The President’s Column

Dear BCABA Members:

Welcome to the first edition of The Clause for 2012. I am honored to assume the role of president of the Board of Contract Appeals Bar Association, Inc., and thank the many members of the BCABA who have helped to make this a thriving group. In particular, I would like to thank David Black, immediate past president of the BCABA, for all of his work last year to advance the BCABA.

In my years as a participant in the BCABA, I have found that its greatest asset is its members. We include in our membership judges from a variety of boards of contract appeals, as well as lawyers from government, private practice and industry. The BCABA has been able to draw upon the breadth of experience of its membership to provide training and networking events throughout each year, events that feature the skills and experience of experienced government contracts practitioners. Equally important is the opportunity that membership in the BCABA offers to meet and develop relationships with members of the government contracts bar. Finally, a goal for the BCABA this year is to increase its membership.

The BCABA successfully presented the annual Trial Practice Seminar on January 24, 2012, at The George Washington University (continued on page 3)
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President’s Column (cont’d):

Law School. The BCABA presented the seminar in conjunction with the Law School’s Government Procurement Law Program. Panel members, who included Judge Diana Dickinson of the Armed Services Board of Contract Appeals, Judge Allan Goodman of the Civilian Board of Contract Appeals, Judge Gary Shapiro of the Postal Service Board of Contract Appeals, Pete Pontzer of the U.S. Army Legal Services Agency, and Jack Tieder of Watt, Tieder, Hoffar and Fitzgerald, LLP, discussed various issues relevant to the litigation process before the boards of contract appeals, including brief writing and discovery. As in years past, the event was well attended and offered valuable information to those attending. Thanks again to Don Yenovkian and Shelly Ewald for their hard work in organizing the event.

By the time this edition of The Clause goes to press, the BCABA will have held its first happy hour of the year. The event, held at Bar Louie on February 29th, is another in a series of networking events held by the BCABA throughout the year. Judge Jonathan Zischkau of the Civilian Board of Contract Appeals and Linda Maramba of Northrop Grumman will speak on their career paths and experiences as government contracts practitioners. We plan to host similar events during the remainder of the year.

As always, publication of The Clause would not be possible without the hard work of Pete McDonald. He exemplifies the dedication of the core membership of the BCABA, and we are indebted to his continued efforts.

I look forward to seeing you at BCABA events throughout the year, and encourage you to become an active member.

Chip Purcell
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 Case Digests, edited by Ryan Roberts (a much-appreciated standard feature). Following the Case Digests is an original and highly worthwhile submission by Judge Shapiro and his brother on the lost art of writing briefs. Caitlin Cloonan and an associate follow with an insightful analysis of the U.S. Foodservice v. United States case, an important decision for those whose clients encounter the troublesome Most Favored Customer clause. Bruce Bowland and Mike Foley then discuss a contract administration problem that has been happening with increasing frequency: Contracting officers treating REAs and claims as “proposals.” Finally, Jeff Chiow and an associate chide GAO for faulting for DCAA on not pursuing internal audit reports.

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. In that regard, we again received articles that were simply unsuitable for publication, such as: “Sweet Tweet Greets Pete!”; “Cruise Ship Hosts CBCA Hearings!!”; and “Pete Wins BCABA Air Guitar Contest!!”

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.
BCABA members – welcome to the Spring (well, close enough) edition of the Case Digests. The Boards were relative quiet during the holidays, but we do have several interesting cases to discuss this quarter.

Perhaps the most interesting of this quarter’s cases is Sharp Electronics. Corp., ASBCA No. 57583, which raised a jurisdictional issue concerning the ASBCA’s authority to hear a claim relating to the performance of a delivery order under a General Services Administration Federal Supply Schedule Contract. There, the ASBCA issued a unique holding that the agency Contracting Officer did not have authority to issue a final decision, and therefore the ASBCA did not have jurisdiction over the resulting appeal, where the lack of jurisdiction was not even argued by the parties. Other jurisdictional issues were discussed in Harry Richardson, ASBCA No. 57582; American General Trading & Contracting, WLL, ASBCA No. 56758; and The Boeing Co., ASBCA No. 57490.

The Boards did not address any interesting cost accounting questions this quarter, but they did decide a pair of appeals involving bankruptcy issues. In USCS Chemical Chartering LLC v. USAID, CBCA No. 2058, the CBCA denied the appeal of a successor company on a claim originating from the contract activities of the predecessor, pre-bankruptcy company. In Broadway Consol. Cos., Inc., ASBCA No. 56905, the ASBCA dismissed a different appeal where a successor company attempted to litigate an appeal ignored by the trustee of the predecessor company. As a whole, it was a bad quarter for bankrupt companies to pursue appeals at the boards of contract appeals.

Other interesting topics this quarter included the termination of a contract where two employees of the contractor became romantically involved, and the rejection of the application of a Federal Rule of Civil Procedure, but the acceptance of the Federal Rules of Evidence as guidance, as applied to appeals at the ASBCA. As Johnny Carson used to say, “weird, wacky stuff.”

One staffing change to note – Katherine Allen has started a new position at the Department of the Treasury, Bureau of Engraving and Printing. Congratulations, Katherine!

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Merchants Automotive Group, Inc. v. Department of Homeland Security
CBCA No. 2362, Nov. 3, 2011 – Judge Sheridan
by John Sorrenti, McKenna Long & Aldridge LLP

Merchants Automotive Group involved a classic mistake-in-offer situation. The Federal Emergency Management Agency (“FEMA”) advertised on GSA E-Buy to lease two 2011 Chevrolet Suburban 1500 LT 4x4s. FEMA’s advertisement specifically stated that it required “two (2)” vehicles for 36 months.

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Three companies, including Merchants Automotive Group (Merchants), submitted a quote. Merchants quoted $1299 per month for a yearly price of $15,588 for the base year and the same amount for the two option years. The second lowest quote was for $1568 per month. FEMA accepted Merchants’ lowest quote and issued a purchase order to Merchants for “[l]ease of 2 each 2011 Chevy Suburban 1500 LT 4x4,” for a total of $15,558 per year with a total value on the order of $46,764 if FEMA exercised all its options.

After Merchants delivered the vehicles, it billed FEMA for $1299 per vehicle per month and upon receiving the first payment, Merchants realized that FEMA was paying $1299 per month for both the vehicles. Merchants claimed that its E-Buy quoted price was a per vehicle price and contacted FEMA requesting a modification to the contract to set $1299 as the price per vehicle. The Contracting Officer denied the modification request and Merchants submitted a claim seeking $15,588 more to cover the annual lease of the second vehicle. The Contracting Officer denied the claim but offered to pay an additional $3227 per year per vehicle for the base and two option years, which would have brought Merchants payment to the amount that FEMA would have paid to the next low bidder. Merchants timely appealed the Contracting Officer’s final decision.

The CBCA turned to the mistaken offer rules addressed in FAR 14.407-4, which state that a mistake in a contractor’s bid that is discovered post-award can be corrected if the correction would be favorable to the Government and would not change the requirements of the specifications. If the correction increases the price of the contract, the price increase cannot exceed that of the next lowest acceptable bid. There must be “clear and convincing” evidence of the mistake, which must either be mutual or, if unilaterally made, it must have been so apparent that the Contracting Officer should have noticed the mistake.

The CBCA recognized that the mistake was unilateral and to obtain post-award relief on a unilateral mistake, the mistake must be a “clear cut clerical or arithmetic error” or a mistaken reading of specifications, but not a mistake in judgment. Furthermore, the contractor has to show that the Government “knew or should have known of the mistake” when the offer was accepted.

Here, Merchants provided no evidence that the quote contained a clerical or arithmetic error or that FEMA should have known about the mistake. Thus, Merchants made a “unilateral error of judgment” in assuming FEMA was conducting the procurement on a per vehicle basis and did not show that the Contracting Officer should have realized Merchants’ mistaken assumption. Accordingly, the CBCA denied Merchants’ appeal because Merchants’ unilateral mistake did not meet the necessary criteria to provide the requested relief. When quoting, contractors must be absolutely certain of the terms and specifications of the requirement in order to not be bound by unfavorable terms.

