Vol. No. XXII,

Issue No. 1

December 2011

The Clause

A Quarterly Publication of the Boards of Contract Appeals Bar Association, Inc.

The President's Column

Dear BCABA Members:

As we conclude the 22nd year of the Boards of Contract Appeals Bar Association, we have much to be thankful for. I can say with certainty that we are a healthy and robust "association of judges, attorneys, legal assistants, and other professionals dedicated to supporting and improving the practice of law before the Boards of Contract Appeals." This year, we presented numerous well attended programs, including:

- A GovCon Legal Career Mentoring event for young attorneys and current law students (my thanks to Program Chair **Susan Warshaw Ebner (Buchanan, Ingersoll & Rooney**);
- The annual Colloquium presented in tandem with the George Washington University School of Law in May (my thanks to Program Chairs **Michele Brown (SAIC)**, **Joe Hornyak (Holland & Knight)**, and **Professor Chris Yukins**);
- "Summer Social" with the BCA Judges (my thanks to Program Chair **Susan Ebner**);
- The annual Executive Policy Forum for Gold Medal Firms (my thanks to Program Chairs **John Pachter** and **Steve Knight (Smith Pachter McWhorter PLC)**);

(*continued on page 3*)

Table of Contents

Boards of Contract Appeals Bar Association, Inc.
Officers

President:
David Black
Holland & Knight LLP
1600 Tysons Boulevard, Ste. 700
McLean, VA 22102
(w): 703-720-8680

Vice President:
Francis E. "Chip" Purcell
Cooley LLP
777 6th Street, NW, Ste. 1100
Washington, DC 20001
(w): 202-842-7841

Secretary:
Hon. Gary Shapiro
PSBCA
2101 Wilson Boulevard, Ste. 600
Arlington, VA 22201
(w): 703-812-1900

Treasurer:
Thomas Gourlay
Army Corps of Engineers
441 G Street, NW
Washington, DC
(w): 202-761-8542

Boards of Contract Appeals Bar Association, Inc.
Board of Directors

President's Column (cont'd):

- Our biggest event of the year – the BCABA Annual Program – which was a smashing success with our highest attendance in the past few years (my thanks to Program Chair **Chip Purcell of Cooley LLP**); and

- Our new Quarterly Network Event at Bar Louie in D.C. (my thanks to Program Chair **Daniel Strouse (Wittie, Letsche & Waldo, LLP)**).

We also continued publishing *The Clause*, which includes articles on cutting edge trends and developments in government contracts law (my thanks to Editor-in-Chief **Pete McDonald (Navigant Consulting, Inc.)**) as well as the new *BCA Case Digests* (my thanks to editor **Ryan Roberts (Sheppard Mullin Richter & Hampton LLP)**).

I also want to thank my fellow officers who help keep things running smoothly during a hectic year, including Vice President Chip Purcell **(Cooley LLP)**; Secretary **Judge Gary Shapiro (Postal Service Board of Contract Appeals)**; Treasurer **Tom Gourlay (U.S. Army Corps of Engineers)**; and Past President Susan Ebner. I also want to thank **Oliya Zamaray (Holland & Knight LLP)**, my neighbor at work, who reviewed feedback forms from our events and provided (solid) advice about stepping around the competing demands of my practice and BCABA. I am grateful for the assistance and encouragement that each of these individuals provided!

But wait! We're not done yet! On **January 24, 2012 from 9:00 - 11:00 AM**, we will present our **Annual Trial Practice Seminar** at the Moot Courtroom of the G.W. Law School (2000 H Street, N.W., Washington, D.C.). This seminar is a unique opportunity for young lawyers and law students to meet judges from the ASBCA, CBCA, and PSBCA and receive invaluable advice and insight into litigating before the Boards of Contract Appeals. Panelists include **Judge Diana S. Dickinson (ASBCA)**; **Judge Alan Goodman (CBCA)**; **Judge Gary E. Shapiro (PSBCA)**; **Peter F. Pontzer (U.S. Army Legal Services Agency)**; and **Jack Tieder (Watt, Tieder, Hoffar and Fitzgerald, LLP)**. To RSVP or ask questions, please contact Suzanne Hope at shope@wthf.com or (703) 749-1545. (My thanks to **Shelly Ewald (Watt, Tieder, Hoffar & Fitzgerald, LLP)**, **Peter Pontzer (Army)**, **Donald Yenovkian (Army)**, and **Jennifer Zucker (Wiley Rein LLP)** for organizing this event!).

Also on **January 24, 2012 starting at 11:00 AM** (immediately after the Trial Practice Seminar), there will be an **open meeting of the BCABA Board of Governors**. Please come and find out what's going on with BCABA, share your views, and ask how you can get involved!

Finally, my thanks to you, members of the BCABA community, for the privilege and honor of serving you this past year. You are in great hands with incoming President Chip Purcell in 2012.

(*continued on page 4*)

<u>President's Column (cont'd):</u>

Never forget to take the time to think about that which is true, noble, right, pure, lovely, admirable, and excellent, so that the great cause of justice we all serve together stays with you.

Best regards,

David Black
President
BCABA, Inc.

Bored of Contract Appeals
(a.k.a. The Editor's Column)
by
Peter A. McDonald
C.P.A., Esq.
(A nice guy . . . basically.)

Leading this issue are the well-appreciated case digests edited by Ryan Roberts (Sheppard Mullin). Following the digests is an insightful analysis of the arbitration process by Ken Jackson. Doug Hibshman (Fox Rothschild) then discusses tactics in SBA size protests, while the prolific (and past BCABA president) Dave Nadler teams with Justin Chiarodo (Dickstein Shapiro) to provide an update on developments related to the FCA's public disclosure bar.

The Clause will reprint, with permission, previously published articles. We are also receptive to original articles that may be of interest to government contracts practitioners. But listen, everybody: Don't take all this government contract stuff too seriously: Get a life. In that regard, we again received some articles that were simply unsuitable for publication, such as: "Demi: "Ashton Couldn't Keep Me From Pete!"; and "Pro Se Brief Wins Writing Award!!"; and "Action Figures of Pete — Now on Easy Pay!!!"

Annual Dues Reminder

This is to remind everyone about the BCABA, Inc., dues procedures:

☺ Dues notices were emailed on or about August 1st.
☺ Annual dues are $30 for government employees, and $45 for all others.
☺ Dues payments are due NLT September 30th.
☺ There are no second notices.
☺ Gold Medal firms are those that have all their government contract practitioners as members.
☺ Members who fail to pay their dues by September 30th do not appear in the Directory and do not receive *The Clause*.
☺ The Membership Directory is maintained on the website.

BCA Case Digests

by

*Ryan E. Roberts**

BCABA members – Happy holidays, and thank you for reading the December edition of the BCABA *Case Digests*. Below are summaries of the most interesting and relevant decisions from the months of August through October.

Two administrative notes before we get to the decisions. First, Judge Shapiro (Administrative Judge for the Postal Service Board of Contract Appeals and current BCABA Secretary) is happy to announce that the PSBCA has started publicizing its expedited decisions on the PSBCA website. Although these cases are not entitled to precedential value under the CDA, the PSBCA judges often look to these cases to inform their analyses of precedential decisions. Second, I'm happy to announce that two of our Contributing Editors have started the next chapter of their careers for new employers: Tara L. Ward has returned to Wiley Rein LLP after a clerkship on the Court of Federal Claims; and Jeffery M. Chiow has started his new position as an Associate at Rogers Joseph O'Donnell, P.C. Congratulations, Tara and Jeffery!

In addition to the usual contract interpretation and performance appeals, the boards took up cost issues in the appeals of *Raytheon* (interpretation of CAS 413) and *SRI* (allowability of indirect costs associated with maintaining a letter of credit). Additionally, the boards took up two accord and satisfaction appeals in *Living Tree* and *COSTAR III,* and a number of appeals which reinforce the general proposition that contractors should seek to enforce the terms of their contracts in the face of Government opposition.

As always, should you have any comments or suggestions, I encourage you to contact me at the email address listed below.

Case Index

Armed Services Board of Contract Appeals Decisions

CI^2, Inc., ASBCA Nos. 56257, 56337, Aug. 2, 2011
BECO Constr. Co., Inc., ASBCA No. 57483, Aug. 4, 2011
General Constr. Servs., Inc., ASBCA No. 57187, Aug. 4, 2011
Tiger Enters., Inc., ASBCA No. 57447, Aug. 5, 2011
The Davis Group, ASBCA No. 57523, Aug. 12, 2011
COSTAR III, LLC, ASBCA No. 56479, Aug. 17, 2011
Zafer Taahhut Insaat ve Ticaret A.S., ASBCA No. 56770, Sept. 14, 2011
Gen. Dynamics Land Sys., Inc., ASBCA No. 57293, Sept. 21, 2011
Tzell Airtrak Travel Group Corp., ASBCA No. 57313, Sept. 22, 2011
Envtl. Safety Consultants, Inc., ASBCA No. 51722, Sept. 28, 2011

(*continued on next page*)

Case Digests (cont'd):

Armed Services Board of Contract Appeals Decisions (cont'd)

SRI Int'l, ASBCA No. 56353, Oct. 5, 2011
Charles Mullens, ASBCA Nos. 56927, 57432, Oct. 13, 2011
D.J. Miller & Associates, Inc., ASBCA No. 55357, Oct. 13, 2011
Thomas Assocs., Inc., ASBCA No. 57126, Oct. 18, 2011
Raytheon Co., ASBCA No. 54907, Oct. 31, 2011

Civilian Board of Contract Appeals Decisions

Eyak Tech., LLC v. DHS, CBCA No. 1975, Sept. 2, 2011
Trygve Dale Westergard v. GSA, CBCA No. 2522, Sept. 15, 2011
KD1 Dev. v. GSA, CBCA No. 2075, Sept. 20, 2011
Rockies Express Pipeline LLC v. Dept. of the Interior, CBCA No. 1821, Sept. 27, 2011
Living Tree Care Inc. v. Dept. of the Interior, CBCA Nos. 2008, 2204, Oct. 5, 2011
Moshe Safdie and Assocs., Inc., CBCA No. 2386, Oct. 13, 2011

Postal Service Board of Contract Appeals Decisions

Sharon Roedel, PSBCA No. 6347, Aug. 1, 2011
Stewartsville Postal Props., PSBCA Nos. 6377, 6382, 6394, Sept. 7, 2011

--*-*-*-*-*

Appeals of Sharon Roedel
PSBCA No. 6347, August 1, 2011 – Judge Shapiro
by John, Sorrenti, McKenna Long & Aldridge LLP

In this case, the United States Postal Service's ("USPS") moved for summary judgment, or in the alternative, to dismiss the appeals. The USPS alleged that the PSBCA could not provide relief on the appeals because the USPS was required by law to terminate appellant's mail transportation contract. In the alternative, the USPS argued that the Board lacked jurisdiction because a meeting of the minds never occurred between the parties, and thus there was no cognizable contract on which to base Contract Disputes Act ("CDA") jurisdiction.

On May 14, 2010, to replace a hospitalized mail delivery contractor, the appellant agreed by telephone to a six-month replacement contract with the USPS to transport mail. Based on this oral agreement, and before signing a written contract, the appellant began to perform the contract. The USPS claimed that it informed the appellant during this telephone call that the contract terms allowed termination of the contract on 24-hours notice, while the appellant maintained that she was told specifically that the contract would last "no shorter" than six months and the previous contractor would not come back even if released from the hospital.

(*continued on next page*)

Case Digests (cont'd):

However, on May 20, 2010, the previous contractor was released from the hospital and the USPS sent the appellant a letter, styled as a Contracting Officer's final decision, that terminated her contract without cost, effective May 21, 2010.

The appellant also received an unsigned written contract from the USPS which included a provision that allowed the USPS to terminate the contract upon 24-hours notice.

Notwithstanding this termination provision, the appellant signed the contract because she was allegedly told that she would not receive payment for services already performed if she did not sign. On June 10, 2010, the USPS Contracting Officer also signed the written contract and then paid the appellant $785.76 for services performed.

The appellant appealed the contract termination, asserting that the termination provision was not part of the original agreement and requesting payment in full. The USPS Contracting Officer responded by issuing a final decision denying the appellant's claim for full payment. The appellant timely appealed this decision and this appeal was consolidated with her appeal of the contract termination. The USPS then moved for summary judgment or dismissal of the appeals.

The PSBCA denied the USPS's motion, finding that disputed issues of material fact existed. Specifically, the Board noted that the appellant submitted testimony about the statements made during the May 14, 2010 phone call that clearly contradicted the USPS's claim that it initially informed the appellant about the termination clause in her contract. Furthermore, the Board found that the USPS did not assert in support of its motion that it informed the appellant that any termination would be no-cost. Accordingly, "the factual dispute concerning the discussion and agreement or lack thereof about a termination right precludes entry of summary judgment."

The Board also rejected the USPS's argument that it lacked jurisdiction because no meeting of the minds occurred, as evidenced by the parties' dispute over whether a no-cost termination clause was included in the contract. This argument did not persuade the PSBCA, which stated, "as we have found the existence of disputed facts whose resolution will determine our jurisdiction to address the merits of Appellant's claim, we must deny the motion to dismiss." The lesson for contractors here is to get those contracts in writing as soon as possible to avoid similar disputes – and possibly to record telephone conversations if they involve discussions about contractual agreements.

Appeals of CI^2, Inc.
ASBCA Nos. 56257, 56337, August 2, 2011 – Judge Delman
by Eugene Scott

In *CI^2, Inc.*, the ASBCA decided two sets of issues on cross-motions for summary

(*continued on next page*)

Case Digests (cont'd):

judgment. First, appellant (CI[2]) claimed an entitlement to the full monthly fixed-price stated in the contract, and secondly, entitlement to damages from the Government's decision to not award two award terms.

The Army awarded appellant a firm-fixed price, award term contract. The contract required that appellant provide labor to review and approve applications for Army base access. Appellant was to invoice monthly in arrears a firm-fixed price per person per month for a specified number of months. The record indicated that appellant, instead of invoicing the full firm-fixed price each month for each person, invoiced a pro-rata share based on the amount of each employee's time actually worked.

Also, although the contract contained an Award Term Plan ("ATP"), the Government did not follow the prescribed evaluation procedures of the ATP, including failing to establish an Award Term Review Board or issue a determination from the Award Term Determination Official.

Appellant moved for summary judgment on each of its two claims: (i) entitlement to the full firm-fixed contract price based on the Government wrongfully directing its invoicing practice; and (ii) damages for the denial of the award terms based on its exemplary performance and that there was no determination that appellant's prices were not reasonable.

The Government moved for summary judgment on a portion of the first claim, that appellant was not entitled to the full firm-fixed price, because of the appellant's deficient performance. The Government moved for summary judgment on the second claim, arguing that award term decisions are within the sole discretion of the Government and the appellant's price was determined to be unreasonable.

Due to the lack of evidence in the record, the Board held that there were material disputes of fact between the parties, and accordingly neither party's motions for summary judgment were granted. The Board found that there was no evidence in the record that the Government directed the appellant to invoice as it did, nor any contemporaneous evidence that appellant disputed or objected to any such Government direction. With respect to the Government's motion, the Board found no evidence to support the Government's position that the appellant's performance was deficient or that its price was not fair and reasonable.

This case presents one of the clearest examples of a lesson that is too infrequently learned. There will be adverse consequences if either party fails to follow the terms of the contract or to timely document the justifications for actions taken. Appellant failed to invoice in accordance with the express terms of the contract and the Government failed to follow the Award Term Plan procedures.

These facts present an opportunity for counsel to point out the benefits of effective

(*continued on next page*)

Case Digests (cont'd):

contract administration planning, so that the parties perform in a manner that is consistent with their contract's requirements.

Appeal of BECO Construction Co., Inc.
ASBCA No. 57483, August 4, 2011 – Judge James
by Christopher Noon, Sheppard Mullin Richter & Hampton LLP

In this case, the ASBCA considered the appeal of a Contracting Officer's final decision denying the Appellant's claim for compensation for extra-contractual work. The subject of the Appellant's claim was a contract for reclamation work on an area of land that formerly contained mill tails that were removed from the area. The Request for Quotations ("RFQ") stated that the mill tails were removed from an area "located on approximately 2.7 acres." The RFQ also included a topographic map showing the site location and two maps respectively entitled "Thistle Site Orientation Map" and "Thistle Site Scope of Work," each of which contained a disclaimer that disclaimed any warranty of accuracy or reliability. The Government did not measure the site but did estimate from aerial maps and existing drawings that the site exceeded 5 acres. The Government did not disclose this acreage estimate to the Appellant.

In preparing its quotation, the Appellant interpreted the RFQ's Scope of Work terms to be completed on the 2.7 acre project site. The Appellant also interpreted all information on the maps to be included in the 2.7 acres because the map scale could not be verified and the maps disclaimed all accuracy and reliability. Accordingly, the Appellant used the 2.7-acre description to quote the Government a fixed price of $34,711. After receiving a notice to proceed, the Appellant walked the perimeter of the site with a handheld GPS device to calculate the area and determined the work site to consist of over 4 acres. At a pre-construction meeting, the Appellant alleged a change in the work area size and requested an increase in the contract price. The Government rejected this price change.

The Appellant proceeded with performing under the contract. Following completion of the contract, the Appellant submitted an invoice requesting an additional $20,808.58 based on a final measurement of the area at 4.3186 acres. The Contracting Officer denied this claim.

The Appellant alleged that the contract misled it to believe that the work site was 2.7 acres when, in fact, the area was 4.3186 acres. The Appellant argued that this was a constructive change that entitled the Appellant to a price adjustment. The Board agreed that the Appellant was misled, and held that the Appellant was entitled to recover for the extra work it performed. The Board repeated the well-established rule that "where the government makes positive statements in the specifications or drawings for the guidance of bidders, a contractor has the right to rely on them regardless of contractual provisions requiring the contractor to make investigations." It was also noted that the Appellant had no obligation to investigate anyway since the contract did not include the FAR 52.236-3, Site Investigation and Conditions Affecting the Work. The Government did not disclose its 5-acre estimate of the site area with the Appellant and should have known that the description of the area in the contract was

(*continued on next page*)

Case Digests (cont'd):

misleading and that the Appellant would rely on it.

This case demonstrates the importance that both parties verify critical information in a solicitation. Disputes such as these could be readily avoided in the future by verifying the important facts that are relied on to form a price quote.

Appeal of General Construction Services, Inc.,
ASBCA No. 57187, August 4, 2011 – Judge Tunks
by Townsend L. Bourne, Sheppard Mullin Richter & Hampton LLP

In this case, the contractor claimed payment for work allegedly performed pursuant to a verbal contract with the Chief of the Logistics Division and Facility Manager for the Munson Army Health Center. The Government argued that the contractor did not have a valid contract with the Government.

