of increased costs data
 - Unallowable costs
 - Labor hour reasonableness
 - Attorney, accountant, and consultant fees
 - Profit
 - Interest on claim

Questions?

Aaron Raddock, CPA, CFE, CFCM

Partner & National Leader, Government Contracts

BDO USA, LLP

703-336-1693

araddock@bdo.com

Paul Debolt

Partner

Chair, Venable Government Contracts Group

Venable, LLP

202-344-8384

padebolt@Venable.com

Emily Unnasch

Associate

Venable, LLP

202-344-4167

eaunnasch@Venable.com