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Red Sea Engineers & Constructors ("Red Sea") appealed the termination for default of its contract for the design and construction of a total of 65 pre-engineered, pre-manufactured buildings at Camp Phoenix and Camp Alamo in Afghanistan. Red Sea moved for summary judgment on the ground that the Government breached the payment provisions of the contract, terminated the contract on the basis of an incorrect contract completion date, and otherwise impeded and delayed its performance of the work. The ASBCA denied the motion, finding no breach as to the Government's rejection of one invoice, no error by the Government on the contract completion dates, and genuine issues of material facts on the remaining alleged grounds for summary judgment.

On September 28, 2009, the Government awarded Red Sea the contract at issue. Red Sea experienced various challenges during performance. At weekly construction coordination meetings held between July and August 2010, the Government noted that the non-payment of workers by Red Sea was a continuing problem. By August 29, 2010, approximately 125 workers went on strike as a result of the non-payment of wages. That same day, the Government issued a show cause notice to Red Sea, inviting it to show cause why the Government should not terminate the contract for default.

On September 9, 2010, Red Sea replied to the show cause notice, stating that the delay in the work was caused by: (i) the Government's failure to meet its payment obligations; (ii) weather and security (base access) delays; (iii) a stop work order for work within 12 feet of an overhead power line; (iv) the Government's failure to timely provide customs clearance documents; and (v) the Government's "arbitrary" rejection of a licensed electrician.

On September 22, 2010, the Contracting Officer terminated the contract for default. The stated basis for the termination was Red Sea's alleged failure to comply with the terms and conditions of the contract, failure to complete the work within the required time and failure to show in its response to the show cause notice that these failures were excusable or otherwise beyond its control.

Red Sea first appealed the default termination and then moved for summary judgment on the grounds that (i) the Government breached the payment provisions of the contract, (ii) the contract was not in default when terminated because the completion date had been extended by a modification, and (iii) the Government breached the implied covenant of good faith and fair dealing by threatening termination when a stop work order was in effect and by interference with Red Sea's business operations through attempts to destroy employment relationships, spreading false statements about payment, and attempts to direct violence to the owner of the company.

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The ASBCA found that the Government had not breached the payment provisions of the contract, citing the common law right of set-off and finding that Red Sea was not excused from its failure to complete the work at the specified times. The Board also found that the default termination was not premature. The ASBCA reasoned that, reading the contract's provisions as a whole and according reasonable meaning to all of the contract terms, the Government had the right to terminate the contract for default. The Board reiterated the rule that for summary judgment to be granted, a moving party must show that there are no genuine issues of material fact and that it is entitled to judgment as a matter of law; the Board found that Red Sea failed to make that showing with regard to its grounds. Lastly, with respect to Red Sea's final allegation, the Board concluded, based on the record, that Red Sea's "employment relationships" were self-destructing as a result of its failing to pay its workers in full the amounts due them.

Appeal of Broadway Consolidated Cos., Inc.,
ASBCA No. 56905, Nov. 14, 2011 – Judge Melnick
by Ryan E. Roberts, Sheppard Mullin Richter & Hampton LLP

Broadway Consolidated Cos., Inc. (“Broadway”) presented the question of whether a company that filed a Chapter 7 bankruptcy retained standing to pursue its claim after the bankruptcy was discharged and the trustee opted not to pursue the claim.

The Department of the Navy contracted with Broadway for the repair of a bridge at the Naval Training Center in Great Lakes, IL. The Navy terminated the contract for convenience, and Broadway submitted a request for equitable adjustment (“REA”) for $578,331.40. The Contracting Officer denied the REA, and Broadway filed a voluntary Chapter 7 bankruptcy petition. Broadway’s trustee discharged the bankruptcy without pursuing the appeal, and upon its completion the Government filed a motion to dismiss.

The ASBCA held that Broadway lacked standing to appeal, and granted the Government’s motion. The ASBCA held that the appeal was clearly governed by Terrace Apartments, ASBCA No. 40125R, 95-1 BCA ¶27,458. That case, and its progeny, “held that a corporation liquidated through Chapter 7 proceedings, such as Broadway, is deprived of the right to pursue claims outside the bankruptcy estate, even after the trustee abandons the claim without pursuing it.”

This line of cases could not be any clearer – if a company files a Chapter 7 petition, the company loses its decision making powers to the bankruptcy trustee regardless of whether any existing claims have been appealed at the ASBCA. Sometimes it’s best to cut your losses and move on.

Reliable Contracting Group, LLC v. Department of Veterans Affairs
CBCA No. 1539, Nov. 16, 2011 – Judge Sheridan
by Benjamin J. Kohr, Wiley Rein LLP

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In this pass-through claim on behalf Reliable Contracting Group, LLC’s (“Reliable’s”) subcontractor, the CBCA had to decide the appropriate compensation for increased costs associated with Reliable’s reasonable misinterpretation of the Government’s design specifications. The core dispute between the parties, who both agreed upon Reliable’s entitlement to damages, centered on the Department of Veterans Affairs’ (“VA’s”) responsibility to compensate Reliable for the costs incurred to correct the deficient hardware installed because of the misinterpretation.

The contract at issue was for the design and construction of a new utility plant and electrical distribution system at the VA’s Medical Center in Miami, Florida. The Government’s solicitation called for two back-up generators at the site, but included an Alternate option requiring a third back-up generator. Under the option, the VA intended for all three generators to run simultaneously in the event of power outage. Reliable’s initial post-award submissions indicated that its subcontractor would install all three generators, but the proposed ancillary electrical equipment would be sufficient for only two to operate simultaneously. Reliable based its submissions on the standard practice in the industry, in which the third generator would typically act as a back-up to the other two. The VA approved this design without recognizing that the three generators’ would not run simultaneously under Reliable’s proposed approach. The error was only discovered after construction was complete, forcing Reliable’s subcontractor to uninstall the insufficient electrical equipment, and re-install equipment sufficient to allow simultaneous operation of all three generators.

Reliable argued that it was entitled to the full amount expended removing and re-installing the ancillary electrical equipment because it reasonably interpreted the VA’s intent regarding the third generator. This approach was reasonable, Reliable argued, because both the VA’s stated requirements and standard industry practice, as well as the VA’s approval of Reliable’s initial circuitry submissions, clearly indicated that the Government only wanted two generators to be on-line at any point in time. The Government countered that, whether the original specifications were clear or unclear, Reliable’s failure to submit a timely final circuitry submission prevented the Government from identifying the misunderstanding prior to construction, and therefore Reliable should be liable for the additional costs incurred in purchasing, installing, and removing the underrated equipment.

The CBCA determined that the extra cost of removing and replacing the underrated equipment was incurred due to the VA’s “failure to adequately review” the contractor’s submissions and identify the inconsistencies. The Board specifically noted that Reliable’s submissions were clear enough to identify any discrepancy with the Government’s intent, and therefore Reliable properly relied on the Government’s approval of its submissions. Furthermore, the Government offered no evidence to rebut the argument that Reliable’s approach was consistent with the industry standard. Because Reliable’s interpretation of the solicitation’s requirement was reasonable, the Government’s failure to properly review these submissions should not be used to penalize the contractor.

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In sum, the case reaffirms contractors’ ability to rely upon the Government’s approval of their approach to fulfilling the contract. Contractors should feel confident that, where their submissions provide adequate information, the onus is on the Government to adequately review those submissions and raise any issues pertinent to performing the contract.

CTI Global Solutions, Inc. v. Department of Justice
CBCA No. 2498, Nov. 28, 2011 – Judge Daniels
by Eugene Scott

Appellant, CTI Global Solutions (“CTI”), asserted entitlement to an equitable adjustment to a purchase order issued against its GSA schedule because of delays on the part of GSA in agreeing to increase appellant’s schedule hourly billing rates.

Appellant holds a GSA schedule contract and after responding to an FBI RFQ for temporary administrative and professional services was awarded a purchase order. The order’s billing rates were the rates in appellant’s RFQ response and not the higher rates in its schedule. In addition, the purchase order and schedule each indicated the specific DOL wage determination that applied to it.

The purchase order was modified twice to extend its term. Each modification expressly specified that the applicable billing rates were those in appellant’s offer and not its GSA schedule rates. Prior to the second FBI purchase order modification, GSA and appellant modified appellant’s schedule contract to increase the billing rates and update the DOL wage determination.

After the second purchase order modification and shortly before the end of performance, appellant submitted a certified claim of $2,334,008.54 to the FBI. The Contracting Officer denied the claim.