The Chief of the Logistics Division and Facility Manager was the ordering officer and Contracting Officer's Representative ("COR") for a task order being performed by another contractor at the Munson Army Health Center. Under that task order, the Chief of the Logistics Division and Facility Manager did not have authority to make purchases exceeding $2,500 and "was not empowered to award, agree to, or sign any contract or modification thereto, or in any way to obligate the Government." The contractor alleged that it entered into an agreement with the Government, through the Chief of the Logistics Division and Facility Manager, to perform a variety of tasks around the Munson Army Health Center, including repairing and distributing equipment, installing door locks, and replacing paper towel and soap dispensers. The contractor performed many of these tasks and subsequently submitted a claim to the Government for the value of the work that it had performed. The Contracting Officer denied the claim.

In less than one page, the Board set forth its decision granting the Government's motion for summary judgment based on the fact that the Chief of the Logistics Division and Facility Manager "did not have authority to bind the Government to purchases of more than $2,500 and that the CO refused to ratify any order that was placed." This case reinforces two important lessons that contractors should already know: (1) verify the authority of Government counterparts to enter into agreements and/or to modify a contract; and (2) get it in writing!

Appeal of Tiger Enterprises, Inc.
ASBCA No. 57447, August 5, 2011 - Judge Delman
by Katherine Allen, Buchanan Ingersoll & Rooney

In *Tiger Enterprises, Inc.*, the Government's motion to dismiss for lack of jurisdiction was granted when it was determined that the contractor failed to submit a claim requesting a final decision on disputed invoices.

(*continued on next page*)

Case Digests (cont'd):

The United States Air Force ("Air Force") issued a bridge contract to Tiger Enterprises, Inc. ("Tiger") for the provision and servicing of washers and dryers at Goodfellow Air Force Base, Texas. Tiger performed under the contract and submitted monthly invoices to the Air Force. Air Force contended that Tiger did not fully perform and was not entitled to the entire monthly invoice payments, and instead sought resubmission of the invoices based on the significantly less monthly amounts the Government believed were properly owed. Tiger began a series of emails with the Air Force on November 3, 2010 seeking payment of the invoices. This series of emails spanned several days, but the issue remained unresolved. Tiger brought this appeal on December 6, 2010, asking that the claim be deemed denied.

Tiger argued that it sought to have these issues resolved, and asked for either final payment or a final decision. The ASBCA however, concluded that Tiger failed to show any specific communication or set of communications to the Government which could be reasonably interpreted as seeking, expressly or impliedly, a CO decision on its disputed invoices for a sum certain. Tiger had several opportunities to file a written request with the contracting officer, explicitly seeking a decision on the payment of the outstanding invoices, but failed to do so at every turn.

The lesson learned here is simple - contractors should be explicit in their requests for a contracting officer final decision on a disputed invoice. Without such a request, the Boards have no jurisdiction to grant the relief they request.

Appeal of the Davis Group
ASBCA No. 57523 August 12, 2011 – Judge James
by Daniel Strouse, Wittie, Letsche & Waldo LLP

The ASBCA was asked to decide whether a claimant was entitled to monetary relief and to an extension of time due to an alleged government delay.

The U.S. Army Corps of Engineers ("COE") awarded a design and build task order to the Davis Group, Inc. (Davis) under a multiple award task order contract. The task order required the design to include storm drainage and compliance with Georgia's Environmental Protection Division ("GAEPD"). GAEPD required detention basins to be at least 1 foot above the high water level. Davis was required to obtain a permit to discharge storm water.

On December 11, 2009, Davis submitted its initial design and a notice of intent to obtain a permit to discharge storm water. On December 23, 2009, COE directed Davis to comply with the Coastal Stormwater Supplement ("CSS"). Despite this direction, AECOM, Davis' design firm, stated that the RFP did not reference CSS and it did not believe that CSS would require it to resubmit its design plans. In light of this, Davis instructed AECOM not to make any efforts to meet CSS requirements until it resolved contractual issues with COE. On January 11, 2010,

(*continued on next page*)

Case Digests (cont'd):

Davis submitted a letter to COE noting that COE indicated Davis would not receive permits until it complied with CSS. Davis asserted that CSS compliance was not a requirement for a permit and constituted a change to the Task Order, causing a "standstill" on performance of the Task Order.

Prior to the submission of Davis' design, a November 1, 2009 report from Davis' subcontractor showed buried wood debris at several locations. Davis delayed notifying COE of this issue until January 18, 2010, when it asserted that this constituted a changed site condition. COE promptly investigated the wood debris and determined that Davis' December 11 design could not be approved because its basins did not meet GAEPD requirements. Therefore, COE and Davis, on February 4, 2010, negotiated a revised design that Davis submitted on March 2, 2010; COE approved the design.

On July 8, 2010, Davis converted an REA into a claim, asserting that COE's direction to comply with CSS was not a part of the RFP; therefore, COE should have approved Davis' December design. Davis argued that COE's failure to approve its December design delayed performance.

The ASBCA concluded that the proximate cause of delay was not CSS compliance; rather, the delay was caused by Davis' failure to timely notify COE of the buried wood debris, which required the parties to negotiate a new design that was not approved until March of 2010. The ASBCA found that GAEPD did not question Davis' compliance with CSS and that AECOM made no efforts to amend its design to comply with CSS. The ASBCA found that CSS compliance was not the proximate cause of the delay; therefore it did not determine whether or not the Contract required CSS compliance. It denied Davis' claim.

This serves as a helpful reminder – a successful delay claim must show that the Government's actions were the proximate cause of the delay.

Appeal of COSTAR III, LLC
ASBCA No. 56479, August 17, 2011 – Judge Clarke
by Steven Cave, Womble Carlyle Sandridge & Rice, LLP

The issue in *COSTAR* was whether the contractor-appellant, COSTAR, was entitled to recover increased health and welfare ("H&W") benefit costs. SEAIR, a member of the COSTAR joint venture "rollovers" during option years two and three and the extension period for increased H&W bteam requested reimbursement for: "(1) its $3.22 per hour payment for H&W benefits during the base year of the Contract (an increase of $0.42) and "rollover" during the option years, (2) payment of enefits during option year 1."

COSTAR's contract was for Naval Base Operating Services. The contract ("Contract" or "Contract 0085") had a 90-day phase-in period, followed by a base year, beginning on

(*continued on next page*)

Case Digests (cont'd):

February 1, 2001 running through January 31, 2003, and three option years. The Contract contained a wage determination, WD 0162, requiring COSTAR to pay a H&W rate of $2.80 per hour. The Contract also incorporated FAR 52.222-41, Service Contract Act of 1965, but notably failed to include FAR 52.222-43, Fair Labor Standards Act and Service Contract Act Price Adjustment. The Board incorporated FAR 52.222-43, however, by operation of law under the "Christian Doctrine."

In support of its claims, COSTAR argued that the Navy was required to reimburse the increased H&W payments because COSTAR paid $3.22 for H&W in accordance with a September 10, 2001 Memorandum of Agreement that amended the applicable Collective Bargaining Agreement ("CBA"). SEAIR's employees were members of the AFL-CIO union, which has an agreed-upon CBA governing compensation of SEAIR's employees, including H&W benefits. As a result of the change to the CBA's terms, SEAIR paid $3.22 in H&W benefits during the base year of the Contract. SEAIR sought reimbursement for the additional amount paid over the originally specified $2.80 per hour.

The Navy countered that the $3.22 rate was first approved by Wage Determination 0162 and incorporated into the Contract during the first option period, rendering COSTAR and SEAIR without recourse to seek reimbursement for the increased base year payments pursuant to FAR 53.222-43. The Navy further argued that claims for reimbursement for increased payments made during performance of the option periods were barred by accord and satisfaction.

The Board addressed each argument individually. It rejected the claim for increased payments made during the base year because although FAR 52.222-43 provides contractors with a price increase resulting from changes in a CBA, the increased price can only be claimed in contract periods beginning after the CBA change formally occurs. The Board found that the change to the CBA did not occur until 2003, after Option Year 1 had begun. Accordingly, the Navy was not required to reimburse COSTAR for the increased base year or Option Period 1 payments.

The Board also agreed with the Navy that the modifications exercising the Contract Option periods, and payments rendered under them, constituted accord and satisfaction, thus barring claims for increased payments remitted during the three option periods. The bilateral contract modifications included the following language:

> Acceptance of this modification by the contractor constitutes an accord and satisfaction and represents payment in full for both time and money for any and all costs, impact effect, and for delays and disruptions [a]rising out of, or incidental to, the work herein revised.

According to the Board, the modification language addressed all the necessary accord and satisfaction elements, including "proper subject matter, competent parties, meeting of the

(*continued on next page*)

Case Digests (cont'd):

minds of the parties, and consideration" and COSTAR was barred from seeking further claims.

The Board did rule in COSTAR's favor for its claim to recover increased payments incurred during the five month extension awarded at the end of the third option period. The Board found that the modification granting the five month extension incorporated WD 0162 and another modification adjusted the price for several of the services rendered, including Grounds Annex, Custodial Annex and Contract Administration, but not Transportation services. There was no accord and satisfaction language in the Contract modification granting the five month extension or adjusting the prices during the extension. Given the lack of accord and satisfaction language and the Navy's awareness of the increased CBA rates, which were negotiated prior to the five month extension, COSTAR was entitled to its option year rollover costs for work performed during the five month extension.

Contractors must carefully review all contract modifications and documentation, and not sign a modification including accord and satisfaction language if they want to reserve the right to bring a claim for additional compensation.

Eyak Technology, LLC v. Department of Homeland Security
CBCA No. 1975, September 2, 2011 – Judge Stern
by Raja Mishra, Crowell & Moring LLP

In *Eyak Technology*, the CBCA partially granted a contractor's summary relief motion against the Government for improper post facto enforcement of the American Recovery and Reinvestment Act ("ARRA") reporting requirements.

The ARRA is better known as the as 2009 economic stimulus package passed by Congress and signed by President Obama. All contracts funded by the ARRA must include FAR clause 52.204-11. The clause requires contractors to disclose quarterly online the amount of ARRA funds invoiced, certain progress measures, certain subcontracting information, the number of jobs funded, the names and total compensation for the five highest officers, and other information. Contractors that fail to so report are placed on a public non-compliant list and receive negative past performance evaluations, among other sanctions.

In September 2008, six months before the passage of the ARRA, Eyak and the U.S. Customs and Border Protection ("CBP") executed a delivery order for $1,177,488.09 for delivery of communications equipment. The ARRA was passed in February 2009. Three months after the passage of ARRA, CBP unilaterally modified the Eyak contract by increasing funding by $656,960,960.60 using ARRA funds. However, Eyak was not notified that ARRA funds would be used. In September 2009, CBP issued a third modification that increased funding and again neglected to mention ARRA funds would be used.

On October 15, 2009, CBP informed Eyak about the Act funding. Eyak had already

(*continued on next page*)

Case Digests (cont'd):

received one payment from these funds, and would essentially complete its performance under the contract seven days after being informed. CBP sent Eyak a letter demanding compliance with the reporting requirements. Eyak refused. The Department of Labor notified Eyak that it would be compliance audited. In December, CBP, in an effort to protect Eyak, drafted fourth and fifth modifications removing Act funding from the contract and replaced it with other funds. But, in January 2011, CBP—after apparent political pressure—proposed a sixth modification that would incorporate FAR 52.204-11, and requested by letter that Eyak comply with the reporting requirements. Eyak again refused, stating that agreeing to such a *post facto* modification would give the appearance of wrongdoing.

Eyak filed a claim with the Contracting Officer requesting implementation of the fourth and fifth modifications, a finding that it was not required to comply with the Act's reporting requirements, and reimbursement of costs and legal fees. The Contracting Officer denied the claim, and Eyak appealed.

In deciding the case, the CBCA noted that the "FAR, in implementation of the [Act], requires that the Contracting Officer indicate in advance that a contract or modification is being funded with [Act] money." The CBCA held that CBP violated this requirement. It concluded that Eyak need not comply with the reporting requirements. "Any other result," said CBCA, "would be inherently unfair to Eyak by requiring it to perform added work, including disclosure of its officers' salaries, without prior notice and agreement." However, the CBCA denied Eyak's request for costs and legal fees, saying Eyak failed to request a sum certain per the Contract Disputes Act, and thus the CBCA lacked jurisdiction to rule on the cost-and-fees request.

The decision underscores that contracting for stimulus funds can be a tricky and politicized endeavor. The CBCA decision establishes that the Government must comply with its own stimulus regulations and give contractors clear notice when seeking to implement the Act's heightened reporting requirements. It also serves as a reminder to contractors to carefully comply with reporting regulations when performing ARRA-funded contracts.

Appeals of Stewartsville Postal Properties
PSBCA Nos. 6377, 6382, 6394, September 7, 2011 – Judge Shapiro
by Oliya Zamaray, Holland & Knight

In this appeal, the PSBCA had to decide whether dismissal with prejudice of a prior appeal renders final the Contracting Officer's decision that a contractor is responsible for snow removal under a Postal Service lease, such that entitlement is established in favor of the Government on grounds of *res judicata*.

Appellant, Stewartsville Postal Properties, LLC, built the Main Post Office in Stewartsville, New Jersey and leased it to the U.S. Postal Service. A dispute arose as to

(*continued on next page*)

Case Digests (cont'd):

whether the provisions of a "Utilities, Service and Equipment Rider" that was listed in the lease under a paragraph entitled "Other Provisions" was actually part of the lease. Appellant contended that two pages that contained the actual language of the Rider were not physically present in the lease that the parties executed and, therefore, were not legally part of the lease. Included in the Rider was a paragraph requiring the lessor to provide snow removal services. In the winter of 2009-2010, Appellant refused to provide snow removal service. The Postmaster arranged for the services to be provided by a contractor. By letter to Appellant, the Postal Service's real estate specialist informed Appellant that it was responsible under the lease for snow removal. Thus, Appellant was expected to reimburse the Postal Service. Appellant replied that because the Rider was not incorporated into the lease, it was not responsible for snow removal. Appellant referred to its letter as a claim and requested a final decision.

In the summer of 2010, the contracting officer issued a final decision, stating that Appellant, as landlord, was responsible for snow removal under the terms of the lease. The final decision informed Appellant of its appeal rights. Appellant filed a notice of appearance on October 29, 2010. But, by letter to the Board on December 10, 2010, Appellant's counsel withdrew the appeal. On December 20, 2010, the Board informed Appellant that withdrawal would result in dismissal of the appeal with prejudice. Appellant did not reply to the Board's notification. On January 19, 2011, the Board dismissed the appeal with prejudice.

The contracting officer began issuing final decisions demanding Appellant pay for snow removal costs the Postmaster incurred at the Stewartsville post office. Appellant timely appealed each of the final decisions; the PSBCA consolidated the appeals. The contracting officer maintained that, because Appellant did not fully pursue the appeal challenging the decision that the contractor was liable for snow removal under the Lease, the decision on liability was binding. Respondent raised *res judicata* as an affirmative defense in the consolidated appeal.

The PSBCA granted the Government's motion for partial summary judgment. Appellant did not respond to the motion. In the absence of an explanation by Appellant, the Board ultimately accepted the argument in Respondent's motion. The Board explained that the regulations implementing the Contract Disputes Act ("CDA") for Postal Service contracts do not define "claim." The Board looked to the lease's Claims and Disputes clause implementing the CDA, noting that it provides a definition. Using that definition, the Board determined that Appellant's letter (which Appellant itself designated as a claim and which expressly requested a contracting officer's final decision and which sought interpretation of the lease) was a CDA claim. Therefore, the contracting officer's response that Appellant had responsibility for snow removal under the terms of the lease was "unequivocal in interpreting the lease responsibilities." As such, the contracting officer's final decision ought to have been appealed within 90 days for the Board to possess jurisdiction to address its merits, or within 12 months to vest jurisdiction with the U.S. Court of Federal Claims. Failure to file a timely appeal results in the contracting officer's decision becoming "final, conclusive, and not subject to review in any forum."

(*continued on next page*)

Case Digests (cont'd):

The Board found that the statutory period for Appellant to appeal the contracting officer's decision in the previously dismissed case had expired. Thus, the contracting officer's final decision that snow removal was Appellant's obligation under the lease is unreviewable. Only the scope of that responsibility as well as the quantum remained for the Board to address.

Appeal of Zafer Taahhut Insaat ve Ticaret A.S.
ASBCA No. 56770, September 14, 2011 – Judge Page
by Jessica Madon, Booz Allen Hamilton

The issue before the Board was whether the contractor, Zafer Taahhut Insaat ve Ticaret A.S. ("Zafer" or "Appellant") submitted a proper claim to the Army Corps of Engineers contracting officer. The Government argued in its motion to dismiss that the Appellant only submitted a request for equitable adjustment ("REA"), rather than an actual claim that could be appealed to the Board. The Government contended that the REA was merely a vehicle for fostering discussions and was not meant to be a claim. The Government specifically argued that the word "request" was substituted for "claim".

The Board rejected this argument, citing to *Reflectone, Inc. v. Dalton*, 60 F.3d 1572, 1575 (Fed. Cir. 1995) (*en banc*), explaining that a Contract Disputes Act ("CDA") claim does not need to be submitted in any particular form or use any particular wording, provided it contains a clear and unequivocal statement that gives the contracting officer notice of the basis and amount of the claim. The Board noted that the REA did contain a sum certain and contained a detailed breakdown of the issues upon which the amount was based. The Board expounded that allowing the Government to unilaterally determine when a submission meets the definition of a "claim" would undermine the CDA.

This Appeal affirms the longstanding holding that an REA can serve as a competent claim, provided the REA contains the basic requirements – a sum certain, the basis of the sum, and a certification.

Trygve Dale Westergard v. General Services Administration
CBCA No. 2522, September 15, 2011 – Judge Walters
by Christopher Noon, Sheppard Mullin Richter & Hampton LLP

The issue before the CBCA was whether the Appellant's appeal of a contracting officer's final decision was untimely. This case provides an important lesson in the interpretation of the period of appeal in the Contract Disputes Act ("CDA"), 41 U.S.C. §§7101-7109.

The Appellant's appeal stemmed from a General Services Administration ("GSA") auction contract under which the Appellant had bid on a boat for sale. The solicitation was accompanied by a photograph that depicted the boat with a boat trailer. Upon being awarded the contract for the boat, the Appellant sought to cancel the contract after learning that the boat

(*continued on next page*)

Case Digests (cont'd):

trailer depicted in the photograph was not included in the sale. Cancellation of the contract was denied and the Appellant asked for a final decision from the contracting officer so that he could begin the appeals process. The contracting officer transmitted a final decision denying the Appellant's claim via email dated February 23, 2011. However, it is not clear when the Appellant received this email message.