CTI asserted that it is entitled to an equitable adjustment to: (1) retroactively apply its current GSA schedule rates to the purchase order as if GSA had promptly approved its requests for increased rates and those increased rates applied to the purchase order; and (2) be paid the equivalent of the increase in the health and welfare benefits mandated by the Department of Labor wage rate determinations.

The CBCA granted most of the FBI’s motion for summary judgment. The Board reasoned that because the FBI purchase order specified the applicable billing rates, which were different than appellant’s GSA schedule, there is no basis for adjusting the order’s price. Judge Daniels noted that “whether GSA was dilatory in processing a request for increased schedule contract rates or not has no bearing on the outcome of this case.”

The Board left open a possible exception based on the facts of this case. At the parties’ request, the board suspended the proceedings to give the parties 30 days to negotiate the wage

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determination issue. The board reasoned that if appellant can show: (1) that its increases in the applicable wage and benefits costs were made to comply with the wage determination; and (2) that it wouldn’t have provided those increased wages or benefits of its own volition, it may be entitled to an equitable adjustment to the billing rates for the period after the wage determination became effective.

The lesson learned here is the practical lesson that contractors should be diligent in negotiating increased prices to its GSA schedules to avoid getting stuck with outdated prices in individual orders placed against that schedule.

Because the board left open the possibility that appellant could potentially recoup the cost of increased wage and benefits costs due to a revised wage determination we’ll need to stay tuned for a decision on the merits of this issue if the parties fail to reach agreement.

Appeal of DG21, LLC
ASBCA No. 56386, Nov. 28, 2012 – Judge Thomas
by Jeffery M. Chiow, Rogers Joseph O’Donnell

DG21, LLC (DG21) a joint venture, filed a claim under its firm fixed-price/indefinite quantity contract to provide base operating support services (BOSS) for Navy Support Facility, Diego Garcia in the Indian Ocean. Under the contract, DG21 was required to reimburse the Navy for electricity in government furnished facilities at the prevailing rate. DG21 claimed that after a year of performance, it was entitled to reimbursement for $1.3 million of electricity costs that exceeded its estimated usage under theories of negligent misrepresentation, superior knowledge, mutual mistake and breach of the duty of good faith and fair dealing. The potential periods of performance under DG21’s contract and all options could total 120 months, so DG21’s asserted damages over the life of the contract may be much higher.

DG21 held the predecessor BOSS contract, under which the Navy provided electricity for free, and under that contract DG21 was required to deliver a monthly report of electricity usage to the Navy. According to the Board’s findings, DG21 developed electricity estimates for its proposal based on those reports in early November 2005. Later that month, DG21 conducted an internal pricing review and substantially and inexplicably reduced its estimate for electricity costs. Still later in the same month, in reply to a question from DG21’s managing member, the Navy erroneously stated that it did not have historical data for electricity consumption. DG21’s proposal manager and its lead estimator testified that its underestimates were based on the Navy’s misstatement that it had no historical usage data, and DG21’s subsequent efforts to calculate an usage estimate. The Board found DG21’s witnesses’ testimony irreconcilable with the facts that DG21 actually possessed accurate historical data and that its pricing decision preceded the Navy’s statement that no usage data existed.

The Board held that DG21 had failed under all of its theories because it had not established either that it was misled by the Navy’s erroneous statement or that it relied upon it.

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DG 21 could not show that the government’s error destroyed its reasonable expectations regarding the fruits of the contract where DG 21 actually possessed the information at issue, and knew it.

Appeal of SplashNote Systems, Inc.
ASBCA No. 57403, Nov. 29, 2011 – Judge Grant
by Gregory Hallmark, Holland & Knight

Perhaps the most noteworthy of several cost allowability issues before the ASBCA in this appeal was whether a bonus paid to a SplashNote executive constituted allowable compensation costs or was an unallowable distribution of profits.

In fiscal year 2005, SplashNote paid its chief executive and majority owner a bonus of $34,168, purportedly pursuant to a "Profit-Sharing Bonus Plan." The company also gave bonuses to two other employees, each in the $6-8 thousand range. SplashNote, which was established in 2000, paid its first bonuses in FY 2005 and also paid bonuses in FYs 2006 and 2007, the other years in which it earned a profit. DCMA found the executive's total compensation in FY 2005 (including the bonus) to be reasonable. However, DCAA determined the bonus to the executive to constitute a distribution of profits, rather than compensation for services. The Government issued a demand for payment of the $34,168 and other costs previously reimbursed but deemed unallowable. The Contracting Officer issued a final decision that SplashNote owed the amounts deemed unallowable and SplashNote appealed.

SplashNote argued that the bonus was, in fact, compensation for services and not a distribution of profits, because DCMA had found the executive's total compensation to be reasonable, DCAA did not question the bonuses paid to other employees, and SplashNote followed a consistent practice in paying out bonuses in years in which the firm made a profit.

The ASBCA agreed with the Government that the bonus paid to the executive was a distribution of profits, and held that the cost was unallowable for reimbursement. The Board cited the cost principle at FAR 31.205-6(a)(6), which provides that "special consideration" must be given to compensation paid to the owners of closely held corporations. That compensation must not be a distribution of profits, which is not an allowable cost. The Board agreed with the Government that the bonus was a distribution of profits rather than compensation for services because SplashNote declared no dividends, the executive's bonus was about 71% of the total amount paid in bonuses, and the firm acknowledged that the bonus constituted "profit-sharing."

That the executive's total compensation was deemed reasonable did not, in the Board's view, reflect on the question of whether the bonus constituted a distribution of profits. The Board also dismissed SplashNote's argument that the other employees' bonuses were not questioned because the allowability of their compensation, unlike the executive's, is not limited by the "distribution of profits" consideration. Lastly, the Board held that the consistency of

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Case Digests (cont’d):

SplashNote's practice of paying profit-sharing bonuses had no bearing on whether the bonus was a distribution of profits.

Contractors should know that the Government is closely examining and strictly enforcing limits on the allowability of executive compensation. Contractors should structure their executive compensation and bonus policies with the FAR cost principles in mind. As this case shows, the Government may treat a bonus to an executive as unallowable even if amount of the bonus is unquestionably reasonable.

Syed Z. Ahmed v. Department of Agriculture
CBCA No. 2509, Nov. 30, 2011 – Judge Hyatt
by Christopher Noon, Sheppard Mullin Richter & Hampton LLP

The issue before the CBCA was whether the Government was responsible for flooding damage caused to leased property as the result of severe rain storms. In this case, the Department of Agriculture (“USDA”) entered into a five-year lease for real property consisting of laboratory and storage space in Remington, Indiana. The property also contained a parking lot near a creek. Although USDA was responsible for maintaining the property, the lease contained a restoration waiver under which USDA had no obligation to restore the property to its original condition upon termination of the lease. The lease also provided that the Government may terminate the lease if “the property is partially or totally destroyed or damaged by fire or other casualty so that the leased space is untenantable as determined by the Government.”

In January 2008, Remington, Indiana experienced severe rain storms that caused the creek near the property to overflow, which flooded and damaged the building. A semitrailer parked by the Government on the property settled into the creek bed in front of a viaduct. The Federal Government subsequently declared the area a major disaster area. The USDA cleaned up and made the repairs necessary to continue use of the facility, however USDA vacated the property when the lease expired at the end of May 2009. Thereafter, the appellant submitted a claim to the Contracting Officer, alleging that the semitrailers were not properly anchored and the parking area was not sufficiently improved to accommodate them. The appellant asserted that the flooding damage was caused as a result of the semitrailer falling into the creek bed and blocking the viaduct, thus causing the creek waters to overflow. The Government rejected the argument that it had negligently maintained the property and blamed the severe rain storms for the damage.

The CBCA focused on the terms of the lease, determining that the lease only required the Government to return the premises in good order and repair excepting ordinary wear and tear and damage for which the Government had no obligation to make repairs. The Board also focused on the lease term that provided that the Government may vacate and pay no further rent in the event of a major casualty that makes the property untenantable. Although there is an

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Case Digests (cont’d):

implied obligation on the part of the Government not to damage the property, the Board found nothing in the record to suggest that the flooding damage may be attributed to a lack of reasonable care of the property by the Government.