On July 18, 2011, the Appellant inquired about the status of the appeal he purportedly had filed with the Board several months earlier. The Clerk of the Board notified the Appellant that the Board had never received a notice of appeal. Since the Appellant was at sea with the U.S. Merchant Marine, the Appellant's father submitted a copy of the notice of appeal form on August 5, 2011 that he indicated had been submitted earlier.

The Government sought to have the Appellant's appeal dismissed for lack of jurisdiction because it alleged the Appellant filed the appeal more than 90 days after Appellant's receipt of the contracting officer's final decision on February 23, 2011. The Board denied the Government's motion to dismiss because the Government could not prove when the Appellant received the final decision.

Under the CDA, an appeal to the Board may be brought if filed within 90 days of <u>receipt</u> of the contracting officer's final decision (41 U.S.C. §7104(a) (emphasis added)). The contracting officer must transmit to the contractor a final decision "by certified mail, return receipt requested, or by any other method that provides evidence of receipt" (FAR 33.211(b)). Accordingly, the Government has the burden of proving the date of receipt by the contractor.

The Board held that the Government did not meet this burden when it could not prove the date the contractor received the email containing the contracting officer's final decision. Although it was clear that the Appellant received the email transmitted on February 23, 2011, the Government could not prove *when* the Appellant received this email. Therefore, the Government could not establish when the CDA's 90-day period began to run and, thus, could not demonstrate that the Appellant's appeal was untimely.

This case serves as an important reminder that the period of appeal in the CDA begins to run on the date of <u>receipt</u>, not on the date the final decision is sent. The Government assumed that the email would be received on the same date it was sent. However, without proof of receipt, the Government cannot assume the statutory period of appeal begins to run on the date the email was sent. In this case, the Board explained that the Contracting Officer could have sought and received from the Appellant a reply email confirmation for receipt of the final decision. It appears that this suggestion would allow contracting officers to meet the evidentiary burden and continue using email to transmit final decisions.

(*continued on next page*)

Case Digests (cont'd):

KD1 Development v. General Services Administration
CBCA No. 2075, September 20, 2011 – Judge Vergilio
by Ryan E. Roberts, Sheppard Mullin Richter & Hampton LLP

This case was first discussed in the June 2011 edition of the *Case Digests*. The core dispute between the parties is whether the lease agreement at issue allowed the contractor to recover operating costs in addition to the standard lease payments. Although the Government made additional operating cost payments initially, it stopped making these additional payments upon the arrival of a new contracting officer. In its decision on the parties' cross-motions for summary judgment, the CBCA held that the plain language of the parties' lease supported the agency's interpretation that operating costs were not reimbursable in addition to the standard lease payments. At the time, however, the CBCA could not determine, based on the record before it, whether the plain language of the lease accurately reflected the intent of the parties.

After reviewing a fully developed record, the CBCA held that there was inadequate support for the contractor's argument that the written agreement failed to accurately reflect the intent of the parties. The CBCA held that nothing in the record demonstrated that the Government intended the agreement to mean that it would reimburse the contractor for operating costs in addition to the lease payments.

Although the CBCA held in the Government's favor on entitlement, it limited the Government's total recovery. The CBCA noted that the Government is required by statute to submit claims against a contractor within six years of accrual. The Board held that, because the Government should have known the plain text of the lease did not entitle the contractor to reimbursement for additional operating costs, it could only recover operating costs already paid for six years prior to the Government's submission of its claim against the contractor.

The important point of this case has not changed since June – contractors must be sure that the contract incorporates all elements of the agreement. Although the Government's performance until the arrival of the new contracting officer demonstrated the Government's agreement with the contractors interpretation of the contract, the lack of written documentation cost the contractor over $200,000.

Appeal of General Dynamics Land Systems, Inc.
ASBCA No. 57293, September 21, 2011 – Judge Grant
by Townsend L. Bourne, Sheppard Mullin Richter & Hampton LLP

At issue in this case was whether the approach utilized by the contractor to determine allocation of residual home office expenses was proper. The contractor asserted that its approach was proper because it was based on an agreement made with the Government in 2003 regarding allocation of such costs. The Government did not dispute that the 2003 agreement provided for the approach used by the contractor to allocate its costs, but claimed that the 2003 agreement was not enforceable because it violated Cost Accounting Standard ("CAS") 403 and

(*continued on next page*)

Case Digests (cont'd):

was based on a unilateral mistake made by the Government.

CAS 403 establishes a formula for allocation of home office expenses to segments based on three factors: (1) payroll dollars; (2) business volume/operating revenue; and (3) capital invested/tangible capital assets plus inventories (CAS 403-50(c)(1)). The 2003 agreement between the contractor and the Government allowed for contracts in process to be included in the third factor, and so the contractor included unbilled receivables as part of its contracts in process under the third factor when making its cost allocations. The Government argued that unbilled receivables could only be included as revenue under the second factor, and not as inventories under the third factor. This position was advanced by the DCAA in an audit report, which concluded that the contractor's approach resulted in certain segments of the company shouldering a disproportionate share of residual home office expenses.

The Board agreed with the contractor's position that the 2003 agreement between the contractor and the Government called for inclusion of contracts in process under the third factor, but it declined to grant the contractor's partial motion for summary judgment, finding that a genuine issue of material fact existed with regard to whether the Government was in fact bound by the 2003 agreement. "Whether the government is bound by its agreement to include unbilled receivables (part of contracts in process) in factor three depends on whether the DCE [DCMA Defense Corporate Executive] was acting within the scope of his authority in agreeing to that." Thus, the Board left it to be determined whether the DCE had authority to bind the Government to "the mistaken legal position the agent agreed to." Because the Board could not determine as a matter of law that the Government was bound by the 2003 agreement, the Board did not examine the Government's unilateral mistake defense.

Appeal of Tzell Airtrak Travel Group Corp.
ASBCA No. 57313, September 22, 2011 – Judge Tunks
by Christine Roushdy, Vinson & Elkins

In hearing this motion for summary judgment, the ASBCA considered whether a contractor's anticipatory repudiation may be excused due to the Government's material misrepresentation. The Department of Defense ("DoD") argued that it was entitled to summary judgment as a matter of law because the Appellant's submission of a Notice of Proposed Cessation amounted to its anticipatory repudiation of the task order. However, Appellant argued that its repudiation was excused by the Government's intentional misrepresentation of material facts of the scope of work in the task order.

Appellant, Tzek Airtrak Travel Group Corp. ("TATGC"), was awarded a task order under a multiple award, IDIQ contract to provide travel reservation services for DoD. Appellant's proposed price was premised upon the Government's estimate of services to be performed under the task order. A portion of the reservations would be made via an automated

(*continued on next page*)

Case Digests (cont'd):

system, while others required the assistance of contractor personnel. The RFP's pricing instructions provided estimates of how much work would be done via the automated system or the personnel supported system. The RFP indicated that the estimated ratio of work would be a 50/50 mix.

Once performance began, Appellant submitted a request for an equitable adjustment ("REA") because the actual ratio of work ordered under the task order was in fact a 90/10 mix, with 90% of reservations being made by contractor personnel, thus requiring Appellant to hire the additional personnel to accommodate the adjusted ratio. After denial of the REA, Appellant notified the Government that, as a result of the inaccurate estimate, it would be unable to perform without an agreement to modify the contract. The contracting officer's response denied Appellant's allegations and included a show cause notice requiring assurances from the Appellant. When Appellant reaffirmed it would cease to perform without a modification, the contracting officer terminated the task order for cause.

In finding for the contractor, the ASBCA held that "a contract is voidable if a party's manifestation of assent was induced by either a fraudulent or a material misrepresentation by the other party upon which the recipient was justified in relying." Further, DoD's negligent or inadvertent misrepresentation, as opposed to one made in bad faith, had no bearing on whether Appellant was justified in relying upon DoD's representations as to the ratio of work under the task order. As such, the Board, drawing all reasonable inferences in favor of the movant, found that TATGC's repudiation of the contract was excused in light of DoD's misrepresentation.

The lesson here is for contractor's to be diligent in enforcing contractual requirements – a contractor need not perform above and beyond the scope of the contract without additional compensation.

Rockies Express Pipeline LLC v. Department of the Interior
CBCA No. 1821, September 27, 2011 – Judge Goodman
by Benjamin J. Kohr, Wiley Rein LLP

In *Rockies Express*, the issue before the CBCA was whether the parties' intentional, but erroneous, decision to not incorporate the applicable provisions of the FAR into their agreement rendered that agreement illegal. The Board held that the agreement was legal as the Government could not reverse its position on the applicability of the FAR at its leisure.

Rockies Express Pipeline LLC ("Rockies") and the Department of the Interior's, Minerals Management Service ("MMS") entered into a precedent agreement ("PA") in 2005 delineating certain conditions precedent, the occurrence of which would require MMS to enter into several contracts with Rockies to transport oil and natural gas via Rockies' pipeline. At the outset of the program that provided the impetus for this agreement (MMS' Royalty-in-Kind or RIK program), MMS asserted that it would utilize standard industry contracts to secure pipeline capacity, and therefore the transportation and sale of natural gas was not governed by the FAR.

(*continued on next page*)

Case Digests (cont'd):

Prior to the contract at issue, Rockies had never contracted with the Federal Government or performed a contract incorporating the FAR. Throughout their negotiations, MMS and Rockies agreed to make material deviations from the pro forma PA, but MMS never discussed the FAR with Rockies nor articulated its position that the FAR did not apply. Subsequent to entering into the PA, a Department of Interior solicitor independently determined that the FAR applied to transportation contracts under the RIK program.

When the PA's conditions precedent were satisfied, the parties attempted to enter into the required contracts, but MMS insisted on incorporating the applicable FAR provisions. When the parties were unable to execute the required contract, Rockies terminated the PA and filed a claim seeking damages for MMS' breach of the agreement. In response, MMS argued that its breach of the agreement was justified because the PA did not comply with the FAR and was therefore an unenforceable illegal contract.

The CBCA rejected MMS' position, noting that the applicability of the FAR was not dispositive in this case. If the FAR did not apply to this procurement, the Board reasoned, then MMS' failure to enter into the required agreements constituted a material breach of the PA. If the FAR did apply to this procurement, the award should only be set aside as illegal where the contractor's actions or statement invited the illegal award or when the illegality itself was so obvious that the contractor should have recognized it. The Board noted that Rockies had never performed a contract with the Federal Government and therefore had no knowledge of the FAR's requirements. Furthermore, for MMS to adopt one position during negotiations with Rockies, only to later state that Rockies should have known the opposite was true, was found to be "hardly worthy of our great government" and contrary to the Board's duty to protect innocent contractors. Finally, the Board noted that the FAR contains deviation provisions that clearly contemplate the unique circumstances that arose in the case, allowing a deviation from the FAR to maintain the legality of the agreement. Thus, the CBCA concluded that a material breach had occurred and that Rockies was entitled to recover.

The primary lesson from CBCA's holding is for contractors to ensure they have an adequate understanding of the requirements imposed when contracting with the Federal Government, but that protections are in place for the innocent contractor should the Government subsequently reinterpret those requirements.

Appeal of Environmental Safety Consultants, Inc.
ASBCA No. 51722, September 28, 2011 – Judge Freeman
By Gregory Hallmark, Holland & Knight LLP

The issue before the ASBCA in this appeal was whether a default termination for failure to complete the work within the specified time was proper where the Government terminated the contract eleven months after its completion date had passed.

(*continued on next page*)

Case Digests (cont'd):

The Government awarded Environmental Safety Consultants, Inc. ("ESCI") a contract on November 13, 1995 to remove old fuel storage tanks and install new ones. The contract completion date was August 16, 1996. ESCI got a late start performing, then proceeded slowly. By August 21, 1996, it had completed only 30-35 percent of the contract work. On October 4, 1996, by which time ESCI had completed less than half of the work, the Government threatened ESCI with default termination and forced ESCI to subcontract the remaining work. ESCI hired a subcontractor, which abandoned the work site on June 16, 1997, with a large unpaid balance due from ESCI.

On June 24, 1997, the parties executed a contract modification that required ESCI to subcontract all remaining work and extended the completion date to June 30, 1997. On September 30, 1997, the contracting officer threatened ESCI with default termination if it did not complete the work by October 3, 1997. On January 3, 1998, the contracting officer again issued a cure notice, giving ESCI ten days to cure a list of discrepancies and again threatening default termination. On January 22, 1998, the contracting officer asked ESCI to show cause why the contract should not be terminated for default. On April 10, 1998, the contracting officer again threatened default termination if an agreement could not be worked out with a surety and a subcontractor to complete the work. On May 8, 1998, the Government issued another show cause letter.

On June 12, 1998, almost one year after the specified completion date, the contracting officer terminated the contract for default for failure to perform the work within the specified time. ESCI appealed the default termination.

The ASBCA sustained the appeal and converted the termination into one for convenience. In the Board's judgment, the Government's actions indicated that the specified completion date was not "of the essence of the contract." When the June 24, 1997 contract modification established the June 30, 1997 completion date, the Government plainly did not contemplate that performance would be completed within one week. The Government subsequently engaged in an extended period of "dalliance," continually reserving its rights, but giving ESCI more chances to complete the work and taking no action to terminate for eleven months. Because the June 30, 1997 completion date was not "of the essence," the Government could not issue a termination for default without first establishing a new, reasonable completion date.

In short, even where a contractor's performance lags far behind schedule, the Government may not be able to terminate for default for failure to complete the work on time if its actions show that time is not of the essence

Living Tree Care, Inc. v. Dept. of the Interior
CBCA Nos. 2008, 2204, October 5, 2011 – Judge Borwick
by Oliya Zamaray, *Holland & Knight LLP*

In *Living Tree*, the CBCA decided whether a contractor is entitled to an equitable

(*continued on next page*)

Case Digests (cont'd):

adjustment for costs incurred in its contract for storm cleanup when it undertook performance outside of the scope of the contract and when its subcontractor incurred fines for illegal conduct.

The National Park Service ("NPS") issued a Request for Quotations ("RFQ") for cutting and removal of storm-damaged and fallen trees within and adjacent to specified roads and trails of the Ozark Riverways. The NPS divided the project into three sections and estimated that the three sections would be roughly equal in the work required, but warned that actual quantities could differ. Therefore, the RFQ strongly urged all bidders to attend a scheduled site visit before submitting a quote. The owner of Living Tree Care ("Appellant"), attended the site visit but did not rely on the road list the NPS supplied to determine the scope of work that would serve as the basis of its quote. Appellant did not fully appreciate the scope of the contract, resulting in delays and increased costs of performance. The NPS issued a modification to extend the contract due date, and allowed Appellant to perform additional brush clearing in lieu of damages for the delay. Appellant submitted a claim for costs associated with alleged extra work, as well as work performed at the direction of the contracting officer's representative, and costs associated with the payment of a fine its subcontractor incurred.

NPS argued that, as a result of the modification, Appellant's claims were barred by accord and satisfaction. The CBCA disagreed, noting that the NPS was confusing the doctrine of accord and satisfaction with release. Quoting the Federal Circuit, the Board explained that "in accord and satisfaction a claim is discharged because some performance other than that which was claimed to be due is accepted as full satisfaction of the claim. A release, in contrast, is a contract whereby a party abandons a claim or relinquishes a right that could be asserted against another." When NPS accepted Appellant's additional brush clearing (accord) in satisfaction of NPS's claim for damages, the "Government extinguished its claim for damages." The modification did not resolve Appellant's other claims, nor did the Appellant release the Government from any other claims Appellant might file in the future.

The Board held that Appellant could not prevail on its claim for the alleged extra work for a number of reasons. First, some of the alleged "extra" work was actually within the scope of the contract. Second, Appellant could not prove that the any of the "extra" work it performed was done at the instruction from an NPS official authorized to bind the Government in contract. Furthermore, the Board held that the "Government is entitled to strict compliance with the specifications irrespective of whether the contractor believes it has devised a better or more economical way of performing the work." Lastly, Appellant could not recover the fine its subcontractor incurred because "reimbursement for fines is an unallowable cost, except when incurred as a result of compliance with specific terms and conditions of the contract" (see FAR 31.205-15).

(*continued on next page*)

Case Digests (cont'd):

Appeal of SRI International
ASBCA No. 56353, October 5, 2011 – Judge Ting
by Tara L. Ward, Wiley Rein LLP

In this case, the ASBCA considered the Government's motion for reconsideration of the Board's February 18, 2011 decision concluding that indirect costs of maintaining a Letter of Credit ("LOC") in fiscal years ("FY") 2005 and 2006 – claimed as general and administrative ("G&A") costs – were allowable. In particular, the Government sought clarification of the Board's statement that the appeal was "sustained in the amount of $609,621 with interest pursuant to 41 U.S.C. §611 running from the putative receipt date of 21 September 2007," which the Government asserted could be interpreted as awarding SRI a lump sum plus interest.

The Board agreed that clarification was necessary, as it had not intended to suggest that a lump sum award interest was necessary or even appropriate. The Board explained that it had held SRI's LOC costs to be allowable indirect costs such that SRI was entitled to include those costs in its indirect G&A cost pool for those years. However, the Board explained that SRI was still required to allocate the allowable LOC costs to affected contracts before the actual amount of allowable costs under each contract could be determined. As such, the Board concluded that "the final indirect cost rate establishment process must run its course," and a lump sum payment would be improper.

In so holding, the Board explained that its decision in *ATK Launch Systems*, ASBCA No. 553959, 09-BCA ¶34,188, and the Court of Federal Claims' decision in *ATK Thiokol, Inc. v. United States* ("*ATK III*"), 76 Fed. Cl. 654 (2007), did not require otherwise. The Board explained that, contrary to SRI's contention, neither case stands for the principle that a contractor need not recover disputed indirect costs through the final indirect cost rate process. In fact, both cases assigned the Government the task of establishing a final indirect cost rate: "Ultimately, a final indirect cost rate and the final amount due under each contract will be established by the [the Government], reconciling any payments that have been paid out on an interim basis, including any damages awarded by the court." *ATK Launch Systems*, 09-1 BCA ¶34,188 at 168,707 (quoting *ATK III*, 76 Fed. Cl. at 668).

The Board remanded the appeal to the Administrative Contracting Officer ("ACO") to determine the amount of LOC costs due for FY2005 and FY2006, and modified the last sentence of its February 18, 2011 opinion to state: "Accordingly, this appeal is sustained. Interest pursuant to 41 U.S.C. §7109 is to run from 21 September 2007."