After reviewing the evidence, which mostly consisted of photographs submitted by both parties, the CBCA held that the appellant’s “evidence does not demonstrate that the semitrailer caused the flood and damaged the building, or that the damage to the building was directly caused by inadequate maintenance measures taken by the Government.” The Board was convinced by the Government’s dated photographs that first show the semitrailers floating in the flood waters and then subsequently at the creek bottom in front of the viaduct. The Board believed this proved that it was the flood waters that caused the semitrailer to dislodge, as opposed to the semitrailer causing the flooding by blocking the viaduct.

This simple case serves as an important – if not obvious – reminder that evidence will make or break a case. However, as this case illustrates, dubious evidence and bad facts will almost always break the case for an appellant.

Appeal of Sharp Electronics Corp.
ASBCA No. 57583, Dec. 6, 2011 – Judge Thomas
by Townsend L. Bourne, Sheppard Mullin Richter & Hampton LLP

At issue in this case was whether the Board possessed jurisdiction over a dispute between Sharp Electronics Corporation (“Sharp”) and the Army Contracting Command (“Army”) regarding the termination of Sharp’s General Service Administration (“GSA”) Multiple Award Schedule (“MAS”) contract, where Sharp submitted its certified claim for early termination fees to the ordering activity Contracting Officer rather than the schedule Contracting Officer. The Board examined FAR 8.406-6, which provides that disputes relating to the terms and conditions of schedule contracts shall be referred to the schedule Contracting Officer for resolution, while disputes arising from the performance of an order may be resolved by the ordering activity Contracting Officer.

Sharp was awarded a delivery order by the Army for the lease of copiers and multifunctional equipment under its GSA schedule contract. The Army executed the first two option periods as provided in the delivery order. However, the Army was informed before the end of Option Year Two that it could not exercise the third option year because this would cause the government to exceed the value of the order by more than 25%, which it stated it could not do. Thus, rather than extend the delivery order for the full period of Option Year Three as provided in the delivery order, the parties executed a modification to the delivery order that exercised part of the third option year, extending the period of performance by six months. Following this six month period, Sharp sent a letter to the Army requesting a modification to the delivery order “evidencing the Army’s Termination for the Government’s Convenience” and submitted
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an invoice for early termination fees. Sharp then filed a certified claim with the Army Contracting Officer and, when the Army Contracting Officer did not issue a final decision within 60 days, Sharp appealed the deemed denial of its certified claim to the Board.

The Board raised the issue of jurisdiction in this case \textit{sua sponte}. Interestingly, both Sharp and the Army argued that the Board had jurisdiction to hear the appeal because the dispute did not pertain to the terms of the schedule contract. The Army argued that the terms of the schedule contract “were never triggered” because the dispute involved the terms of the modification rather than the provisions of the schedule contract. Sharp claimed that the terms and conditions of the schedule contract were incorporated into the delivery order such that the dispute involved a breach of the delivery order and not the schedule contract. The Board disagreed with both parties, stating:

The key issue before us is an interpretation of the scope of the termination provisions of the Schedule Contract. Are termination charges only due as a result of unilateral action by the government or do these provisions impose termination charges on the government if the lease period is reduced, even as here, by bilateral agreement of the parties?

As such, the Board determined that the Army Contracting Officer did not have authority to issue a decision on Sharp’s certified claim and, therefore, the Board lacked jurisdiction to hear the appeal. This case serves as another reminder to contractors to be mindful of unique jurisdictional requirements for dispute resolution – especially those related to schedule contracting.

\textbf{Appeal of Harry Richardson}
ASBCA No. 57582, Dec. 9, 2011 – Judge Melnick
by Raja Mishra, Crowell & Moring LLP

In this appeal, the ASBCA granted the U.S. Air Force’s motion to dismiss for lack of jurisdiction because appellant simply failed to submit his initial claim to the contacting officer, an oversight that proved fatal to his appeal.

The events at issue occurred at Edwards Air Force Base in California. Constance Farmer served as the manager of the Edwards Aero Club at the base. She was also the domestic partner of appellant, Harry Richardson. In November of 2010, the Aero Club entered into Contract No. EDWA-F-11C0008 with Richardson to provide services as an air frame and power plant mechanic. Under the contract’s general provisions, the Contracting Officer could terminate the contract for convenience. In addition, the contracts disputes clause said all disputes “shall be decided by the Contracting Officer[…].” The disputes clause provided for the appeal of an adverse Contracting Officer decision to the ASBCA.

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In March of 2011, the base’s chief of resource management confronted Farmer about her relationship with Richardson, and announced the contract would be terminated. The Contracting Officer issued a modification terminating the contract for convenience. Richardson did not submit a claim to the Contracting Officer pursuant to the disputes clause in the contract. Instead, he sent a letter of appeal straight to the ASBCA, arguing “no where [sic] in any of the contract [sic] or in any of its attachments does it refer to relationships between coworkers being a reason for contract termination nor does it state that such relationships are forbidden.”

The ASBCA never reached Richardson’s contention. The Board began its decision by noting that the case raised a major jurisdictional issue. The Aero Club is a Non-Appropriated Fund Instrumentality (NAFI) of the Air Force. Historically, NAFIs were outside the Board’s jurisdiction under the Contract Disputes Act of 1978 (“CDA”). But the Board’s charter permits it to entertain appeals “pursuant to the provisions of contracts,” and indeed the Board has frequently adjudicated appeals against NAFIs pursuant to disputes clauses. A recent Federal Circuit case raised the question of whether the CDA doctrine barring NAFI adjudication was in fact dead doctrine. See Slattery v. United States, 635 F.3d 1298 (Fed. Cir. 2011).

But the Board refused to answer this interesting doctrinal question. Instead, it said: “[I]n the absence of a claim and final [Contracting Officer] decision the Board lacks jurisdiction over an attempt to directly appeal a NAFI’s cancellation of a contract . . . the linchpin of the Board’s jurisdiction over any appeal is the initial submittal of the claim to the Contracting Officer, followed by a final decision.” The Board dismissed the claim for lack of jurisdiction.

It is unclear whether appellant’s fatal procedural gaffe was the product of sloppy lawyering or his status as a pro se litigant. Although the underlying lesson is one that we often repeat – that contractors must perfect their claim before filing an appeal – the more interesting points were, unfortunately, not discussed. Regardless, would-be litigants should retain counsel well-versed in government contracts to ensure that claims are properly adjudicated.

Appeal of American General Trading & Contracting, WLL
ASBCA No. 56758, Dec. 13, 2011 - Judge Melnick
by Katherine Allen, U.S. Department of the Treasury, Bureau of Engraving and Printing

In American General Trading & Contracting, WLL (“AGT”), the ASBCA denied the parties' cross-motions for summary judgment on AGT's first claim that the Government negligently estimated the quantity of work to be performed under the contract. The Board also denied as moot the Government's motion to dismiss for lack of jurisdiction regarding a FAR Part 50 claim because AGT secured jurisdiction on the basis of an alternative legal theory - breach of an implied-in-fact contract.

On February 17, 2003 the U.S. Army Central Command-Kuwait awarded a $7.8 million firm-fixed price contract with total item numbers adjustment to AGT for laundry services at five locations in Kuwait. The solicitation and contract included estimated requirements of the

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amount of laundry services to be provided based upon predicted numbers of troops at each camp. AGT relied upon these estimated requirements to determine its contract price. However, on March 20, 2003 President Bush ordered the invasion of Iraq, resulting in fewer soldiers in the Kuwait camps. Accordingly, over the course of the contract's six month base term, the actual amount of laundry provided to AGT from the five camps was 72.4% below the estimated average requirements. AGT also alleges that it was instructed to construct two more facilities at Camp Victory and 35th Brigade, with additional costs to be paid by the Government.

The Government argued that because the laundry requirements decreased due to the deployment from Kuwait to Iraq, AGT's claim was barred by the sovereign acts doctrine, unless the contract provided a specific remedy. The Board concluded, however, that AGT's claim was a challenge to the reasonableness of the estimate, not a challenge to the Government's sovereign act of deploying troops.

AGT argued that during the time frame in which AGT was bidding the contract, the officials responsible for the solicitation knew of the impeding invasion and its impact on the laundry services requirement, but failed to correct the estimates. AGT however, did not present any evidence about what information was reasonably available for the purpose of the laundry requirements estimate. AGT's cross-motion for summary judgment was accordingly denied as it failed to present evidence of uncontroverted facts supporting its case.

AGT initially relied upon FAR 50.103-2(c) in its second claim as grounds for entitlement to repayment for additional costs incurred when building the two extra sites. The Government correctly argued that the ASBCA does not have jurisdiction over such matters. However, the Board concluded that although not specifically stated in the original claim as presented to the contractor officer, the facts support a claim based on the theory of breach of an implied-in-fact contract allowing it to survive summary judgment.

This case is a reminder to contractors that an action constitutes the same claim as what was presented to the Contracting Officer so long as it arises from common or related facts. Therefore, contractors are free to change their legal theory of recovery as the case evolves, so long as it stems from the same set of facts as asserted in the original claim, and essentially seeks the same relief.

**Appeal of Harold N. Colerick**  
PSBCA No. 6356, Dec. 14, 2011 – Judge Shapiro  
by Ryan E. Roberts, Sheppard Mullin Richter & Hampton LLP

In this Appeal, the PSBCA had to decide whether the termination of Appellant’s mail transportation contract was made under the Postal Service’s notice termination or convenience termination procedures. Appellant’s contract included eight of the Postal Service’s standard terms and conditions, including language that explicitly stated that the “Termination for the

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Postal Service’s Convenience” clause did not apply. Upon termination of the contract, Appellant received a letter stating that the contract was being terminated under the notice termination clause.

Despite the clear language in both the contract and the letter, the Postal Service asked Appellant to sign a contract amendment stating that the contract was being “terminated pursuant to the Termination for Convenience clause.” In subsequent communications the Postal Service repeatedly confused the two clauses, referring to them interchangeably. The Postal Service also failed to provide the required 90 days under the notice termination clause. Based on this confusion, the Appellant filed a Notice of Appeal seeking the increased damages available to him under the Termination for Convenience clause.

The PSBCA held that the contract was terminated under the notice provision of the contract. Judge Shapiro noted that, despite the Postal Services’ “sloppy use of critical terminology” the contract only included the notice termination clause, which the termination letter properly cited when ending the contract. Furthermore, the parties reached an agreement resolving the Postal Service of liability to the failure to provide notice. The PSBCA held that Appellant was therefore only entitled to the remedies available to him under the notice clause, and denied the Appeal.

**Appeal of Quimba Software, Inc.**
ASBCA No. 57636, Dec. 19, 2011 – Judge Delman
*by Tara L. Ward, Wiley Rein LLP*

In this case, the ASBCA considered whether Rule 6(d) of the Federal Rules of Civil Procedure (“FRCP”) applied to enlarge the Contract Disputes Act’s (“CDA”) deadline for filing an appeal of a Contracting Officer’s final decision. The board answered in the negative, dismissing the appeal and reaffirming the board’s strict adherence to the statutorily imposed 90-day deadline.

Quimba had been performing a cost-type contract for software awarded by the Air Force Research Laboratory in July of 2003. In November of 2010, the Defense Contract Audit Agency notified Quimba in writing that the Government intended to disallow certain deferred compensation costs Quimba had claimed in its fiscal year 2004 incurred cost proposal. After informing the Government of its preference that the parties correspond by email, on January 6, 2011, Quimba sent an email contesting the Government’s position on its incurred cost proposal. On March 4, 2011, the ACO emailed Quimba its final decision demanding payment of the unallowable deferred compensation costs. Quimba acknowledged receipt of the ACO’s final decision the same day.

Quimba filed its appeal with the ASBCA on June 3, 2011 – 91 days after the ACO’s final decision. In response to the Government’s motion to dismiss the appeal, Quimba argued

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that the deadline should be altered to account for Quimba’s having received notice via email rather than regular mail. Specifically, Quimba argued that the board should follow FRCP 6(d), which provides a party that consents to receiving notice via email an additional three days to act.

The Board rejected Quimba’s argument. According to the board, Rule 6(d) addresses the time given a party litigating in federal court but “does not address the statutory appeal period provided to a contractor upon receipt of a Contracting Officer’s decision under the CDA.” Under the CDA, 41 U.S.C. §7104(a), Quimba was required to file its appeal of the ACO’s final decision within 90 days of having been notified. Citing Quimba’s failure to meet this jurisdictional requirement, the board dismissed its appeal as untimely.

At bottom, Quimba confirms agency boards’ strict construction of the statutory deadline for filing an appeal. The Federal Rules of Civil Procedure, particularly Rule 6(d), does not provide any flexibility to a contractor appealing a Contracting Officer’s final decision, even where the Government consents to email notification.

**Appeal of Distributed Solutions, Inc.**
ASBCA No. 57266, Dec. 28, 2011 – Judge Clarke
by Ryan E. Roberts, Sheppard Mullin Richter & Hampton LLP

In Distributed Solutions, Inc., the ASBCA had to decide the parties’ cross-motions for summary judgment as to whether the contract and modifications allowed the Government royalty-free use of the developed software after completion of contract performance.

The Air Force Non-Appropriated Fund Purchasing Office contracted with Judds, Inc. (later changed to SMC Interactive, Inc. (“SMT”)) for “software development, maintenance, help desk, training and enhancements for the [Internet-based Purchasing System].” The contractor was tasked with providing customized software to meet the specifications of the Statement of Work, but the contract did not include a provision defining the relative intellectual property rights of the parties. To address this issue, the parties executed a modification which stated that SMT retained ownership of the software, but the Government retained a “continuous and non-exclusive” royalty-free license to use the software to operate its eProcurement system.

In the modification implementing the novation agreement allowing Distributed Solutions, Inc. (“DSI”) to assume performance responsibility, the parties agreed that the performance substitution applied to the above quoted modification (reflecting the intellectual property rights of the parties) “for the entire life of the contract and will not be considered complete until the contract is closed.”

In its appeal, DSI argued that the language “valid for the entire life of the contract” divested the Government of its royalty-free license at the end of the contract. Therefore, DSI argued that it was entitled to several million dollars a year in royalty fees.

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The ASBCA disagreed, and held that the Government retained its “continuous and non-exclusive” royalty-free license for the software. The Board reasoned that the language “valid for the entire life of the contract” did not “unambiguously evidence the divestiture of the Government’s license rights.” Given that it was counterintuitive that the Government would voluntarily agree to divest itself of its license rights, the ASBCA held that DSI’s interpretation did not fall within the “zone of reasonableness” and granted summary judgment for the Government.

If the parties truly intended to alter their license rights with the modification, then DSI should have insisted on much stronger language that clearly evidenced the royalty structure going forward. Without this language the facts seem to indicate that the contractor is merely trying to pull a fast one on the Government.

Appeal of The Boeing Company
ASBCA No. 57490, Jan. 6, 2012 –Judge Melnick
by Benjamin J. Kohr, Wiley Rein LLP

In this appeal, the ASBCA addressed the issues of whether a claim against The Boeing Company (“Boeing”) under the Contracts Disputes Act (“CDA”) was brought in a timely manner and, if not, whether the Board was precluded from finding jurisdiction due to the untimely nature of the claim. The Board held: (1) the claim had accrued more than six years prior to the Contracting Officer’s final decision, and was therefore untimely; (2) there was insufficient justification to toll the statute of limitations; and (3) that the ASBCA lacked jurisdiction due to the untimely nature of the claim, thus rendering the claim a nullity.

In October of 2000, Boeing submitted a Cost Accounting Standards (“CAS”) Disclosure Statement to the Defense Contract Management Agency (“DCMA”), providing: (1) notice that Boeing had changed its accounting practices following its merger with McDonnell Douglas Corporation; and (2) an analysis of the cost impact of the accounting change. The Defense Contract Audit Agency (“DCAA”) audited Boeing’s analysis and determined that the accounting change would result in approximately $7.4 million in increased costs to the government due to the reduced allocation of cost to firm-fixed priced contracts. In September 2003, the Contracting Officer (“CO”) sent Boeing a letter determining that the change was not desirable, proposing a contract adjustment of $6.42 million plus interest, and requesting Boeing’s response “so we can finally settle this issue.” Several rounds of negotiations occurred between 2003 and 2005, with subsequent intermittent discussions occurring until 2010. The CO issued a final decision demanding $6.42 million from Boeing on October 25, 2010.

Boeing appealed the final decision and argued that the Government’s claim was untimely due to its failure to comply with the CDA’s requirement that Government claims against a contractor be submitted within six years after accrual of the claim. In response, the Government contended that the CO’s September 2003 letter constituted a final decision and

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therefore the claim was timely. In the alternative, the Government asserted that Boeing induced the Government into missing the claim submission deadline by leading the CO to believe that the matter was on the verge of settling, and therefore the CDA’s statute of limitations should be equitably tolled.