In sum, where a contractor's indirect costs are deemed allowable, an agency board will not award those costs in a lump sum, but rather will rely on the final indirect cost rate establishment process prescribed by the FAR, including the allocation of allowed costs to affected contracts.

(*continued on next page*)

Case Digests (cont'd):

Appeal of Moshe Safdie and Associates, Inc.
CBCA No. 2386, October 13, 2011 – Judge Pollack
by Katherine Allen, Buchanan Ingersoll & Rooney, PLLC

In *Moshe Safdie and Associates, Inc*., the CBCA denied Appellant's Motion for Summary Relief, which alleged a redesign remedy contained in a "Design Within Funding Limitations" clause (FAR 52.236-22) is the sole and exclusive remedy that can be utilized by the Government.

The General Services Administration ("GSA") issued a contract to Moshe Safdie and Associates, Inc. ("MSA") to design a new courthouse in Springfield, Massachusetts which could be constructed for $35 million. MSA brought a claim of approximately $3 million for uncompensated changes to the design efforts. GSA filed an affirmative counterclaim for $5,275,880, alleging MSA's failure to deliver a design that could be built within the target budget until twenty months after the contract due date caused GSA to incur escalated construction costs. Alternatively, GSA requested any amount due to MSA be offset by these damages.

Notably, the design contract incorporated FAR 52.236-22, the "Design Within Funding Limitations" clause, also known as a Limitation of Funds ("LOF") clause. The clause states in relevant part that "[w]hen bids or proposals for the construction contract are received that exceed the estimated price, the contractor shall perform such redesign services as are necessary to permit contract award within funding limitation."

MSA argued that where a contract provides a specific performance remedy, that remedy is the sole and exclusive remedy which can be used by the Government, to the exclusion of consequential or other damages. MSA also argued that if the law doesn't mandate a legal bar to additional damages, the LOF clause limits the Government's remedy solely to performance of a redesign, negating the Government's entitlement to consequential or actual damages.

The CBCA concluded that there is no black letter bar to the Government pursuing both specific performance and actual or consequential damages. The determination of any such bar will be case specific. There were too many questions of law and fact regarding the specific LOF clause at issue in this case, making it inappropriate for resolution on a summary relief basis.

Thus, contractors should be aware that they may be liable for damages above and beyond those outlined in an LOF clause.

(*continued on next page*)

Case Digests (cont'd):

Appeals of Charles Mullens
ASBCA Nos. 56927, 57432, October 13, 2011 – Judge Freeman
by Jeffery M. Chiow, Rogers Joseph O'Donnell, P.C.

The contractor appealed both the no-fault termination of his concession contract and the denial of his $90,000 claim alleging that the Government terminated his contract in bad faith and the Government moved to dismiss both claims. Charles Mullens provided boat and recreational vehicle maintenance for the Fort Huachuca, Arizona Morale Welfare and Recreation ("MWR") Fund. The daughter of a civilian MWR financial officer allegedly removed her boat from Mullens' facility without paying the repair bill. Shortly thereafter Mr. Mullens' contract was terminated. At the time of the termination, Mr. Mullens' contract option had not been exercised due to an acknowledged "government oversight." The concession contract was not covered by the Contracts Disputes Act, but rather by "the rules and regulations promulgated" for non-appropriated fund instrumentalities. The contract included a Disputes clause similar to the CDA Disputes clause.

With respect to the first claim appealing his termination, Mr. Mullens argued that his eviction from Fort Huachuca was a final, appealable order and that the contracting officer's denial of his claim cured any alleged jurisdictional defects. The Board found that it lacked jurisdiction over the first claim because the termination was an exercise of the Government's rights and not a "claim" cognizable under the contract's Disputes clause.

Regarding Mr. Mullen's second claim alleging bad faith, the Government argued that there was no contract in place, and therefore the Board lacked jurisdiction. The Board noted that Mr. Mullens submitted a claim in a sum certain for a Government breach of a contract and that the contracting officer issued a final decision under the Disputes clause which Mr. Mullens timely appealed. Thus, the Board found it had jurisdiction. Whether there was an inadvertent failure to exercise the option and whether Mr. Mullens' continued performance was ratified went to the merits of the appeal according to the Board. The decision made clear that the result would have been the same if the contract was covered by the CDA.

Contractors should understand that a no-fault termination, without more, is not a government claim. Additionally, this decision emphasizes the importance of complying with the Disputes clause in order to preserve a contractor's claims.

Appeal of D.J. Miller & Associates, Inc.
ASBCA No. 55357, October 13, 2011 – Judge Page
by Daniel Strouse, Wittie, Letsche & Waldo LLP

The ASBCA had to determine if the Centers for Disease Control and Prevention ("CDC" or "the Agency") wrongfully diverted work under a requirements contract to other contractors and government employees.

(*continued on next page*)

Case Digests (cont'd):

The Agency entered into a requirements contract that required it to purchase Call Management Services and On-Site Teleconferencing from D.J. Miller & Associates ("DJMA"). The Contract specified that DJMA would use complex telephone equipment to perform as an operator and set up teleconferences. In addition, DJMA would perform "ancillary services," such as receptionist services, when relevant to the calls.

The orders from the Agency drastically declined over the term of the contract. DJMA attributed this to: 1) a lifted hiring freeze, which allowed the Agency to hire DJMA employees; 2) the Agency's hiring of Elite to provide temporary employment services that included secretarial work; and 3) the Agency's hiring of DESA to perform conference support work, including teleconference support.

DJMA filed a claim with two bases: underpayment of the Contract and diversion of required services in bad faith. The Agency paid the claim for the first ground to the IRS, pursuant to a lawful levy, but denied the diverted requirements claim; DJMA appealed.

DJMA argued that the Agency acted in bad faith by failing to utilize the maximum estimated services, hiring its employees, and paying its claim directly to the IRS. It argued that Elite's contract overlapped with its Contract requirements because Elite also performed secretarial duties including answering phones and transferring calls. DJMA also argued that DESA's contract overlapped with the requirements of its Contract because both required teleconference support.

The ASBCA held that under a requirements contract the Agency is only required to purchase the services specified in the contract. It concluded that the services specified in the Contract were different than the work specified in the DESA and Elite contracts. The work involved different requirements and different skills. The ASBCA emphasized that DESA and Elite used simple phone systems, as opposed to a complex phone system. Further, during the term of the Contract, the Agency increasingly relied upon its website and clearinghouses to provide information to the public, minimizing the requirements under the Contract.

With regard to the Agency hiring DJMA employees, the ASBCA found that Agency did not act in bad faith. The ASBCA noted that under a requirements contract, the Government may vary its requirements, if it does so in good faith. The party alleging a breach bears the burden of proving bad faith, which involves showing a lack of a valid business reason for ordering less from the contract or intent to injure the contractor. The ASBCA held that DJMA merely offered the opinions of its own witnesses that the Agency acted in bad faith—it did not offer any credible evidence. The ASBCA dismissed the assertion that the Agency acted in bad faith by paying its claim to the IRS because the payment was in accordance with a lawful levy and was made four years after contract performance.

Practitioners should take note – a claim for diverted work under a requirements contract should be directly tied to the requirements.

(*continued on next page*)

Case Digests (cont'd):

Appeal of Thomas Assocs., Inc.
ASBCA No. 57126, October 18, 2011 – Judge James
by John Sorrenti, McKenna Long & Aldridge LLP

In this case, the Government motion for reconsideration of the ASBCA's May 17, 2011 decision in which the Board held that the contracting officer ("CO") was required to waive FAR 42.709-1(a)(1) penalties for individual unallowable costs submitted by the contractor. The Government argued that the Board erred because waiver of penalties is required only when the aggregate of all unallowable costs at issue is under the $10,000 threshold, as set by FAR 42.709 -5(b), and that the waiver does not apply to individual unallowable costs.

The FAR provisions in question implement 10 U.S.C. §2324, which provides that contractors are subject to penalties when they submit a settlement proposal for indirect costs that includes an unallowable cost that violates a cost principle in the FAR or DFARS. In examining the FAR provisions, the Board noted that FAR 42.709-1(a) refers to "indirect cost" in the singular and thus the statutory and regulatory penalties apply to an expressly determined unallowable cost. However, the Board then noted that FAR 42.709-5(b) refers to "the unallowable costs" in the plural, and thus the statutory and regulatory provisions requiring waiver of the penalty apply to the amount "of the unallowable costs" in the contractor's proposal.

Because of this apparent conflict, and thus uncertainty, regarding the FAR provisions, the Board looked at the explanatory statements of the drafters of the regulation to determine the appropriate interpretation. The Board found that the drafting team clarified its meaning in response to a comment on the original proposed version of the FAR provision. Specifically, the Board found that the drafting team "evinced the intent that the FAR 42.709-5(b) $10,000 waiver threshold referred to the portion of the total penalizable costs (included in a settlement proposal) allocated to covered contracts as opposed to individual cost elements." Accordingly, the Board granted the Government's motion for reconsideration and modified its earlier opinion to reflect that the waiver of the penalty did not apply because the aggregate of the individual cost elements was over $10,000.

As a result of this opinion, contractors should be aware that any penalty assessed under FAR 42.709-1(a) will still apply, even if the individual cost elements are each under $10,000 as long as the aggregate amount of the cost elements is greater than $10,000.

Appeal of Raytheon Co.
ASBCA No. 54907, October 31, 2011 – Judge Delman
by Ryan E. Roberts, Sheppard Mullin Richter & Hampton LLP

This case required the ASBCA to interpret the meaning of "full compensation" in CAS 413. Raytheon sold two business segments (one each in 1998 and 2000) which constituted

(*continued on next page*)

Case Digests (cont'd):

"segment closings" under CAS 413.50(c)(12). Each segment had a pension fund surplus for which Raytheon owed the Government an adjustment. The Federal Circuit held that Raytheon's failure to pay this adjustment constituted a violation of CAS 413 entitling the Government to interest, compounded daily, on the owed amount. On remand, the ASBCA had to decide over what period this interest should be measured.

CAS 413 states that interest will accrue until the "United States receives full compensation for the price adjustment" owed. Raytheon argued that the Government receives full compensation when the price adjustment is paid without interest. The Government argued, however, that it is fully compensated only when the adjustment plus interest is paid.

The ASBCA agreed with the Government, holding that "full compensation" includes the payment of interest. The Board cited Federal Circuit precedent for the well recognized meaning of "full compensation" in ordinary contract cases – precedent which stated that full compensation includes the payment of interest.

Additionally, the ASBCA rejected Raytheon's textual argument that the purpose of including "full compensation" in CAS 413 was to make it clear that interest compounded until the Government received the full amount of the price adjustment. The Board held that Raytheon's interpretation failed to give any reasonable additional meaning to the term "full compensation." Even without the inclusions of "full compensation" in the regulation, the Board held, Raytheon would be required to pay the adjustment owed and applicable interest as "part of its overall responsibility under the statute."

Given the ASBCA's interpretation of CAS 413, contractors should strongly consider paying any owed adjustments, plus interest, as soon possible. Otherwise, interest on the amount owed will continue to compound daily until the Government receives its "full compensation."

Case Digests (cont'd):

Anatomy of an Arbitration: Arbitrating Subcontract Disputes

by

*Kenneth M. Jackson**

Suppose that two companies decide to form a teaming agreement to try to win a federal contract. They are successful, and under the terms of the agreement, one will be the prime contractor and the other the subcontractor. In one scenario, during the formation of the subcontract, the subcontractor is upset about the alleged failure of the prime contractor to allocate the work in accordance with the teaming agreement. In a second scenario, suppose that the contract and subcontract performance is proceeding according to plan when it is interrupted by numerous changes, constructive changes, and partial terminations. The parties are unable to agree on any aspect of, or even the fact of, such changes or the nature (default or convenience) of the terminations.

In either case, the subcontractor might have filed suit to seek its remedies, and the prime contractor filed counter-claims and defenses, and the long, expensive, and ultimately unsatisfactory process of litigation might have begun. Fortunately, the contract managers for both the prime contractor and the subcontractor realized that a conflict might arise during the course of the teaming agreement or the subcontract and agreed on an alternative dispute resolution clause for both the teaming agreement and the subcontract. They understood that when contractors and subcontractors have an ongoing business relationship and interdependency, their wisest course is to settle their differences by negotiation or mediation. Pre-dispute clauses can be broadly written to provide for informal steps in dispute resolution before engaging in litigation, or even a mediation or arbitration process, and before hiring attorneys or neutral mediators or arbitrators. As a member of the management team, the contract manager should understand the anatomy of dispute resolution processes before agreeing to the terms of an alternative dispute resolution clause. This article describes one of the important alternative processes, arbitration, and provides sources of information for drafting dispute resolution and arbitration clauses.

When Arbitration Becomes Necessary

When a contract manager and the rest of the management team realize that a dispute between the parties can only be resolved by a binding decision of a third party—such as a judge or an arbitrator—because informal efforts and mediation have failed, arbitration often is, and can be made to be, more advantageous than litigation.[1] Federal statutes and court decisions are supportive of arbitration.[2] Alternative dispute resolution between the U.S. federal government and its prime contractors in appropriate cases is encouraged by procurement regulations.[3] Prime contractors and subcontractors, higher-tier subcontractors and their subcontractors and vendors, team members, and joint venturers may enter into agreements whereby disputes between them will be resolved by an arbitrator's (or a panel of three arbitrators') decision and

(*continued on next page*)

Anatomy of an Arbitration (cont'd):

award.[4]

Pre-dispute arbitration agreements may be included in the terms and conditions of the subcontract, teaming agreement, or joint venture agreement. If not, the parties can agree to arbitrate by entering into a separate "submission agreement," which specifies details about the conduct of the arbitration. Even if there is a pre-dispute arbitration agreement, the parties can agree to supplement it with a submission agreement. Any such supplement should be crafted with an eye toward ensuring an economical and efficient process. This is useful when the pre-dispute arbitration agreement does not address all of the factors that should govern the arbitration. Time-tested arbitration rules, such as the American Arbitration Association's Commercial Arbitration rules, will address most governing factors.

There are some constraints, however. Contracting officers shall not consent to subcontracts that make the results of arbitration, judicial determination, or voluntary settlement between the prime contractor and the subcontractor binding on the government.[5] Also, cost principles make the costs of legal, accounting, and consulting services in connection with the defense or prosecution of lawsuits or appeals between contractors arising from teaming arrangements or joint ventures unallowable, unless incurred as a result of compliance with specific terms and conditions of the prime contract or written instructions from the contracting officer or when agreed to in writing by the contracting officer.[6]

Advantages Over Litigation

Nevertheless, arbitration between contractors and subcontractors remains a viable and advantageous alternative to litigation, provided that it does not become equivalent to litigation in terms of time, expense, consuming of the time of management and other human resources, or inflexibility. The advantages of arbitration also include:

- Confidentiality;
- Administration by the American Arbitration Association (AAA)[7] or another provider such as JAMS[8] or CPR[9];
- The ability to select neutral and experienced arbitrators with expertise;
- The ability to tailor remedies;
- Limitations on formalities; and
- Forum control.

While the use of a not-for-profit provider (also called an "institutional convener" or "administrator") such as the AAA involves an expense, there are a number of advantages that would be absent without a provider. These include:

- Ensuring and maintaining the integrity of the process;
- Panels of qualified, experienced, and evaluated arbitrators;
- A code of ethics for arbitrators;
- Case management services;

(*continued on next page*)

Anatomy of an Arbitration (cont'd):

- Electronic document management tools;
- Rules and procedures adapted to the types of disputes (commercial, large complex cases, employment, construction, etc.); and
- A comprehensive library and information center.

Without an administrator, the parties to an *ad hoc* arbitration would have to develop a carefully and thoroughly drafted submission agreement, detailed procedural rules, exert extra care in selecting an arbitrator, and seek judicial intervention for the resolution of procedural disputes.

The Arbitration Agreement

The first determinant for realizing the advantages of arbitration is the arbitration agreement. Poorly drafted arbitration clauses and submission agreements are a pitfall for the unwary. They should:

- Cover all disputes;
- Include all potential parties;
- Provide a sound methodology for selecting the arbitrator or panel of arbitrators;
- Specify the place of arbitration and governing law; and
- Provide for limitations on discovery, entry of judgment, and correction of factual or legal substantive errors that affected the decision.

Drafters of arbitration agreements should consult available guides, such as the AAA's Drafting Dispute Resolution Clauses.[10]

Choosing the Arbitrator

Poor choices of arbitrators can be a significant pitfall. Use of an administrator with a panel of experienced, neutral, and procurement-savvy arbitrators from which the parties can choose is a first step to avoid disappointment. Resources are available to help in this process.[11] The parties should evaluate a potential arbitrator's résumé, review any publicly available awards, consider his or her publications and presentations, check references, and look for evidence of strong case management skills that will promote an efficient arbitration.

Best Practices in Arbitration

There are also pitfalls arising from failure to follow best practices, such as the following:

- Getting a reasonably firm estimate of arbitration costs and expenses from the arbitrator or administrator following the preliminary conference;
- Obtaining reasonably estimated legal fees and expenses from outside attorneys;

(*continued on next page*)

Anatomy of an Arbitration (cont'd):

- Insisting that attorneys will not expand discovery and motion practice to be equivalent to litigation;
- Expediting arbitration;
- Insisting on fact pleading;
- Providing for the direct exchange of motions and documents with the arbitrator;
- Maintaining civil and cordial relationships with the other party;
- Insisting that your attorneys cooperate with opposing counsel on all aspects of the case;
- Continuing settlement efforts;
- Using a single arbitrator in appropriate cases; and
- Addressing the issue of communications with witnesses during their testimony by seeking an order to restrict communications during cross-examination.

Fortunately, there is an excellent resource available for business users, in-house counsel and outside attorneys, and arbitrators that provides sound advice for promoting economy and efficiency in arbitration. The College of Commercial Arbitrators has published its "Protocols for Expeditious, Cost-Effective Commercial Arbitration" included in the second edition of its *Guide to Best Practices in Commercial Arbitration*.[12] In addition, there are many other sources of information available for keeping abreast of developments in arbitration law and practice.[13]

Pre-Hearing Conference

A key step in the arbitration process is the initial pre-hearing conference, which is conducted by the arbitrator, normally in a telephone conference call. Experienced counsel know the agenda generally, and the two sides will consult with each other in advance of the hearing to agree upon anything that may not be covered in the arbitration or submission agreement; e.g., dates and specific location of the evidentiary hearing, parameters of discovery, motion practice, logistics, briefing schedules (if needed), the law and rules that will govern the arbitration, and the issues to be arbitrated. It is often helpful for the contract managers to be listening in to the call with their attorneys, because they may have practical guidance for the attorneys, such as document production capabilities, scheduling conflicts, specific knowledge of the disagreements, and information about prior settlement discussions.

The arbitrator will identify the documents received, such as the "Demand for Arbitration," the "Statement of Claim," the agreement between the parties that provides for arbitration, the "Answer and any Counter-Claim," and the parties' checklists for conflicts. The arbitrator will also ask if any other documents have been filed with the administrator/provider. He or she will want to know if there are any undisclosed or undetermined claims. The possibility of a bifurcated hearing will be discussed, whereby a hearing will be held on liability, and, assuming that liability is found, a second hearing held on damages.

(*continued on next page*)

Anatomy of an Arbitration (cont'd):

The arbitrator will identify the scope of the claim and any counter-claim; e.g., the compensatory damages, attorneys' fees, arbitration costs, and interest. If the case warrants and counsel wish to submit pre-hearing briefs, dates will be set for those. Those briefs should specify a detailed statement of claims and counterclaims, damages, defenses, a statement of issues asserted by each party, and their positions with respect to each of them, as well as legal authorities. A date will also be set for any motion to join additional parties, and a date for filing any dispositive motions and response and reply dates for any such motion. Dates will also be set for the identification of witnesses and for expert witnesses. Absent objection, the parties will be reminded that the disclosures should include the full name of each witness, a short summary of expected testimony, and copies of any expert reports and the expert's *curriculum vitae*.

Likewise, a date should be set for the advance filing and identification of exhibits. Sometimes a joint notebook of exhibits is practical. If not, the parties will be instructed to bring one copy of the proposed exhibits for the arbitrator and one for the other party. Usually, a third copy is required for the ease of witnesses whose testimony will involve the need to refer to a number of documents during the course of their testimony.

It is a usual practice to ask the claimant to make a brief statement of the claim and the respondent for a brief statement of the answer, and then to ask both parties if the issues to be arbitrated can be agreed upon at the time of this pre-hearing management conference. If there are any stipulations or declarations of uncontested facts, exhibits, or witnesses at the time of the preliminary hearing, that data can be documented. Otherwise, a date by which such data shall be submitted can be set.

There should be discussions about discovery, such as dates for propounding and answering interrogatories and dates for requesting and producing or objecting to requests for documents and subpoenas. If a witness cannot be subpoenaed or cannot attend the arbitration, the parties will be asked if affidavits or depositions will be permitted. The arbitrator will set a notice date, typically 10 days advance notice, in case another preliminary or motions hearing is necessary.

The parties may wish to submit post-hearing briefs, and may do so if allowed by the arbitrator. If so, those dates can be set in this preliminary hearing, or, more likely, they will be set at the conclusion of the evidentiary hearing. If the form of the award, discussed below, is not otherwise specified, the parties should address that question. Do they want a standard award, a reasoned award, or a decision with findings of fact and conclusions of law? Each of these options carries different cost and time burdens as discussed below.

The arbitrator will ask if either party wishes to raise questions on any matters that will apply in the evidentiary hearing; e.g., burdens of proof, burdens of going forward, standards of proof, or rules of evidence.[14] The arbitrator also seeks to work with counsel for any timesaving suggestions. He will remind the parties of the rules regarding *ex parte*

(*continued on next page*)

Anatomy of an Arbitration (cont'd):

communications, and any other applicable rules. Finally, the arbitrator should commit to a time by which a scheduling order will be submitted to the parties or to the administering agency, if any. The parties can agree to accelerated or direct exchange by simultaneously transmitting documents to the arbitrator and to opposing counsel in lieu of submitting them through the administrative provider.

To promote efficiency in evidentiary hearings, the arbitrator may suggest the use of written submissions and telephonic or televised conference calls as well as in-person hearings. The arbitrator, recognizing that the Federal Arbitration Act provides as one of the grounds for a court to vacate an arbitrator's award the refusal to hear evidence pertinent and material to the dispute, may suggest to counsel that they not devote much time to objecting to evidence or testimony without sound reasons for doing so. The arbitrator serves as trier of both fact and law, and should be capable of assessing evidence for what it is worth. If the parties prepare a joint exhibit notebook and present contemporaneous joint expert testimony focusing on the points of disagreement, considerable time and expense can be saved. There will be a discussion about the use of a court reporter for the hearing.

Evidentiary Hearing

After identifying the arbitrator's name and the style of the case; the date, time, and place of the hearing; and reminding the parties of the governing rules and scope of the hearing, the arbitrator identifies any additional disclosures; asks for reconfirmation of his authority; and asks counsel, the parties, and witnesses to identify themselves and sign a roster with name, title, affiliation, and role in the proceeding. A reminder is given that a record is being made of the proceedings. The witnesses are sworn in. The arbitrator will submit into the record "Arbitrator's Exhibit No. 1," which basically consists of the claim, answer, motions, responses, dispositions, and any other documents received by the arbitrator in advance of the hearing. The arbitrator will remind the parties of the prohibition of *ex parte* communications during the hearing, and request that everyone involved exhibit the highest standards of civility and professionalism during the hearing.

The parties are then invited to submit any motions. Typically, there will be a motion to sequester non-expert witnesses. Expert witnesses should be identified. Often, to accommodate witness schedules, arrangements will be made to call a witness out of order. The parties are reminded of the agreed form of award.

The arbitrator will ask the parties if they have any questions or concerns regarding the procedures or if there are other preliminary matters they wish to raise. The parties will be advised that omissions in opening statements will not constitute waiver of a defense or claim. Assuming it is true, the arbitrator will note that no amended or new claims or counterclaims have been filed, nor have any additional parties been joined within a requisite number of days before this hearing.

(*continued on next page*)

Anatomy of an Arbitration (cont'd):

The parties will start with opening statements, although the respondent may defer until he or she puts on his or her direct case. If there are joint stipulations of fact not otherwise before the arbitrator, the arbitrator will ask that they be read into the record at the outset of the opening statement. Usually, the arbitrator will state that the respondent has the right to cross-examine, and the claimant has the right to redirect. After the claimant has rested, the respondent will put on its defense and/or counterclaim. The claimant has the right to cross-examine, and the respondent has the right to redirect. The arbitrator typically will withhold any questioning of witnesses until the parties have concluded their examination, unless something is not clearly heard or needs clarification.

Following closing arguments, the arbitrator may have questions of counsel, confirm that neither party has further proof to offer or witnesses to be heard, set the date for filing of post-hearing briefs, if applicable, set a date for the close of evidence, the date by which the hearing will be declared closed, and the date by which the award will be made. As appropriate, the parties and counsel are complimented on their competence, civility, and professionalism.

Award

There are several forms awards can take. A standard award may be limited to a simple decision in favor of one party. An itemized award breaks down an award into specific parts. A reasoned award provides a written explanation of why the arbitrator decided the way he or she did. An award that includes findings of fact and conclusions of law is more comprehensive, and, frankly, more expensive. Regardless of the type of award, the arbitrator should prepare a responsible award; i.e., one that provides complete information regarding parties, counsel, applicable laws, rules and regulations, the arbitration or submission agreement, dates and summaries of claims and counter-claims, prior awards (if the case is bifurcated into liability and damages phases), hearing dates, and solicitation of further evidence at the close of the case. The decision should dispose of all claims, state the relief granted and to whom, costs of arbitration, attorneys' fees and expenses, incorporate all interim awards verbatim, and deny all claims not expressly allowed or denied.[15] Once the award is dated and signed, the arbitrator's jurisdiction is ended.[16]

Conclusion

In conclusion, if in forming a contract, subcontract, teaming agreement, or joint venture you accept the possibility, however unlikely, of an intractable conflict with the other party, the use of a dispute resolution clause that provides for arbitration where negotiation and mediation fails can resolve disputes fairly, efficiently, and economically with a final, binding, and enforceable decision. While it is possible that arbitration will be as expensive as litigation, better practices are available for parties, their attorneys, and arbitrators that will minimize the legal and other expenses, shorten the time consumed by management and employees that is

(*continued on next page*)

Anatomy of an Arbitration (cont'd):

diverted from their normal responsibilities, limit public information about the dispute, and provide the possibility of retaining a valued business relationship that would be lost with protracted litigation.

---

* - Kenneth M. Jackson, Esq., CPCM, NCMA Fellow, is a member of the Music City Chapter of NCMA. He provides mediation and arbitration services through the American Arbitration Association, the Financial Industry Regulatory Authority, the Better Business Bureau, the Mediation Group of Tennessee, the Nashville Conflict Resolution Center, and privately. He is a past national president of NCMA and is an Honorary Life Member.

Endnotes

[1] - *For an instructive comparison*, *see* Jeffrey R. Cruz, "Arbitration vs. Litigation: An Unintentional Experiment," *available at* www.adr.org/si.asp?id=4289.
[2] - Administrative Dispute Resolution Act, 5 U.S.C. §§571–584, and Chapter 1 of the Federal Arbitration Act, 9 U.S.C. §§1–16.
[3] - Federal Acquisition Regulation (FAR) 33.214.
[4] - For ease of reference, it will be assumed that a single arbitrator is used. An arbitral panel may be appropriate for disputes involving very large sums of money and in certain other circumstances.
[5] - FAR 44.203(b)(4).
[6] - FAR 31.205-47(f)(5).
[7] - Information concerning AAA commercial rules and administrative services can be found at www.adr.org.
[8] - *See* www.jamsadr.com.
[9] - *See* www.cpradr.org.
[10] - Available at www.aaauonline.org/upload/drafting_dispute_res_clauses_guide.pdf. Also, consult "Drafting Arbitration Clauses: Avoiding the 7 Deadly Sins," *available at* www.aaauonline.org/upload/drafting_arb_clauses_avoiding_7_deadly_sins.pdf; and the 2011 edition of the *JAMS Clause Workbook*, "A Guide to Drafting Dispute Resolution Clauses for Commercial Contracts," *available at* www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS-ADR-Clauses.pdf.
[11] - *See*, e.g., CPR's "Due Diligence Evaluation Tool for Selecting Arbitrators and Mediators," *available at* www.cpradr.org/Resources/ADRTools/NeutralEvaluationSelectionTool.aspx. If administered, check the rules regarding selection of arbitrators; e.g., AAA Rule 12 for employment arbitration (www.adr.org/sp.asp?id=32904); commercial cases (www.adr.org/sp.asp?id=22440); and construction cases (www.adr.org/sp.asp?id=22004).
[12] - James M. Gaitis (editor-in-chief) and Curtis E. von Kann and Robert W. Wachsmuth (eds.), *The College of Commercial Arbitrators Guide to Best Practices in Commercial Arbitration*, second ed. (Huntington, New York: JurisNet, LLC, 2010).

(*continued on next page*)

Anatomy of an Arbitration (cont'd):

Endnotes (cont'd)

[13] - For example, Willamette University College of Law newsletter, "Recent Developments in Dispute Resolution" (*available at* **www.willamette.edu/wucl/cdr/newsletter/index.php**), states that Ohio State, Missouri, Pepperdine, Cardozo, South Texas, and other law schools publish journals on dispute resolution.

[14] - Some agreements require the application of the "Federal Rules of Evidence." In my view, this generally adds to the time and cost of the arbitration, and may lead to a lack of finality of the decision.

[15] - There is a distinction between partial final awards (which dispose of some issues) and interim awards (such as deciding liability in a bifurcated proceeding). The arbitrator retains authority in an interim award, and it is important because of some case law to expressly state that the interim award is not final. Partial awards should be used only when specifically called for by the arbitration or submission agreement. Where partial final awards are used, the arbitrator should specifically state that he or she retains jurisdiction over all other issues, and expressly state that not all issues have been awarded.

[16] - This is known as the doctrine of *functus officio*, and the exceptions to its application are clerical and computational errors, submitted but unadjudicated issues, and clarification of ambiguities in the award.

SBA Size Protests: Powerful Tool to Challenge Competitor's Contract Award; How to Minimize Risks When Targeted

by

*Douglas P. Hibshman**

The federal government sets aside a significant portion of its procurement dollars each year for purchasing goods and services from small businesses. In 2010, government agencies allotted $97.9 billion—nearly 23 percent of all federal procurement dollars—to small business contracts.[1] These set-asides present substantial opportunities for qualifying small business concerns (SBCs) to compete for and perform federal contracts. This also means, however, that small business set-asides are frequently subjected to size protests filed under the U.S. Small Business Administration's (SBA) size regulations, especially because SBA size protests can be filed by just about any SBC, so long as the challenger was an offeror on the contract.[2]

The evidentiary bar to trigger an SBA investigation of the size of a protested concern is incredibly low. The SBA size regulations merely require a protesting SBC to demonstrate that there is "some basis for the belief" that the protested concern is other-than-small in order for the SBA to initiate an investigation of the protested concern's size.[3] Any SBC with access to the Internet can find and provide the SBA with the required evidence. The SBA readily accepts business profiles, newspapers articles, contract and subcontract histories, publicly available corporate filings, and affidavits as evidence when determining whether to initiate a size investigation.[4] Rarely does the SBA find that a size protest does not meet the low evidentiary threshold required to initiate a size investigation of the protested concern.

Once a size investigation is triggered, the SBA demands that the protested concern turn over—within three days—some of its most intimate business information, including: corporate formation documents and annual reporting documents; ownership information and the names of all directors and officers; income statements for the past three years; and tax returns and audited financial statements for the past three years.[5] Further, the SBA directs protested concerns to reveal all business, financial, or familial relationships between the concern, its owners, or its directors and officers and any other business concern.[6] In other words, the SBA conducts a comprehensive audit of a protested concern's ownership, business structure, relationships, and financial standing during a size investigation. Size investigations can be incredibly taxing on SBCs due to the sheer volume of information and documentation demanded by the SBA within a three-day time frame.

The existence of any business, financial, or familial relationships between the protested concern and any other business may cause a finding of affiliation between the two concerns and

(*continued on next page*)

SBA Size Protests (cont'd):

lead the SBA to rule that the protested concern is other-than-small.[7] Such a finding causes a procuring agency to disqualify the protested concern from competing for or receiving small business set-aside contract awards under the same or lower size standard until the concern is recertified as small by the SBA.[8] Accordingly, SBA size protests may be used by an SBC to challenge the eligibility of its competitors to receive small business set-aside contract awards. Indeed, the seemingly gradual increase in size protests over the past several years suggests that SBCs may be taking advantage of this tool to challenge large concerns masquerading as small businesses, to eliminate competition for set-aside awards, and to exercise leverage over the procurement process.

This article describes size protests and how they are filed with the SBA, how the SBA conducts size investigations, reasons why an SBC offeror might file a size protest, how the SBA determines whether affiliation exists between a protested concern and another business, and how an SBC can protect itself from being disqualified from a set-aside contract award due to a substantiated SBA size protest.

What Is an SBA Size Protest?

All procurements set aside for SBCs by federal procuring agencies have a size standard established by a North American Industry Classification System (NAICS) code.[9] A procurement's size standard is represented in terms of a concern's annual receipts or the number of employees employed by the concern.[10] A procurement only has one size standard assigned to it by the procuring agency based on the type of goods or services being acquired by the agency.[11] Size standards based on gross annual receipts range from $750,000 to $35.5 million and size standards based on number of employees range from 100 to 1,500 employees.[12]

For example, procurements set aside for small business general construction contractors under NAICS code 236220 (Commercial and Institutional Building Construction) have a $33.5 million size standard.[13] Concerns with gross annual receipts below $33.5 million are considered small for a procurement assigned NAICS code 236220 and are eligible to compete for and receive the contract award.[14] Concerns with gross annual receipts that exceed the $33.5 million size standard are other-than-small for the procurement and ineligible to compete for the set-aside award.[15] The same analysis applies to procurements with size standards based on the number of a concern's employees. Concerns that have fewer employees than the applicable size standard are small for a particular procurement, whereas concerns that have more employees than the applicable size standard are other-than-small and ineligible to compete.[16]

SBCs are able to self-certify their size when competing for small business set-aside awards.[17] Self-certification is generally done in an offeror's proposal and through the government's Online Representations and Certifications Application (ORCA) Internet database. The self-certification aspect of the set-aside process makes it possible for firms that do not actually satisfy the size standard of a procurement to compete for and receive the set-aside award. In other words, a concern whose gross annual receipts exceed the $33.5 million size

(*continued on next page*)

SBA Size Protests (cont'd):

standard assigned to a NAICS code 236220 general construction procurement may intentionally or inadvertently self-certify that it satisfies the size standard. This enables businesses that are not SBCs to fraudulently or inadvertently receive small business set-aside awards. In order to ensure that small business set-aside contracts are awarded only to SBCs, the SBA size regulations allow a host of "interested parties" to challenge a contract awardee's size through a size protest.[18] The SBA has exclusive jurisdiction over all size protests and is the only federal agency capable of making a formal size determination regarding a concern.[19]

While the SBA does not publish statistics regarding the number of size protests that it receives each year, anecdotal evidence indicates that size protests are becoming increasingly more common. The economic downturn in many industries has caused many contractors, especially SBCs, to make their way into the federal market to pursue contracts and work. Procuring agencies are receiving two or three times as many bids and proposals for procurements as they did just a few years ago. As more contractors seek to compete for small business set-aside awards, SBA size protests will continue to increase. Contracting officers on most small business set-asides expect that they will receive one or more size protests challenging the contract awardee's size.

How Is a Size Protest Filed and What Is Required?

The procedures for filing a size protest are found in 13 C.F.R. §121.1001 et seq. The SBA size regulations allow a wide range of "interested parties" to file a size protest, including the contracting officer, any offeror not eliminated from an award competition for reasons unrelated to size, and, in limited circumstances, a large business concern.[20] The fact that almost any offeror for a set-aside contract award may file a size protest, regardless of whether the offeror is next in line for the contract award, significantly increases the pool of potential protestors.

Size protests must be filed quickly—within five business days of bid opening (for non-negotiated procurements) or from the date the protestor receives notice of the identity of the contract awardee (for negotiated procurements).[21] Failure to file within the five-day time frame results in the automatic dismissal of the protest by the SBA.[22]

The level of specificity required in a size protest is minimal. A protest need only be "sufficiently specific to provide reasonable notice as to the grounds upon which the protested concern's size is questioned."[23] As long as the protest provides "some basis for the belief or allegation stated in the protest," the protest will be sufficient to trigger an SBA investigation into the protested concern's size.[24] While a protestor needs to do more than merely allege that a protested concern is small, not much more is required because the "some basis for belief or allegation" threshold is an exceptionally easy hurdle to overcome.