The Board noted that a claim accrues under the CDA “when the events giving rise to liability were known or should have been known.” See FAR 33.201. Because the CO’s 2010 final decision did not articulate any facts occurring after the 2003 letter relating to the basis of the Government’s claim, the Board determined that the Government knew, or should have known, any basis for its claim in 2003. Thus, the Board found that the clock began running on the CDA statute of limitations in September of 2003.

The Board rejected each of the Government’s arguments for timeliness. The Board held that the CO’s September 2003 letter was not a final decision asserting a claim within the meaning of the CDA, as it failed to demand a sum certain and reflected a desire to engage in negotiations rather than submit a claim. The Board also rejected the Government’s request for equitable tolling because it found no evidence in the record that Boeing engaged in any misconduct that could have induced the Government into missing the deadline for submitting its claim. The Board noted that the CO specifically invited Boeing to engage in negotiations, and that Boeing’s continued resistance to settling the issue should have heightened, rather than diminished, the Government’s awareness of the need to issue a final decision.

Finally, the Board addressed whether the six-year CDA statute of limitations was a condition of the Board’s jurisdiction or a substantive issue which would allow the Board to sustain Boeing’s complaint on the merits. The Board found that the Federal Circuit’s decisions, in both Arctic Slope Native Association v. Sebelius, 583 F.3d 785 (Fed. Cir. 2009) and Systems Development Corp. v. McHugh, 658 F.3d 1341 (Fed. Cir. 2011), held that the presentment of a timely claim is a jurisdictional requirement under the CDA, and thus the Government’s claim was a “nullity.” The Board discussed, at length, the intervening holdings in Henderson v. Shinseki, 131 S. Ct. 1197 (2011) and Cloer v. Secretary of Health & Human Services., 654 F.3d 1322 (Fed. Cir. 2011) (en banc), each of which considered the jurisdictional limitations imposed by other statutes of limitation. Ultimately, the Board found that none of the intervening precedent undermined the jurisdictional requirement of a timely claim under the CDA, noting: “Given that [the claim] is invalid [due to its untimely nature], it is a nullity and we lack jurisdiction to entertain an appeal from it.”

The Board’s holding presents an important reaffirmation for government contractors. As the ever increasing demand for Government audits causes the number of unresolved DCAA audits and cost accounting issues to multiply, contractors should be particularly wary of untimely claims. In particular, when presented with a Government claim, contractors should ensure that they determine when the claim accrued and calculate whether the claim is still timely under the CDA.

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USCS Chemical Chartering LLC v. U.S. Agency for International Development
CBCA No. 2058, Jan. 11, 2012 – Judge Daniels

by Daniel Strouse, Wittie Letsche & Waldo LLP

The CBCA was asked to decide the following question: if a government contractor entering bankruptcy fails to list a claim against an agency among its assets, is its successor company, emerging from the bankruptcy, able to prosecute the claim?

On March 9, 2009, Chemical filed a certified claim with USAID asserting that it suffered damages due to government-caused delays in performance of its contract.

Prior to issuance of the Contracting Officer’s final decision, U.S. Shipping Partners, P.C. and its affiliates, which included Chemical, petitioned for chapter 11 bankruptcy reorganization. The entity under the bankruptcy court’s supervision is referred to as “Chemical II.” Chemical II failed to include Chemical’s claim against USAID as an asset on its assets schedule filed in the bankruptcy proceeding; however, the schedule included a paragraph stating: “Debtors might not have identified . . . all of their causes of action against third parties as assets in their Schedules . . . The Debtors reserve any and all of their rights with respect to any causes of action they may have, and . . . the Schedules . . . shall [not] be deemed a waiver of any such causes of action” (the “Reservation Clause”).

On March 31, 2010, the bankruptcy court issued its final decree closing the bankruptcy case. The entity that emerged from bankruptcy is referred to as “Chemical III.”

On April 15, 2010, the USAID Contracting Officer denied Chemical’s claim, and Chemical III appealed. USAID moved to dismiss, asserting that: (i) the doctrine of judicial estoppel barred the contractor from pursuing the matter; and (ii) Chemical III lacked standing to pursue the case. The Board decided the case based only on the issue of standing.

To have standing, a party must actually suffer an injury. Here, Chemical was the only party that suffered such an injury; Chemical III did not. Further, although Chemical III assumed Chemical’s assets through the reorganization, the Board cited precedent to support its finding that Chemical III did not hold the right to proceed with the appeal on Chemical’s claim, since the schedule of assets presented to the bankruptcy court did not include Chemical’s claim against USAID. Chemical III argued that nonetheless, the Reservation Clause preserved its right to pursue Chemical’s claim, and therefore, Chemical III had the requisite standing to pursue that claim. The Board found that the Reservation Clause was merely boilerplate, and that if applied as Chemical III argued, it would render the listing of assets useless, and leave the bankruptcy court and creditors with no basis to determine an appropriate resolution of the bankruptcy.

The Board also noted that because the bankruptcy court did not dispose of the
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undisclosed asset (Chemical’s claim), the claim remained a part of the bankruptcy estate and Chemical III could ask the bankruptcy court to reopen the proceedings to permit Chemical II to pursue the claim, or to transfer the claim to Chemical III.

This case drives home an important point: a contractor filing a bankruptcy petition should include all of its claims.

Appeal of Parsons-UXB Joint Venture
ASBCA No. 56481, Jan. 12, 2012 – Judge Melnick
by Jeffery M. Chiow, Rogers Joseph O’Donnell

In an earlier decision on the Government’s motion for summary judgment, the Board determined that Parsons-UXB Joint Venture (the JV) exceeded the available contract funding in violation of the contract’s Limitation of Funds clause when it submitted an invoice for reimbursement of taxes imposed by the State of Hawaii. The JV had previously challenged Hawaii’s imposition of the taxes in litigation against the state. Notwithstanding its determination that the JV exceeded the contract ceiling, the Board did not grant summary judgment because it found there were genuine issues of material fact to be resolved at trial concerning “if and/or when [the JV] had reason to foresee it would be liable for” the taxes.

This decision concerns a pretrial motion in limine seeking to preclude a Government expert’s testimony at trial. and seeking the exclusion of the expert’s report which concluded that the tax bill was foreseeable. The expert report also opined that there was no evidence the JV had paid the taxes. The JV contended that the expert’s report consisted of legal conclusions and recitations of fact intended to advise the Board on the legal implications of the evidence. The Government argued the expert’s opinion should be accepted because “an accounting expert should be permitted to testify regarding the allowability of the costs of a transaction.”

Citing federal precedent concerning the introduction of expert evidence and Federal Rule of Evidence 702, the Board excluded the expert’s report and his testimony finding that his opinion was not based upon any scientific, technical, or other specialized knowledge and did not help the trier of fact. The Board found none of the facts described by the expert required any expertise, and all were within the Board’s competence to determine as the trier of fact. The Board also found that deciding whether two lump sum tax payments had been paid was a simple factual question. Most importantly, the Board held that foreseeability was a legal question to be decided by the Board. The Board cited Rumsfeld v. United Technologies Corp., 315 F.3d 1361, 1369 (Fed. Cir. 2003), for the general proposition that expert testimony pertaining to issues of law is inadmissible, but did not analyze that decision which held that interpretation of cost accounting standards is a question of law on which expert testimony should not be heard.

This case is a reminder that while not strictly binding, Boards look to the federal rules of (continued on next page)
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evidence for guidance. See ASBCA Rule 20(a) and CBCA Rule 10. Also, to be admissible, expert opinions must explain rather than advocate.

Singleton Enterprises v. Department of Agriculture
by Eugene Scott

This appeal concerns when a contractor is entitled to reformation of its contract for a unilateral mistake in its bid. The Department of Agriculture used the sealed bid acquisition process to contract for restoration of a marsh in Louisiana. The principal task under the contract called for dredging and excavation. After reviewing the bids, respondent’s contract specialist determined that there was no need for bid verification before award because there was no evidence of a mistake in bids. Subsequently, the appellant, Singleton Enterprises was notified of its low bid status and then awarded a contract.