The SBA accepts all manner of documentary evidence when determining whether a size protest meets the "some basis for belief or allegation" threshold. Business profiles of the protested concern from sources such as Dun & Bradstreet, Manta, or

(*continued on next page*)

SBA Size Protests (cont'd):

governmentcontractswon.com are useful to show a concern's estimated revenue or number of employees.[25] Newspaper articles, trade publications, and publicly available business filings can also be used to show a concern's ownership structure, management, and relationships with other concerns. Affidavits from individuals with knowledge of a protested concern's size can also be used to support a size protest. Internet content is often the most fertile source of information regarding a protested concern's size. Many times a protested concern's own website will contain information regarding affiliation relationships between the concern, its owners, or its directors and officers and another business. Accordingly, SBCs should be wary of the information it puts on its website regarding teaming partners and business relationships to avoid having its own website used against it as evidence during a size protest.

Size protests should be as detailed as possible and should include copies of any relevant evidence that sheds lights on the protested concern's size. The SBA considers the totality of the evidence presented with a size protest and no one piece of evidence needs to definitively show that the protested concern is other-than-small.[26] While using an attorney to prepare a size protest is sound strategy to ensure that all possible arguments are fleshed out, legal counsel is by no means required. Size protests that are carefully prepared by the owners or project managers of an SBC are often sufficient to demonstrate that a protested concern is other-than-small.

When the SBA determines that sufficient grounds exist on the face of a protest to investigate the size of the protested concern, it proceeds to conduct an investigation of the protested concern's ownership, business structure, relationships, and financial standing. The SBA's first order of business is to provide the protested concern a copy of the protest and demand all of the concern's pertinent business and financial data.[27] This includes corporate formation documents and annual reporting documents, ownership information and the names of all directors and officers, tax returns and audited financial statements for the past three years, and all information regarding relevant relationships between the protested concern and other business entities.[28] A size protest ultimately shifts the burden of proof to the protested concern to demonstrate that it is small under the applicable size standard.[29]

The SBA demands information from the protested concern by directing the concern to complete SBA Form 355, the "Application for Small Business Size Determination."[30] Form 355 contains 29 questions and requires the protested concern to provide comprehensive information regarding its ownership, business structure, relationships, and financial standing. Form 355 is similar to many Internal Revenue Service forms in complexity and correspondingly provides little guidance for the layperson on how to properly prepare the form, or sufficiently answer its questions. Form 355 must be completed and returned to the SBA within three business days.[31] This incredibly short deadline requires the protested concern to divert much of its attention and effort during that three-day time frame to chase down documents and information in an effort to prove that it is small. This is especially burdensome on concerns that are truly small businesses because they must expend significant time and effort proving to

(*continued on next page*)

SBA Size Protests (cont'd):

the SBA that they are small. Failure of a protested concern to actively respond to the protest allegations or to properly prepare Form 355 may lead the SBA to presume that the protested concern is other-than-small.[32]

Why File a Size Protest?

The primary benefit of a successful size protest is that it provides an SBC the ability to disqualify an other-than-small contract awardee from performing a set-aside contract award. The contracting officer must terminate the contract award where the SBA issues a size determination finding the contract awardee to be other-than-small, unless the awardee files a timely appeal with the SBA's Office of Hearings and Appeals (OHA).[33] The disqualification of an other-than-small contract awardee generally causes the procuring agency to award the contract to the offeror that is next in line. Accordingly, it may be worthwhile for an SBC offeror to file a size protest in the hopes of wrestling the contract award from a disqualified contract awardee, even where the size protest may have a limited chance of success. A size protest—much like a post-award bid protest filed with the Government Accountability Office (GAO) or the US Court of Federal Claims (COFC)—potentially provides an unsuccessful offeror another chance at the contract award. So long as the protestor has a reasonable and good-faith basis for the protest, even a small chance of obtaining the contract award may be enough to justify filing a size protest in the hopes of proving the contract awardee to be other-than-small and forcing the awardee to disgorge its award.

A protestor need not rely solely on the evidence that it is able to uncover regarding a protested concern's size. As long as the protestor provides sufficient evidence to persuade the SBA to initiate a size protest, the SBA may uncover evidence from the protested concern or from other sources during the size investigation that shows the protested concern to be other-than-small.[34] For example, a size protest may allege that the protested concern is other-than-small based upon its joint venture relationship with a large concern. However, the SBA may discover through the tax returns and financial data provided by the protested concern that its own gross annual receipts cause it to exceed the procurement's size standard. Accordingly, an SBC should consider not only the strength of its own evidence, but also the evidence that the SBA may uncover during its size investigation when weighing whether to file a size protest.

If a size protest is successful, the protested concern will be ineligible to compete for small business set-asides until it is recertified as small by the SBA. Specifically, the SBA size regulations state that "[a]fter an adverse size determination, a concern cannot self-certify as small under the same or lower size standard unless it is first recertified as small by SBA."[35] An adverse size determination against a protested concern terminates that concern's ability to compete as an SBC for all federal small business set-aside procurements, except those with higher size standards than the procurement for which the size determination was issued.[36] A protested concern found to be other-than-small may never be able to recertify as an SBC if its gross annual receipts or number of employees significantly exceed applicable size standards. Further, it may take concerns deemed to be other-than-small by the SBA months or even years

(*continued on next page*)

SBA Size Protests (cont'd):

to recertify as an SBC. Thus, the ability of an SBC to potentially exclude competitors from future small business set-aside competitions provides increased incentive for SBCs to file size protests challenging concerns believed to be other-than-small.

Additionally, size protests allow protestors to exercise some leverage over the protested procurement. The SBA size regulations indicate that size determinations should be issued within 15 business days after the SBA's receipt of the protest.[37] However, a significant portion of size determinations are not decided by the SBA within this 15-day time frame. The SBA may take several weeks or sometimes several months to issue a size determination. Because the SBA size regulations generally prohibit a procuring agency from permitting the protested concern to perform the contract award while a size protest is pending, the procurement process is stayed until the size determination is issued by the SBA.[38] This procurement delay may be a collateral benefit for the protestor. For example, a protestor that is the incumbent contractor on the protested procurement may be able to obtain a contract extension until the size determination is issued. Further, the delay caused by a size protest may be useful in providing the protestor additional time to weigh its options for filing a possible bid protest with the GAO or COFC (although GAO bid protests, like size protests, generally have short filing deadlines). In sum, a size protest allows the protestor to not only challenge a suspected other-than-small concern, but to also exercise some leverage over the procurement at issue.

SBA Affiliation Rules

How to Avoid Being Targeted for a Size Protest. An SBC must aggregate its gross annual receipts or number of employees with those of its affiliated businesses.[39] The SBC's aggregated annual receipts or employees, including those of its affiliates, are used by the SBA to determine if the SBC is other-than-small under the applicable size standard. For example, an SBC with annual receipts of $25 million and its affiliated company with annual receipts of $20 million will exceed the $33.5 million size standard of a NAICS code 236220 (Commercial and Institutional Building Construction) procurement under the SBA affiliation rules.[40] Protested concerns that exceed the procurement's size standard due to affiliation will be disqualified from a set-aside procurement and forced to forfeit the contract award.

The SBA finds affiliation between two concerns when one concern controls or has the power to control the other, or a third party controls or has the power to control both.[41] Control of one concern over another may be based on common ownership, common management, identity of interest, joint ventures (including the ostensible subcontractor rule), the newly organized concern rule, or based upon a totality of the circumstances.[42]

A finding of affiliation between an SBC and an other-than-small concern causes the SBC to lose its small business status, even though the SBC is small based upon its own annual receipts or number of employees. The aggregation of the other-than-small concern's gross annual receipts or employees with those of a SBC will cause the SBC to exceed applicable small business size standards. In other words, the finding of affiliation between an SBC and

(*continued on next page*)

SBA Size Protests (cont'd):

other concerns is generally the kiss of death for the SBC's ability to compete for small business set-asides. Accordingly, affiliation ties between an SBC and other concerns should be avoided to protect the SBC from losing its small business status. SBCs can take a number of preventative steps to safeguard themselves from an adverse size protest finding. This section addresses the SBA's specific grounds for finding affiliation and how an SBC can protect itself from SBA size protests.

Affiliation Based on Common Ownership or Management. The SBA finds affiliation between an SBC and another concern where common ownership exists between the concerns.[43] The SBA size regulations hold that common ownership exists where an individual, concern, or other entity owns or has the power to control 50 percent or more of a concern's voting stock or a block of voting stock that is large compared to other outstanding shares; or two or more individuals, concerns, or other entities can combine their minority stock holdings to control a concern.[44] The SBA also finds affiliation between an SBC and another concern where common management exists, which occurs "where one or more officers, directors, managing members, or partners who control the board of directors and/or management of one concern also control the board of directors or management of one or more other concerns."[45]

Ownership and management ties between an SBC and other concerns must be carefully regulated by the SBC to ensure that the relationships do not adversely affect the SBC's size. SBCs should analyze their ownership and management structure before submitting a bid or proposal for a small business set-aside. Likewise, an SBC must analyze the ownership and management interests that it, its owners, directors or officers, and other key personnel hold in other concerns. SBCs should minimize or dissolve any ownership or management ties with other concerns that may be viewed as affiliation with that other concern if they want to maintain their SBC status. For example, the owner of an SBC should divest itself of all ownership interests in another concern that exceed 49 percent of the overall ownership interests of the other concern. The owner of an SBC that owns 50 percent or more of another concern will cause the SBC to be affiliated with the other concern based on common ownership.[46] The smaller the percentage of common ownership that exists between an SBC and other concerns, the less likely the SBC will be found affiliated with those other concerns.

Directors and officers and key personnel of SBCs may also want to divest themselves of management positions in other concerns to minimize the risk of a finding of affiliation. The SBC's corporate and other business documents and filings should be regularly reviewed and updated to ensure that the documents do not list owners or managers that are affiliated with other concerns due to common ownership or management. Ties between an SBC and dormant or defunct affiliates should be severed by dissolving the affiliates before the SBC submits a bid or proposal for a set-aside procurement. OHA, the appellate body responsible for hearing size determination appeals, held in one recent appeal that an SBC was affiliated with its dormant yet still existing related business because the SBC failed to formally dissolve the related concern before submitting a proposal for a set-aside procurement.[47]

(*continued on next page*)

SBA Size Protests (cont'd):

Identity of Interest. The SBA finds affiliation between an SBC and another concern where there exists "identical or substantially identical business or economic interests" between the two concerns.[48] This occurs when an SBC fails to maintain arms-length relationships with its subcontractors, suppliers, and other business partners; is economically dependent on another concern; or has relationships with other concerns that suggest a lack of independence. The SBA routinely finds that businesses that share resources, such as employees, equipment, office space, administrative staff, bonding capacity, lines of credit, phone numbers, and other ties are affiliated due to an identity of interest. For example, OHA has held that the leasing of office space in the same building, sharing a common reception area, telephone system, and a receptionist are clear indicators of affiliation between two concerns based on an identity of interest.[49]

Familial relationships also can lead to an identity of interest between an SBC and other concerns. OHA has repeatedly held that it is presumed that "family members have identical interests and must be treated as one person."[50] This "presumption arises not from active involvement in each other's business affairs, but from the family relationship itself."[51] Therefore, the SBA presumes that an identity of interest exists between spouses, siblings, parents, and children for affiliation purposes.[52] This presumption is rebuttable by the family members by showing the SBA that a "clear line of fracture" exists between the family members.[53] A protested concern may show a clear line of fracture "by proving there is no business relationship or involvement with each other's business concerns" or that the family members are "estranged."[54]

OHA found in a recent appeal that a father and son who each operated separate and independent construction companies were affiliated based upon familial identity of interest.[55] OHA found that the protested concern failed to rebut the presumption of familial identity of interest because the son's company listed his father as vice president in the company's corporate documents. The father had no active role in managing the affairs of his son's company and the father's vice president title was merely an "honorary position" based on his previous history with the company. However, this familial connection was enough to find an identity of interest and affiliation between the two concerns and to force the son's company to forfeit a small business set-aside contract award.

Affiliation based upon an identity of interest can be avoided by ensuring that an SBC enters only arms-length relationships with other concerns and is capable of standing on its own two feet. SBCs that are dependent upon other concerns for employees, equipment, lines of credit, office space, or other resources will likely be found affiliated with those other concerns. SBCs should not share resources of any kind with another concern unless that relationship is based upon an arms-length contractual relationship and the SBCs pay fair market value for the resources obtained. Even where a SBC's relationships with other concerns are arms-length, those relationships should be minimized to the extent possible because resource sharing creates the appearance of affiliation between two concerns.

(*continued on next page*)

SBA Size Protests (cont'd):

SBCs should also ensure that a "clear line of fracture" exists between it and familial interests to avoid affiliation based on familial identity of interest. The easiest way to establish a familial line of fracture is for an SBC to avoid business relationships with family member-owned concerns. If avoidance is not possible or desirable, an SBC should only engage in arms-length transactions with family member-owned concerns. Familial involvement in an SBC's ownership and management should be avoided altogether, or significantly controlled if that involvement may lead to affiliation with another concern. The presumption of identity of interest between family members is difficult to rebut. Accordingly, an SBC should monitor and limit the involvement of family members or family-owned concerns in the SBC's business affairs to avoid the appearance of affiliation.

The "Ostensible Subcontractor" Rule. The SBA finds affiliation between an SBC and its ostensible subcontractor. An "ostensible subcontractor" is defined as a subcontractor that "performs primary and vital requirements of a contract" or a subcontractor that an SBC is "unusually reliant" upon to perform a contract.[56] It is common and permissible for an SBC to enter teaming agreements with key subcontractors to perform a set-aside contract. These agreements allow an SBC and its subcontractors to take advantage of each other's capabilities and to pursue federal work they would otherwise not be able to perform individually.

However, SBCs that enter teaming arrangements must take care to avoid affiliation under the ostensible subcontractor rule by becoming overly reliant on any one subcontractor. This may occur by allowing a subcontractor to perform the "primary and vital requirements of a contract," which may include providing the lion's share of project management, essential equipment, or key employees. There is no bright-line test to determine when a subcontractor becomes an ostensible subcontractor based on the work or services provided.[57] The SBA analyzes all aspects of the relationship between an SBC and its alleged ostensible subcontractor for affiliation purposes, to include the terms of the SBC's contract proposal, the terms of the teaming agreement between the two concerns, and whether the subcontractor is an other-than-small business concern.[58]

To avoid affiliation under the ostensible subcontractor rule, an SBC should ensure that its proposal-related documents and teaming arrangement do not, on their face, show the existence of an ostensible subcontractor relationship; not oversell the capabilities, assets, or work to be performed by a subcontractor in its proposal; and ensure that the SBC will perform the primary and vital requirements of a contract. SBCs must also ensure that they control the relationship with their subcontractors and make the key decisions on a procurement. The mere appearance that a large subcontractor is carrying an SBC or calling the shots for an SBC on a procurement may lead to a size protest alleging affiliation under the ostensible subcontractor rule.

The "Newly Organized Concern" Rule. The SBA finds affiliation between an SBC

(*continued on next page*)

SBA Size Protests (cont'd):

and its newly organized concern. Affiliation under the newly organized concern rule arises where former directors or officers, principal stockholders, managers, or key employees of an SBC organize a new concern in the same or related field of operation, serve as the new concern's managers and key personnel, and share resources or provide assistance to the SBC.[59] The presumption of affiliation between an SBC and its newly organized concern may be rebutted by showing a clear line of fracture between the two concerns.[60]

An SBC should fully analyze the pros and cons of creating a new concern because the new concern could be deemed affiliated with the SBC if they share current or former managers, key employees, or resources. SBCs that form or spin off new concerns should ensure that they only maintain arms-length relationships with those new concerns.

Totality of the Circumstances. The SBA may also find affiliation between an SBC and another concern based upon the "totality of the circumstances."[61] Totality of the circumstances is not an independent basis of affiliation.[62] Thus, affiliation may exist under a totality of the circumstances theory even though affiliation may not exist under an independent basis of affiliation, such as common ownership, common management, identity of interest, the ostensible subcontractor rule, or the newly organized concern rule.[63]

Totality of the circumstances allows the SBA to consider the entirety of the evidence introduced against a protested concern during a size protest to determine if reliance exists between the protested concern and another concern. In other words, totality of the circumstances acts as a "catchall" for the SBA to find affiliation where many factors suggest that affiliation exists, but no one independent ground of affiliation is found.[64] SBCs may seek to avoid affiliation with another concern under a totality of the circumstances theory by implementing safeguards similar to those used to avoid affiliation based on common ownership, common management, identity of interest, the ostensible subcontractor rule, or the newly organized concern rule.

Conclusion

For SBCs seeking to minimize competition for small business set-aside contract awards, SBA size protests can be a powerful tool because they are relatively easy to file and will likely lead the SBA to initiate a comprehensive size investigation of the protested concern. The SBA turns a protested concern's life upside down during a size investigation by demanding the protested concern's intimate business, financial, and relationship data. Once a size investigation is initiated, you never know what the SBA may turn up on the protested concern. Accordingly, size protests may provide SBCs with another chance at obtaining a set-aside contract award if the protested concern is disqualified from the procurement as other-than-small.

If you are a potential target of such a protest, there are a number of steps that you can take to reduce the likelihood of disqualification. The preemptive steps addressed in this article

(*continued on next page*)

SBA Size Protests (cont'd):

are a good place to start. Common sense and a solid understanding of the SBA size regulations and affiliation rules will enable most SBCs to protect themselves from successful size protests and to maintain their small business status for years to come.

---

* - Douglas P. Hibshman is a Senior Associate with Fox Rothschild LLP's Washington, D.C., office, where he represents large and small business clients in the government contracts and construction fields.

Endnotes

1. *See* U.S. Small Business Administration, 2010 Small Business Procurement Scorecard: Government-Wide Performance (2010).
2. *See* 13 C.F.R. §121.1001(a)(i) (providing that "[a]ny offeror whom the contracting officer has not eliminated for reasons unrelated to size" may file a size protest).
3. 13 C.F.R. §121.1007(b).
4. *See, e.g., Size Appeal of Allan Baker, d/b/a Korrect Optical*, SBA No. SIZ-4486 (Dun & Bradstreet reports sufficient to trigger a size investigation).
5. *See* 13 C.F.R. §121.1008(c) & SBA Form 355, *available at* http://www.sba.gov/sites/default/files/inv_form 355.pdf (last visited Aug. 3,2011).
6. *See id.*
7. *See* 13 C.F.R. §121.103.
8. *See* 13 C.F.R. §121.1009(g)(5) & 13 C.F.R. §121.1010(a). However, recertification is not required nor does the prohibition against future self-certification on set-aside contracts apply if the SBA size determination is based solely on a finding of contract-specific affiliation under the so-called "ostensible subcontractor rule" or "non-manufacturer rule." See 13 C.F.R. §121.1010(b).
9. *See* 13 C.F.R. §121.101(a).
10. *See* 13 C.F.R. §121.201.
11. *See* 13 C.F.R. §121.402(b).
12. *See* 13 C.F.R. §121.201.
13. *See id.*
14. *See* 13 C.F.R. §121.402(a).
15. *See id.*
16. *See id.*
17. *See* 13 C.F.R. §121.405.
18. *See* 13 C.F.R. §121.1001.
19. *See* 15 U.S.C. §637(b)(6).
20. *See* 13 C.F.R. §121.1001(a).
21. *See* 13 C.F.R. §121.1004(a).
22. *See* 13 C.F.R. §121.1004(d). Note that the time limits do not apply to protests filed by contracting officers or the SBA itself. *See* 13 C.F.R. §121.1004(b).
23. 13 C.F.R. §121.1007(b).
24. *Id.*
25. *See, e.g., Size Appeal of Bush Techs., LLC*, SBA No. SIZ-5242 (2011) (protester met specificity threshold by submitting information from a government website and the protested concern's website); *Size Appeal of Flowsense Building Servs., Inc.,* SBA No. SIZ-5072 (2009) (similar).

(*continued on next page*)

SBA Size Protests (cont'd):

Endnotes (cont'd)

26. *See* 13 C.F.R. §121.1009(e) and (b).
27. *See* 13 C.F.R. §121.1008(a).
28. *See id.,* & SBA Form 355, *available at* http://www.sba.gov/sites/default/files/inv_form355.pdf (last visited Aug. 3, 2011).
29. *See* 13 C.F.R. §121.1009(c).
30. *See* 13 C.F.R. §121.1008(b). (The SBA has discretion to extend the deadline. In practice, the SBA will often grant a short extension so long as the contracting officer agrees to the extension.)
31. 13 C.F.R. §121.1008(c). (The SBA has discretion to extend the deadline. In practice, the SBA will often grant a short extension so long as the contracting officer agrees to the extension.)
32. *See* 13 C.F.R. §121.1008(d).
33. *See* 13 C.F.R. §121.1009(g)(2)(i). If the awardee files a timely OHA appeal, the contracting officer need not terminate the contract, but must consider whether performance can be suspended pending OHA's decision. *See* 13 C.F.R. §121.1009(g)(2)(ii).
34. *See* 13 C.F.R. §121.1009(b).
35. 13 C.F.R. §121.1009(g)(5). As noted above, recertification is not required nor does the prohibition against future self-certification on set-aside contracts apply if the SBA size determination is based solely on a finding of contract-specific affiliation under the so-called "ostensible subcontractor rule" or "non-manufacturer rule." *See* 13 C.F.R. §121.1010(b).
36. *See id.*
37. *See* 13 C.F.R. §121.1009(a)(1).
38. *See* 13 C.F.R. §121.1009(a)(3). The procuring agency need not delay the award indefinitely. If the SBA does not issue its determination within 15 business days, the contracting officer may award the contract if he or she determines in writing that there is an immediate need to award the contract and that waiting until the SBA makes its determination will be disadvantageous to the government.
39. *See* 13 C.F.R. §121.103(a)(6).
40. *See* 13 C.F.R. §121.104.) (c). A concern's annual receipts for affiliation purposes are based on a three-year average of receipts.
41. *See* 13 C.F.R. §121.103(a)(1).
42. *See* 13 C.F.R. 121.103.
43. *See* 13 C.F.R. §121.103(c)(1).
44. *See* 13 C.F.R. §121.103(c). If a concern's stock is widely held, the concern's board of directors and CEO or president will be deemed to have the power to control the concern in the absence of evidence to the contrary. *See id.*
45. 13 C.F.R. §121.103(e).
46. *See* 13 C.F.R. §121.103(c).
47. *See Size Appeal of Hallmark-Phoenix 8, LLC*, SBA No. SIZ-5046 (2009).
48. 13 C.F.R. §121.103(f).
49. *See Size Appeal of Pershield, Inc*., SBA No. 3952 (1994).
50. *Size Appeal of Osirus, Inc*., SBA No. SIZ-4546 (2003).
51. *Size Appeal of Speegle Constr., Inc.*, SBA No. SIZ-5147 (2010).
52. *Size Appeal of Breiner Constr. Co., Inc*., SBA No. 3316 (1990).
53. *Size Appeal of Tech. Support Servs*., SBA No. SIZ-4764 (2006).
54. *Speegle Constr.*, *supra* n.52.
55. *See id.*
56. 13 C.F.R. §121.103(h)(4).
57. *See Size Appeal of TKTM Corp.*, SBA No. SIZ-4885 (2008) (Ostensible subcontractor relationship existed where prime contractor indicated in its proposal that its subcontractor would perform approximately 25 percent of

(*continued on next page*)

SBA Size Protests (cont'd):

Endnotes (cont'd)

the work, the prime contractor was reliant on the subcontractor's "enormous capacity" and its heavy equipment, and the prime contractor would perform primarily administrative functions); *Size Appeal of Alutiiq Int'l Solutions LLC*, SBA No. SIZ-5098 (2009) (A subcontractor that was going to perform approximately 45 to 49 percent of the contract work was not an ostensible subcontractor).

58. *See* 13 C.F.R. §121.103(h)(4).
59. *See* 13 C.F.R. §121.103(g).
60. *See id.*
61. 13 C.F.R. §121.103(a)(5).
62. *Size Appeal of Specialized Veterans, LLC*, SBA No. SIZ-5138 (2010).
63. *See, e.g., Size Appeal of Logmet, LLC*, SBA No. SIZ-5155 (2010) (totality of the circumstances is a basis for affiliation when the SBA "is unable to establish affiliation under any of the other specific affiliation rules, yet the relationship between the parties taken as a whole is indicative of affiliation.").
64. *See id.*

The Public Disclosure Bar: New Answers and Open Questions

by
David Nadler
and
*Justin A. Chiarodo**

Continuing a trend of judicial and legislative activity regarding the False Claims Act's (FCA) public disclosure bar, the Supreme Court recently held that a federal agency's Freedom of Information Act (FOIA) responses constitute "reports" that are subject to the bar.[1] *Schindler Elevator Corp. v. United States ex rel. Kirk*[2] reinforces the court's broad interpretation of the public disclosure bar, also seen recently in *Rockwell International Corp. v. United States ex rel. Stone*[3] and *Graham County Soil & Water Conservation District v. United States ex rel. Wilson*.[4]

This article discusses the evolution of the public disclosure bar, from its enactment in 1986 to its current form as amended by last year's Patient Production and Affordable Care Act. It then discusses Schindler and other recent circuit court and district court cases interpreting the public disclosure bar, identifying several key unresolved issues that will continue to make the public disclosure bar one of the more contentious and frequently litigated areas of the FCA.

Background

As originally enacted, the FCA[5] did not limit the sources from which a relator could acquire information supporting a qui tam action. In *United States ex rel. Marcus v. Hess*,[6] the Supreme Court upheld the relator's recovery of a bounty, even though he learned of the allegations supporting his suit in a federal criminal indictment. As the criminal indictment meant the government was already keenly aware of the underlying fraud allegations, having to pay Hess a bounty where he added nothing to the case was seen as improperly diverting money that should have been returned to the government. More than 60 years later, the Supreme Court characterized *Hess* as the "quintessential" parasitic qui tam suit.[7]

Congress, at the request of the attorney general, took swift action following *Hess* to limit the ability for parasitic relators to recover FCA bounties.[8] One congressman introduced a bill to eliminate all private suits under the FCA.[9] The Senate Judiciary Committee proposed a less draconian response, seeking that a relator have "original" knowledge of an underlying fraud in order to proceed with a suit.[10] The legislative history shows competing concerns about the FCA's qui tam provisions. One camp advocated a need for private clients to step in where the government is unable or unwilling to act on alleged fraud, while the other sought to maximize the government's discretion to pursue fraud claims while minimizing a relator's ability to cash in on parasitic lawsuits that did not contribute to identifying fraud.

The latter camp carried the day, as the final version of the bill dramatically reduced the

(*continued on next page*)

The Public Disclosure Bar (cont'd):

ability of relators to proceed, even in cases where the relator had "original" knowledge of the alleged fraud that the government failed to act on. The amended statute expressly barred qui tam actions "based upon evidence or information in the possession of the United States, or any agency, officer or employee thereof, at the time such suit was brought."[11]

The courts construed this "government knowledge bar" broadly, severely limiting the ability of relators to bring cases where the government was already in possession of the information underlying the suit. One significant case was decided by the Court of Appeals for the Seventh Circuit shortly before the 1986 FCA amendments. In *United States ex rel. Wisconsin v. Dean*,[12] the State of Wisconsin conducted its own investigation into Medicare fraud, which led the state to file an FCA action to recover damages. The state had earlier brought the information underlying its suit to the government's attention because it was required to do so under the Social Security Act. The district court dismissed under the government knowledge bar, and the Seventh Circuit affirmed, finding that the 1986 amendments did not provide the court with discretion to exercise jurisdiction over the case. The court suggested that the disappointed parties take the matter up with Congress.[13]

As *Dean* suggests, the sweeping "government knowledge bar" had substantially limited new qui tam actions and reduced government FCA recoveries. In response, Congress revisited the bar during the drafting of the 1986 amendments. The legislative history of the 1986 amendments (not unlike the 1943 amendments) reflects an effort to balance the desire to encourage private citizens to bring forward cases of fraud (recognizing that government investigatory resources are scarce and government officials may not be privy to the fraud) with the desire to check parasitic lawsuits (which would wrongly reward opportunistic whistle-blowers who contribute nothing to uncovering fraud).

Unfortunately, the legislative history behind the 1986 amendment is not very clear about exactly how this balance was struck — the Supreme Court observed that "the drafting history of the [1986] public disclosure bar raises more questions than it answers."[14] The court noted, for example, that the House and Senate Judiciary Committees each reported bills that contained very different public disclosure bars. "[T]he Senate bill, for example, did not include the words 'administrative,' 'audit,' or 'investigation,' . . . , nor did it contain an original source exception."[15] This lack of clear history regarding the meaning of the language in the 1986 amendments, coupled with a number of undefined terms, contributed to competing interpretations.

The 1986 amendments provide that courts do not have jurisdiction over claims by private plaintiffs that are "based upon the public disclosure of allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media."[16] Where information underlying a qui tam suit is "publicly disclosed," relators may proceed with the suit only if they are an "original source" for the information. An "original source" is an "individual who has direct and independent knowledge of the information on which the allegations are

(*continued on next page*)

The Public Disclosure Bar (cont'd):

based and has voluntarily provided the information to the government before filing an action . . . which is based on the information."[17]

The public disclosure bar proved highly contentious and was frequently litigated, ultimately reaching the Supreme Court in *Rockwell International Corp. v. United States*[18] and again in *Graham County Soil & Water Conservation District v. United States ex rel. Wilson*.[19] The court in both *Rockwell* and *Graham County* construed the public disclosure bar broadly.

In *Rockwell*, relator Stone brought an FCA action for claims related to Rockwell's systems for creating "pondcrete" blocks of toxic material and cement. The relator predicted the blocks would fail. Though his prediction came true, it was after he had left the company and for a different reason: Rockwell had reduced the amount of cement used in the blocks. The news media publicized the problem of the leaking pondcrete blocks , after which the FBI raided Rockwell. The government intervened in the case, ultimately obtaining a jury verdict based on Rockwell's use of reduced cement content that postdated Stone's employment.

The parties acknowledged that the defective pondcrete problem had been publicly disclosed, leaving Stone's status as an "original source" to be resolved by the Supreme Court. Justice Scalia, writing for the court, confirmed that the "original source" requirement is jurisdictional and that the allegations to determine whether a relator is an original source are those in the amended complaint.[20] The court concluded Stone was not an "original source" for the allegations in the amended complaint giving rise to the damages award because he had left Rockwell before the changed practices that gave rise to those damages.[21]

The public disclosure bar again reached the Supreme Court just a few years later in *Graham County*. In *Graham County*, the Department of Agriculture awarded contracts to two North Carolina counties to repair flood damaged areas. Relator Wilson, at the time a local government employee involved in the administration of the contracts, notified local and federal officials about suspected fraud in the program. Three separate entities issued reports identifying problems and irregularities with the program: (1) an accounting firm hired by the county; (2) the North Carolina Department of Environment, Health, and Natural Resources; and, later, (3) the USDA's Office of Inspector General.

The Court of Appeals for the Fourth Circuit held that although the information underlying the suit had been disclosed in the reports by the accounting firm and the North Carolina Department of Environment, Health, and Natural Resources, the FCA only barred actions disclosed in federal "administrative" reports.[22] Justice Stevens, writing for the court, interpreted the public disclosure bar broadly, construing the provision addressing administrative reports, hearings, audits, and investigations to include those at the state and local level (and finding no such limitation in the text or legislative history of the 1986 amendments).[23]

Around the time of the Graham County decision, and partly in response to the court's broad reading of the public disclosure bar, President Obama signed into law the Patient

(*continued on next page*)

The Public Disclosure Bar (cont'd):

Protection and Affordable Care Act (PPACA).[24] PPACA replaced the existing version of 31 U.S.C. §3730(e)(4) with new language. It now reads:

> 4(A) The court shall dismiss an action or claim under this section, unless opposed by the Government, if substantially the same allegations or transactions as alleged in the action or claim were publicly disclosed —
>
> (i) in a Federal criminal, civil, or administrative hearing in which the which the Government or its agent is a party;
>
> (ii) in a congressional, Government Accountability Office, or other Federal report, hearing, audit, or investigation; or
>
> (iii) from the news media;
>
> unless the action is brought by the Attorney General or the person bringing the action is an original source of the information.
>
> (B) For purposes of this paragraph, "original source" means an individual who either (i) prior to a public disclosure under subsection (e)(4)(a), has voluntarily disclosed to the Government the information on which allegations or transactions in a claim are based, or (2) who has knowledge that is independent of and materially adds to the publicly disclosed allegations or transactions, and who has voluntarily provided the information to the Government before filing an action under this section.[25]

Unfortunately, there is a paucity of legislative history regarding the PPACA amendments to the public disclosure bar, though the text makes clear that the changes are significant.

The PPACA narrowed the public disclosure bar in several ways and expanded the ability of a relator to qualify as an "original source." It abrogated *Graham County*'s holding that the public disclosure bar applied to disclosures in state and local reports, hearings, audits, and investigations by limiting the bar to only those disclosures in a federal setting. It also expanded the "original source" exception, by no longer requiring that relators have "direct and independent" knowledge of the information for which the relator claims to be an original source. The PPACA now allows relators without direct knowledge to proceed with suits based on information that "is independent of and materially adds" to the publicly disclosed allegations (those terms are not defined). It also clarifies when an "original source" must disclose information to the government.

Most significantly, the PPACA empowers the government to oppose the dismissal of a qui tam action even where the case is based on publicly disclosed information *and* for which the relator is not an original source. This controversial change is particularly troubling, as the new language does not include express limitations (or guidance) on the government's ability to oppose dismissal under the public disclosure bar — opening the door for parasitic lawsuits like *Hess* to proceed.

(*continued on next page*)

The Public Disclosure Bar (cont'd):

As the PPACA makes no mention of retroactivity, the Supreme Court has held that it does not apply to cases pending as of the date of enactment.[26] The pre-PPACA version of the bar thus continues to apply to hundreds of pending FCA cases.[27] The PPACA amendments raise many questions, including the meaning of terms such as "materially adds" and the scope of any limitations on the government's ability to oppose dismissal of a case that is based on publicly disclosed information. The role and significance of the public disclosure bar in cases post-dating PPACA will be significantly impacted by how the government uses this "veto power" and whether the courts impose limitations on its use.

Schindler Elevator Corp. v. United States ex rel. Kirk

The Supreme Court construed the pre-PPACA version of the public disclosure bar for the third time in four years in *Schindler Elevator Corp. v. United States ex rel. Kirk*, addressing whether FOIA responses constitute "reports" subject to the bar. Schindler Elevator Corporation entered into hundreds of contracts with the United States that were subject to the Vietnam Era Veterans' Readjustment Assistance Act of 1972 (VEVRAA). VEVRAA requires contractors to report, among other information, how many contractor employees qualify for covered veteran status. VEVRAA's implementing regulations tasked Schindler with submitting "VETS-100" reports with this information.[28]

Relator Daniel Kirk was a U.S. Army and Vietnam veteran who had worked for Schindler for 25 years until he resigned in 2003. In 2005, Kirk filed a qui tam suit against Schindler. The United States did not intervene. In his 2007 amended complaint, Kirk alleged that Schindler violated its VEVRAA reporting obligations by both failing to file VETS-100 reports and by filing false reports. Kirk asserted that Schindler's claims for payment under affected contracts violated the FCA because Schindler falsely certified compliance with VEVRAA.[29]

To support his allegations, Schindler relied on information his wife had obtained by filing FOIA requests with the Department of Labor (DOL) for Schindler's VETS-100 reports between 1998 and 2006. The DOL responded that Schindler had not filed any VETS-100 reports for five of the nine years for which Kirk's wife sought records. It provided copies of the reports that Schindler did file, which Kirk asserted were false.[30]

Schindler moved to dismiss on a variety of grounds, including that the court did not have jurisdiction under the FCA's public disclosure bar. The district court dismissed Kirk's complaint, finding that Kirk failed to state a claim for which relief could be granted on several counts and that other claims tied to Kirk's FOIA requests were based on publicly disclosed information and subject to the public disclosure bar. The Court of Appeals for the Second Circuit reversed, finding that the FOIA requests did not constitute administrative "reports" or "investigations."[31] The Second Circuit's position was consistent with the Court of Appeals for the Ninth Circuit,[32] but inconsistent with the Court of Appeals for the Third Circuit.[33]

(*continued on next page*)

The Public Disclosure Bar (cont'd):

The Supreme Court reversed and remanded in a 5-3 decision. Justice Thomas wrote the majority opinion. Noting that the public disclosure bar did not define the term "report," the court looked to its plain meaning. Reviewing sources including *Webster's Dictionary* (defining a report as a "notification") and *Black's Law Dictionary* (defining a report as an "official or formal statement of facts or proceedings), the court concluded that "report" should be construed broadly. A broad meaning of "report" is "consistent with the generally broad scope of the FCA's public disclosure bar."[34] The court cited its recent decision in *Graham County* in support of its view that the public disclosure bar should be construed broadly.[35]

The court then determined that a FOIA response constituted a "report" under the public disclosure bar. It noted that FOIA requires an agency receiving a FOIA request to "'notify the person making such request of [its] determination and the reasons therefor.'"[36] Where an agency denies a FOIA request, it must "'set forth the names and titles or positions of each person responsible for the denial,' 'make a reasonable effort to estimate the volume of any [denied] matter,' and 'provide any such estimate to the person making the request.'"[37] The court also observed that many federal agencies maintained detailed procedures for FOIA responses that require written disclosures and statements. The court remanded the case for a determination whether Kirk's suit is "based upon" the allegations or transactions disclosed in the FOIA reports at issue.[38]

Justice Ginsburg wrote the dissent, joined by Justices Breyer and Sotomayor. The dissent advocated a more limited interpretation of the term "report," consistent with the Second Circuit's decision below. For a "report" to be subject to the public disclosure bar, it should involve a compilation or analysis of information with the purpose of "synthesizing that information in order to serve some end of the government" similar to a hearing or audit.[39] The dissent maintained that the DOL's FOIA responses did not involve this synthesis of information and that the majority opinion would hamper the ability of relators to substantiate their allegations before filing suit. Justice Ginsburg referred to the heightened pleading standards of Federal Rule of Civil Procedure 9(b) as a sound reason why a whistle-blower like Kirk would seek corroboration for his allegations through FOIA, and suggested the issue was worthy of Congress's attention.[40]

Schindler leaves unresolved several public disclosure bar questions. It did not resolve whether information produced as part of a FOIA response forever precludes qui tam actions based on that information — both the relator and the government voiced concern that companies might FOIA their own incriminating documents to preclude qui tam lawsuits. Schindler also left unresolved the circuit split on how "based upon" is defined. (The split is discussed in *United States ex rel. Ondis v. Woonsocket*.)[41] It also did not resolve when a relator must provide information to the government to qualify as an "original source." (The split is discussed in *United States ex rel. Duxbury v. Ortho Biotech Products, L.P.*,[42] in which the Supreme Court denied certiorari.)