Almost seven months after contract award and after appellant terminated its subcontractor performing the services, appellant notified the Contracting Officer of the alleged mistake in bid. Appellant requested an increase in the contract price of $265,000 or more than fifty (50%) percent. However, appellant failed to provide any documentation to prove that it intended to bid a price than the price it actually bid. The Contracting Officer denied appellant’s claim, concluding that there was not clear and convincing evidence of a mistake because she did not receive substantiating evidence to determine what costs were utilized in the preparation of the bid.

Appellant argued that the disparity between the Government’s cost estimate and the third highest bidder should have put the Contracting Officer on notice of the mistake before the award. The appellant further argued that the Government’s cost estimate was unreasonable.

The CBCA confirmed that in order for a contractor to show entitlement to reformation of its contract for a unilateral mistake-in-bid, the contractor must establish by clear and convincing evidence each of the following elements: (1) a mistake in fact occurred prior to the contract award; (2) the mistake was a clear-cut clerical or mathematic error or a misreading of the specifications and not a judgment error; (3) prior to award, the Government knew or should have known that a mistake had been made; (4) the Government did not request bid verification; and (5) proof of the intended bid is established.

The CBCA determined that appellant failed to meet elements three and five. Regarding element three, appellant failed to show that the Government knew or should have known of the mistake before award. A disparity of bids alone is not sufficient to put the Contracting Officer on notice of a pre-award mistake when the Contracting Officer in analyzing bids relied on a reasonable government estimate. Further, regarding element five, appellant did not present clear and convincing evidence of what its intended bid would have been absent the mistake.

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This case emphasizes the need for proper and thorough bid review before proposal submission. The five-part test for demonstrating a right to contract reformation is a high burden, and in this case the failure to perform an adequate review resulted in a significant cost to the contractor.

**Rafael Portillo v. General Services Administration**  
CBCA No. 2516, Jan. 24, 2012 – Judge Somers  
by Steven Cave, Womble Carlyle Sandridge & Rice, LLP

The ultimate issue in *Portillo* was whether, under the plain terms of a lease, the Government could terminate the agreement. The appellant, Mr. Portillo, filed a claim for unpaid rent pursuant to a lease (the “Lease”) entered into by his predecessor in interest and the General Services Administration (“GSA”). After having his claimed denied by GSA, Mr. Portillo appealed the decision to the CBCA. The appeal was denied on summary relief because the terms of the Lease were unambiguous and allowed GSA to terminate the agreement after providing written notice at least sixty days in advance of termination, which GSA undisputedly did.

The “Lease,” entered into by the parties on January 28, 1998, called for GSA to rent office space in Sonora, California “for a term of ten (10) years, eight (8) years firm, subject to termination and renewal rights.” The Termination Clause included in the Lease allowed GSA to terminate the lease “. . . in full or in part at any time after 8 years by giving at least 60 days notice in writing to the lessor and no rental shall accrue after the effective date of termination.” The Lease also included a term anticipating the GSA’s need to vacate the premises prior to termination, stating that “in the event of total vacancy, the rental rate will be reduced by $6.80 per square foot per annum.”

While the Lease was in effect, GSA issued several supplemental lease agreements (“SLAs”). SLA 2, issued December 8, 1998, “established that the ten-year, eight-year firm lease term would commence on October 26, 1998, and would expire on October 25, 2008, subject to termination rights.” *Id.*

After assuming the Lease pursuant to his purchase of the subject property in 2006, Mr. Portillo also agreed to modify the Lease by accepting an SLA from GSA. SLA 6, issued to Mr. Portillo on July 14, 2010, stated that:

NOW THEREFORE, these parties for the considerations hereinafter mentioned covenant and agree that the said Lease is amended, effective upon execution by the Government, as follows: to extend the lease for one (1) year, six (6) month firm term.

. . . .

TO HAVE AND TO HOLD the said premises with their appurtenances

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from the term beginning on October 26, 1998 through October 25, 2011, inclusive; subject to termination and renewal rights as may be hereinafter set forth. *Id.*

On January 26, 2011, GSA notified Mr. Portillo, by letter, of the Government’s intent to completely vacate the leased space on March 11, 2011 and terminate the lease effective April 27, 2011. The GSA’s letter stated that it would pay the reduced rental rate from March 12, 2011 through April 26, 2011 and would stop paying rent altogether as of the termination date.

The parties subsequently exchanged letters regarding the GSA’s right to terminate the Lease. In his correspondence to GSA, Mr. Portillo disputed the rent reduction and GSA’s right to terminate, claiming that GSA was responsible for paying rent until at least October 25, 2011. GSA’s responses asserted that it had the right to terminate on April 27, 2011 pursuant to SLA 6.

After reviewing his formal claim, the Contracting Officer issued a denial notification on June 6, 2011 because “GSA had acted consistently with the terms of the lease, and [] the lease authorized GSA to terminate the lease after the firm term had expired.”

According to the CBCA, in his appeal, Mr. Portillo argued that:

the original lease, which provided for a term of “ten (10) years, eight (8) years firm,” would have created an eighteen-year lease term. The fact that the Government issued SLA number five to extend the original lease term to October 25, 2010, and thereafter issued SLA number six to extend the lease term to October 25, 2011, reflects the parties’ understanding that the stated term was not cumulative, but, instead, included a “firm” period (eight years in original lease), and a subsequent period during which the Government could terminate the agreement with sixty days notice.

In addressing the merits of the appeal, the CBCA granted GSA summary relief because GSA complied with the terms of the Lease when it terminated the agreement. The CBCA found that while SLA 6 extended the lease for one year, it was subject to the termination rights that allowed GSA to terminate the lease at any time on or after the “firm term.” Contrary to the appellant’s interpretation, the CBCA agreed with GSA that the “firm term” created by SLA 6 was six months from the date of execution and GSA had the right to terminate the Lease on April 27, 2011 without penalty. Thus, Mr. Portillo was not “entitled to any greater compensation than he received under the terms of the lease agreement.”

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Introduction by Judge Shapiro

This article was inspired by a BCA judges panel presentation involving brief writing before the Boards, which I moderated during the October, 2011 annual conference of the Board of Contract Appeals Bar Association, Inc. Following the panel discussion, it occurred to me that an article on the subject could be useful to attorneys who practice at the Boards. I then thought that after sharing my view from the bench on effective techniques in preparing post-hearing briefs, reactions to those views from a trial attorney would provide an interesting contrast. To ensure that such reactions would be unfettered, I turned to my brother, an experienced trial lawyer who does not practice before the Boards, and who, by long experience, I knew would not hesitate to disagree with me.

Judge Shapiro: I consider the purpose of a post-hearing brief to be assisting the Board to reach the conclusion that your position is correct and should be accepted. The post-hearing brief is your opportunity to speak directly to the judge. Keep that in mind while preparing it. Indeed, briefs may be even more important in Board practice than in other courts. A Board trial is heard by a single presiding judge, but the decision itself is made by a panel. The other panelists are limited, inherently, to reading the record – which includes your briefs. When I review a draft decision from another judge – I read the briefs first. Make it count.

One concept that should be considered as a sacrosanct rule is not to mislead the judge under any circumstances. It is critical for lawyers to maintain their credibility, both for the case at hand and for the future. Being intellectually honest in your briefs should be your guide. Examples might include identifying a fact as undisputed, where it is contested by your opponent, or stating that there is no contrary precedent, where that is not undeniably accurate. (Consider a slightly milder approach: Research failed to disclose applicable precedent to the contrary.)

If contrary precedent exists, even if from a non-binding forum, such as the Court of Federal Claims or a district court, identify it, and deal with it directly. You should never assume that your judge will not become aware of contrary precedent if you leave it out. Your opponent will point it out, or we will find it ourselves. Either way, your credibility has been harmed affecting the perceived persuasiveness of your brief.

Similarly, if a contrary version of a key fact exists, address it and explain why the version you espouse is more worthy of belief. This is far better than ignoring the contrary fact. Your opponent will not ignore it, and will point out your failure to have considered it.

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Response by Attorney Shapiro: Judge Shapiro has invited me to disagree with him, and I must oblige. As a trial attorney, your primary responsibility is to your client, and the post-hearing brief presents a unique opportunity for advocacy. From counsel’s perspective, the purpose of the post-hearing brief is to persuade the Court to rule in your client’s favor. While your brief should not mislead the Court, as doing so risks undermining your credibility (boding poorly for your client) and could violate ethical obligations, you should be presenting the issues from one side only. Your goal is to appear objective, while advancing your client’s position through artful emphasis of facts, organization, and persuasive argument. For example, when framing the issues, do not overly slant them in your favor; the appearance of neutrality helps to pass the intellectual honesty precept referenced by Judge Shapiro.