(*continued on next page*)

The Public Disclosure Bar (cont'd):

Though *Schindler* addressed only the pre-PPACA version of the public disclosure bar, it is likely to carry great weight in the interpretation of the PPACA version because that version also does not define "report" (and thus it is likely the Supreme Court would interpret the new language in a similar way). It also cements the current court's resistance to interpretations of the FCA that would expand its reach beyond the plain meaning of the statute, as seen earlier in *Rockwell* and *Graham County*. This fact may lead Congress to answer Justice Ginsburg's call for congressional action — Congress has twice in the past several years substantially amended the FCA, in part responding to Supreme Court decisions (before the PPACA in 2010 and around the time of *Graham County*, the Fraud Enforcement and Recovery Act of 2009[43] eliminated defenses previously available under *Allison Engine Co. v. United States ex rel. Sanders*[44]).

Other Recent Circuit Court and District Court Cases

Other recent circuit court and district court decisions confirm that the public disclosure bar remains a key issue in FCA cases, particularly whether a relator's suit was "based upon" prior public disclosures (itself a key issue on remand following Schindler). In *United States ex rel. Poteet v. Bahler Medical, Inc.*,[45] the Court of Appeals for the First Circuit affirmed the dismissal of an FCA suit brought by the former employee of a medical device manufacturer. Realtor Poteet had brought an action against spine surgeons and medical device distributors, alleging that they had defrauded the government by accepting kickbacks from the manufacturer in exchange for promoting off-label product uses. The district court dismissed the complaint against the surgeons under the public disclosure bar, finding that the allegations underlying the complaint had been disclosed in complaints filed in both state and federal courts, as well as in coverage in the *New York Times*.

The First Circuit affirmed, rejecting the relator's argument that her amended complaint contained additional information about the alleged fraud that was not disclosed in the prior suits and in the news media. The court noted that because the allegations ultimately targeted the same fraudulent scheme, the public disclosure bar applied. The court relied on First Circuit precedent that a qui tam action is "based upon" prior disclosures if the relator's complaint contains allegations that are "substantially similar" to those disclosures.

The Court of Appeals for the D.C. Circuit also recently upheld the dismissal of a nonintervention FCA case under the public disclosure bar in *Davis v. District of Columbia*.[47] Relator Davis filed suit alleging that the District of Columbia made false claims for Medicaid reimbursement. The court concluded that Davis's allegations had been publicly disclosed in a September 2000 GAO report, *Anti-Deficiency Act Violation Involving the District of Columbia Health and Hospitals Public Benefit Corporation*,[48] which described "the commingling of funds . . . at the core of Davis's allegations."[49] The court also noted the allegations had been disclosed in Davis's own prior lawsuit against the District of Columbia for breach of contract.[50]

The court rejected Davis's argument that he qualified as an original source, noting that

(*continued on next page*)

The Public Disclosure Bar (cont'd):

even if David had "direct and independent" knowledge of the information underlying his suit, he did not demonstrate to the district court that he provided the information to the government prior to filing suit.[51] In a nod to the circuit split related to the disclosure timing requirements, the court cited its prior decision in *United States ex rel. Findley v. FPC-Boron Employees Club*,[52] where it held that not only must a relator "meet section 3730(e)(4)(B)'s explicit requirements that the relator have 'direct and independent' knowledge and provide the information to the federal government prior to filing a claim," but that the relator must also "provide the information to the government prior to any public disclosure."[53] (Other circuits have held the disclosure only needs to be made prior to filing the suit.) The court noted that *Rockwell* may have called into question the implicit requirement in *Findley* that the disclosure of original source information to the government occur before the public disclosure, but determined that it did not impact the case because Davis failed to meet even the more permissive standard for this required disclosure.[54]

At least two other circuits have recently held that the relators' cases were not barred by the public disclosure bar. In *United States ex rel. Hixson v. Health Management Systems, Inc.*,[55] the relators filed suit against two companies contracted to work for Iowa's Medicaid program. The relators claimed that the defendants violated the FCA by obtaining federal funds to pay for medical care resulting from medical negligence, without seeking reimbursement from the negligent providers as required by law. The district court denied the defendant's motion to dismiss under the public disclosure bar, but granted it for failure to state a claim, and the relators appealed.

The defendants argued that the relators' allegations had been publicly disclosed in state administrative documents showing the defendants did not seek reimbursement of Medicaid funds from medical providers found liable for malpractice. The Court of Appeals for the Eighth Circuit, citing its decision in *United States ex rel. Rabushka v. Crane Co.*, [56] noted that the public disclosure bar exists only "when the essential elements comprising [the] fraudulent transaction have been publicly disclosed so as to raise a reasonable inference of fraud" and that the disclosure must reveal the "critical elements of the fraudulent transaction themselves." The court found the state administrative reports did not satisfy this standard:

> Here the defendants rely on disclosures in state administrative documents showing that the defendants did not pursue reimbursement of Medicaid funds from tortfeasors in medical malpractice cases. We conclude that these documents do not disclose the "essential elements" of what the relators sought to prove. *See Rabushka*, 40 F.3d at 1514. In addition to showing that the defendants failed to seek reimbursement, the relators had to show that the defendants participated in claiming federal funds without deducting the money that they should have obtained from the tortfeasors. Because the administrative documents that the defendants relied on did

(*continued on next page*)

The Public Disclosure Bar (cont'd):

> not disclose this essential element — the false claim itself — we cannot say that their claims were "based upon . . . public disclosure of allegations or transactions" under the FCA. See 31 U.S.C. §3730(e)(4)(A) (2008).[57]

The court nonetheless affirmed the dismissal of the relators' suit, finding that the defendant's interpretation of the applicable Medicaid reimbursement regulations was reasonable and there was no controlling authority to the contrary. "[A] statement that a defendant makes based on a reasonable interpretation of a statute cannot support a claim under the FCA if there is no authoritative contrary interpretation of that statute. That is because the defendant in such a case could not have acted with the knowledge that the FCA requires before liability can attach."[58]

The Seventh Circuit also recently concluded that the public disclosure bar did not apply, on the grounds that the relator alleged specific facts about a specific fraud, whereas the public disclosures addressed general, industry-wide practices.[59] Relator Baltazar had filed suit alleging that a chiropractor for whom she had worked had submitted fraudulent bills to the Medicaid and Medicare programs. Her allegations stemmed from a purported firsthand account of improper billing, including upcoded bills.

The district court dismissed the complaint under the public disclosure bar, based on several reports documenting widespread fraudulent billing practices in the medical profession. One such report from the Department of Health and Human Services, Office of Inspector General, addressed billing fraud within the chiropractic industry (*Chiropractic Services in the Medicare Program: Payment Vulnerability Analysis* (2005)).

The Seventh Circuit concluded that the relator's suit was based upon her own observations of alleged fraud, not any of the reports, and thus the public disclosure bar did not apply. According to the court, general reports of improper practices (as with the 2005 report) that do not address specific fraudulent schemes do not foreclose a qui tam suit based upon specific fraudulent conduct personally witnessed by the relator.[60]

The decision was consistent with the holdings of the Courts of Appeal for the Ninth, Tenth, Eleventh, and D.C. Circuits, which have held that reports documenting "a significant rate of false claims by an industry as a whole — without attributing fraud to particular firms — do not prevent a qui tam suit against any particular member of the industry."[61] However, the court also questioned the value of reports documenting allegedly widespread fraudulent practices to support government prosecutions: "The United States could not file suit against a chiropractor, tender the copies of the . . .[r]eports, and rest its case. The chiropractor would prevail summarily, because these reports do not so much as hint that any particular provider has submitted fraudulent bills."[62]

(*continued on next page*)

The Public Disclosure Bar (cont'd):

Baltazar was recently cited by the United States District Court for the District of Columbia, where the determined it had jurisdiction but nonetheless dismissed the complaint for failure to plead fraud with particularity (as in *Hixson*).[63] The relator alleged that the defendant failed to implement certain technologies and thereby failed to take reasonable measures to determine whether Medicaid claimants had third-party insurance. The relator alleged that this failure facilitated the submission of false claims.[64]

The defendant cited several sources, including GAO reports and testimony from Senator Grassley, that it believe evidenced a public disclosure of the allegations in the relator's complaint. The court concluded that while some of the sources provided background information on the allegations, including the problem of verifying whether a Medicaid beneficiary has third-party coverage, it did not rise to the level of "allegations or transactions" as contemplated by the public disclosure bar.[65] The court noted that, unlike other cases involving findings of public disclosures subject to the bar, the public disclosures at issue "did not suggest where the fraud was occurring, what percent of actors within the industry were purportedly engaged in it, the nature of any schemes used to facilitate the payment of false Medicaid claims, or any specific entities that allegedly engaged in such activity."[66]

As in *Hixson*, the court nonetheless dismissed the relator's complaint for failure to plead fraud with particularity despite finding it had jurisdiction. The court noted that the complaint failed to identify any specific individuals associated with the alleged fraud, failed to identify any specific false claims purportedly submitted by the defendant, and failed to allege that a lack of access to records precluded it from identifying specific false claims or individuals.[67]

In a recent district court case examining whether a relator's suit was "based upon" public disclosures following a government investigation, the United States District Court for the Northern District of Oklahoma dismissed a relator's qui tam suit alleging that Boeing falsely certified that it provided parts approved by the Federal Aviation Administration as part of an aircraft maintenance contract with the U.S. Air Force.[68] the court found that the allegations were "substantially similar" to publicly disclosed information uncovered in a prior Air Force Office of Special Investigations' inquiry regarding allegations that the manufacturer filed a false claim related to the repair of a fire-damaged aircraft. As with *Poteet*, *Hixson*, and *Baltazar*, *Lancaster* shows the public disclosure bar remains a key provision in the defense of FCA cases in which the government does not intervene.

Conclusion

The well-reasoned opinion in *Schindler* makes clear that Federal FOIA responses are "reports" subject to the bar and continues the Supreme Court's practice of construing the public disclosure bar broadly to help prevent parasitic qui tam actions. However, the decision leaves open several issues that are likely to feature in pending cases not subject to the PPACA amendments, particularly the meaning of "based upon" and the timing for when a putative "original source" must provide that information to the government (issues that have been

(*continued on next page*)

The Public Disclosure Bar (cont'd):

recently litigated in the lower courts). Recent circuit court and district court decisions still frequently address these issues and are likely to continue to do so, absent guidance from the Supreme Court. Moreover, as *Schindler* did not opine on the meaning of the current version of the public disclosure bar in the PPACA, it leaves open many more questions related to the new provisions. The only certainty is continued litigation (and possible legislation) regarding the public disclosure bar.

---

* - David M. Nadler is a partner and Justin A. Chiarodo is an associate with Dickstein Shapiro LLP, where they represent companies in False Claims Act (FCA) cases. Contact Nadler and Chiarodo at Nadlerd@dicksteinshapiro.com, and ChiarodoJ@dicksteinshapiro.com, respectively.

Endnotes

1. Schindler Elevator Corp. v. United States ex rel. Kirk, 131 S. Ct. 1885 (2010).
2. *Id.*
3. Rockwell International Corp. v. United States ex rel. Stone, 549 U.S. 457 (2007).
4. Graham Cnty. Soil & Conservation Dist. v. United States ex rel. Wilson, 130 S, Ct. 1396 (2010).
5. 31 U.S.C. §§3729-3733.
6. 317 U.S. 537 (1943), *superseded by statute*, Pub. L. No. 99-562, 100 Stat. 3153, *as recognized in* United States ex rel. Stinson, Lyons, Gerlin & Bustamante, P.A. v. Provident Life & Acc. Ins. Co., 721 F. Supp. 1247 (S.D. Fla. 1989).
7. *See Graham Cnty*., 130 S. Ct. at 1406.
8. *See generally* Robert Salcido, *Screening Out Unworthy Whistle-blower Actions: An Historical Analysis of the Public Disclosure Jurisdictional Bar to Qui tam Actions under the False Claims Act*, 24 Pub. Cont. L .J. 237 (1995).
9. *See* 89 Cong. Rec. 2800 (1943).
10. *See* 89 Cong. Rec. 7570 (1943).
11. Act of Dec. 23, 1943, 57 Stat. 608, 609 (codified at 31 U.S.C. 232(C) (1946 ed.)).
12. 729 F.2d 1100 (7th Cir. 1984), *superseded by statute*, Pub. L. No. 99-562, 100 Stat. 3153, *as recognized in* United States ex rel. Hartigan v. Palumbo Bros., Inc., 797 F. Supp. 624 (N.D. Ill. 1992).
13. *See id*. at 1106-07.
14. Graham Cnty. Soil & Conservation Dist. v. United States ex rel. Wilson, 130 S. Ct. at 1407.
15. *Id.*
16. 31 U.S.C. §3730(e)(4)(A) (2008).
17. 31 U.S.C. §3730(e)(4)(B) (2008).
18. Rockwell International Corp. v. United States ex rel. Stone, 549 U.S. 457 (2007).
19. *Graham Cnty*., 130 S. Ct. 1396 (2010).
20. *Rockwell*, 549 U.S. at 473-74.
21. *Id.* at 475.
22. *Graham Cnty*., 130 S. Ct. at 1401.
23. *Id.* at 1402-09.
24. Pub. L. No. 111-148, 124 Stat. 119 (2010).
25. 31 U.S.C. §3730(e)(4).
26. *Graham Cnty*., 130 S. Ct. at 1400 n.1.

(continued on next page)

The Public Disclosure Bar (cont'd):

Endnotes (cont'd)

27. Current Justice Department statistics show more than 550 active FCA cases pending as of September 20, 2010. *See* http://www.justice.gov/civil/docs_forms/C-FRAUDS_FCA_Statistics.pdf, (last visited May 20, 2011).
28. Schindler Elevator Corp. v. United States ex rel. Kirk, 131 S. Ct. at 1889.
29. *Id.* at 1890.
30. *Id.*
31. *Id.*
32. *See* United States ex rel. Haight v. Catholic Healthcare West, 445 F.3d 1147 (9th Cir. 2006), *abrogated by* Schindler Elevator Corp. v. United States ex rel. Kirk, 131 S. Ct. 1885 (2011).
33. *See* United States ex rel. Mistick PBT v. Hous. Auth. of Pittsburgh, 186 F.3d 376 (3d Cir. 1999).
34. Schindler Elevator Corp. v. United States ex rel. Kirk, 131 S. Ct. at 1891.
35. *Id.*
36. *Id.* at 1893 (alteration in original) (quoting 5 U.S.C. §552(a)(6)(A)(i)).
37. *Id.* (alteration in original) (quoting §552(a)(6)(C)(i), (F)).
38. *Id.* at 1896.
39. *Id.* at 1897 (Ginsburg, J., dissenting) (citation omitted).
40. *Id.* at 1898 (Ginsburg, J., dissenting).
41. United States ex rel. Ondis v. Woonsocket, 587 F.3d 49, 53-57 (1st Cir. 2009).
42. United States ex rel. Duxbury v. Ortho Biotech Products, L.P., 579 F.3d 13, 22 (1st Cir. 2009).
43. Pub. L. No. 111-21, 123 Stat. 1617 (2009).
44. Allison Engine Co. v. United States ex rel. Sanders, 553 U.S. 662 (2008).
45. United States ex rel. Poteet v. Bahler Medical, Inc., 619 F.3d 104, 110 (1st Cir. 2010).
46. *Id*. at 114.
47. Davis v. District of Columbia, 413 Fed. Appx. 308, 2011 WL 611814 (D.C. Cir. Feb 15, 2011) (per curiam).
48. B-285725, Sept. 29, 2000.
49. *Davis*, 2011 WL 611814, at *1.
50. *Id.* (citing Davis v. Williams, 892 A.2d 1144 (D.C. 2006) (affirming dismissal for failure to exhaust administrative remedies)).
51. *Id.* at *2.
52. United States ex rel. Findley v. FPC-Boron Employees' Club, 105 F.3d 675 (D.C. Cir. 1997).
53. *Davis*, 2011 WL 611814, at *2.
54. *Id.*
55. United States ex rel. Hixson v. Health management Systems, Inc., 613 F.3d 1188 (8th Cir. 2010).
56. United States ex rel. Rabushka v. Crane Co., 40 F.3d 1509, 1512-14 (8th Cir. 2010).
57. *Hixson*, 613 F.3d at 1188 (alteration in original) (footnote omitted).
58. *Id.* at 1190.
59. United States ex rel. Baltazar v. Warden, 635 F.3d 866 (7th Cir. 2011).
60. *Id*. at 868
61. *Id*.
62. *Id*.
63. *See* United States ex rel. Digital Healthcare, Inc. v. Affiliated Computer Servs., Inc. No. 06-1299, 2011 WL 1495928 (D.D.C. Apr. 20, 2011).
64. *Id*. at *2-4.
65. *Id.* at *11.
66. *Id*. at *14.
67. *Id*. at *15-17.
68. United States ex rel. Lancaster v. Boeing Co., No. 03-CV-810-GKF-PJC, 2011 WL 888366 (N.D. Okla. Mar. 11, 2011).