Strive to keep your brief as succinct as possible, avoiding rhetoric, irrelevant detail, and unnecessary repetition. When citing authority, avoid string citations; cite the leading case or one binding on your forum and move on. I disagree with Judge Shapiro’s belief that contrary authority from a non-binding forum should be identified and distinguished. If a problematic decision is not precedent for your case, there is no ethical obligation to cite it. Identifying such a decision, which may not have otherwise been found by your adversary or the Court, adds superfluous length to your brief, takes focus away from your argument, and might create an unnecessary obstacle.

Judge Shapiro: Be sure to address issues that are important to the judge. Try to anticipate the judge’s concerns and deal with them directly. Like counsel, judges have various styles. Some are more directive than others. Pay attention for direct guidance, or for more subtle clues to identify issues that matter to the judge. Some judges may tell you expressly about issues that are troubling or important to them. For others, you need to be alert for hints, such as a question the judge asked during a hearing or conference. Again, while judicial styles differ, I see no problem with counsel asking affirmatively whether there are any issues that the judge specifically would like to see addressed. There is no guarantee that this will result in direct guidance from the judge, but it may, and I see no harm in asking.

Response by Attorney Shapiro: Expanding upon the excellent advice Judge Shapiro gives here, if the judge reveals criticism of your adversary’s position, pick up on the point in your brief and drive it home. In one matter in which I represented tenants of a rent stabilized apartment in Manhattan, I moved to dismiss a non-primary residence eviction proceeding on jurisdictional grounds. The issue turned on whether the landlord’s predicate notice (which correctly identified the Manhattan apartment sought to be recovered) was jurisdictionally defective because its envelope misstated the Manhattan apartment number. At oral argument, the landlord’s attorney said “we got lucky” because the Postal Service forwarded the envelope to the tenants’ other home in Spencertown, where the tenant signed for it. When this statement was made, I saw the judge’s body language change; he perked up and wrote himself a note. In my post-argument brief, I quoted adversary counsel’s “we got lucky” verbiage and argued that notice is a matter of due process, not getting lucky. The language from my brief was used verbatim by the judge in his decision dismissing the proceeding.2

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Brief Perspectives (cont’d):

Judge Shapiro: While lawyers and Board judges concentrate on familiar government contract concepts and arguments presented, counsel often lose sight of a basic motivator for judges. Judges want to be fair. We want our decisions to serve justice. Judges may reach a result that may seem inequitable where the law requires it – but we do not like it and will look more extensively for an alternative. Given this most basic of judicial motivations, it seems to me that in addition to presenting the facts as favorably and honestly as you can and arguing the appropriate legal principles, a well-crafted post-hearing brief also might seek to persuade the judge directly that ruling in your favor is the most fair result. Appealing to a judge’s sense of fairness directly most certainly is not out of bounds in my opinion, and I believe it should be included in most post-hearing briefs.

Response by Attorney Shapiro: Judge Shapiro provides more quality advice here. I expand on it by opining that it is helpful to explain how your client’s position makes sense from a policy perspective. Even if you can cite to favorable precedent, it is more effective to explain why the judge should follow the precedent, than simply to tell the judge that he must do so.

Judge Shapiro: As specialty tribunals with expertise in the subject matter, Board judges already are familiar with most legal issues that come before us. Therefore, we are more dependent on the lawyers for factual explanations. Depict the facts in your briefs honestly and accurately, but with an emphasis and in a context that tells the story of what happened in a way that presents your client as sympathetically as possible.

I cannot emphasize enough that it is essential that you cite sources for every assertion of fact. We will check all such citations to the record to ensure they are accurately presented. Judges dislike going through the record ourselves to determine whether a proposed fact you wish us to find is indeed supported. It is your job to lead us to the piece of evidence in the record that supports the fact you ask us to find. The post-hearing brief is your opportunity to persuade the judge that the facts as you present them are what really happened. A record citation for every single assertion goes a long way to achieving that goal. Consider carefully the adjectives and adverbs you use to modify facts. Do not include them if they can be viewed as altering the meaning of the fact you seek to establish.

Response by Attorney Shapiro: In the Statement of Facts, you should endeavor to appear objective and employ advocacy through the emphasis of certain facts. The Statement of Facts should never have an argumentative tone. It is essential to cite the record accurately and not out of context; otherwise, you risk loss of credibility. Facts can be tedious to read, so it is best to avoid compound sentences and keep your statements concise. For cases involving long complex fact patterns, consider limiting certain facts to general statements and expanding those statements with more detail in your argument. It is appropriate to do so as long as you provide record citations within the argument section.

The Statement of Facts is usually where you define short-hand terms you will use

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Brief Perspectives (cont’d):

throughout your brief. Briefs read easier when meaningful defined terms are used. As it is critical to keep the parties clear, instead of using acronyms or procedural identifiers (e.g., Plaintiff, Claimant, Appellant, etc.), I prefer defining parties by descriptive words such as Owner, Tenant, Driver, Passenger, etc. Descriptive words should also be used to define things, tangible or otherwise (e.g., it is better to use “Owner’s Checking Account” than “Account 15283439”). For occurrences or conduct, consider using a little advocacy in crafting your definitions. For example, you might define the five things your client relied upon to justify termination of a contractor as the “Contractor’s Improper Acts” instead of the “November 2011 Occurrences.” Be very careful though not to be overzealous in this regard; defining the five things as “Carrier’s Immoral and Unconscionable Crimes” would likely reflect poorly on the author.

Judge Shapiro: In presenting your legal arguments, address all key issues without ignoring obvious weaknesses in those arguments. Do not avoid potentially compelling counterpoints of your opponent. While this may sound obvious, be certain not simply to recite a litany of the law; apply the legal principles to the facts. Try to cite to mandatory authority where multiple sources are available for a legal proposition. Keep in mind the hierarchy of case sources in Board practice. My view of that hierarchy in descending order of priority, assuming no Supreme Court precedent: Federal Circuit/Court of Claims; the Board you are before; the other Boards; Court of Federal Claims/Claims Court; other sources such as district courts.

At times, a legal principle is stated in precedent in a helpful way fitting your argument, but in a decision with a holding that is harmful to you. In such circumstances, I believe it to be preferable to cite a different case. By relying on a decision whose ultimate holding is adverse, you provide your opponent the golden opportunity to respond by invoking the very case on which you rely, and arguing that the adverse holding supports your opponent’s ultimate position. You are then placed in the uncomfortable position of arguing in a reply brief why the very case on which you asked the judge to rely really is distinguishable.

Response by Attorney Shapiro: Judge Shapiro’s directive to include in the initial brief anticipated counterpoints seems desirable from the judicial perspective, since the Court strives to reach a correct and fair decision. To that end, full disclosure and consideration of applicable legal considerations on both sides is beneficial. However, for trial counsel, the extent to which your brief should address anticipated counterarguments as opposed to saving them for reply (assuming you have the right to reply) is a strategic decision, which sometimes turns on your assessment of adversary counsel. Most times, I choose to wait for my opponent to articulate his arguments before responding to them, while being mindful of what those arguments may be, and careful not to say anything he could use in presenting them. I lean this way primarily to avoid the risk of introducing potential problems with my client’s case which opposing counsel may not otherwise raise, and to allow my reply brief to be an impactful final submission. However, I sometimes make preemptory attacks on my adversary’s anticipated arguments when I am almost certain that he will raise a particular argument, or when I have assessed opposing

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Brief Perspectives (cont’d):

counsel as having weak litigation skills and feel that I could lure him into presenting his positions from a defensive posture.

I concur with Judge Shapiro’s advice regarding citation to authority. In addition, it is always helpful to research whether the presiding judge has rendered past opinions on your issues; if you find such a document, identify it as your judge’s decision, quote the favorable language, and model presentation of your argument after it. You should always cite authority using proper blue book format and avoid long string cites. If your case involves statutory construction, quote the statute before introducing your interpretive case law, and to the extent it helps your case, include discussion of statutory scheme and commentary as well as legislative history.

Judge Shapiro: Advising about writing style is difficult. Judges recognize that lawyers have differing styles, and a variety of approaches can be effective. My experience though, suggests that at least for me, briefs utilizing the following stylistic suggestions are more likely to be persuasive.

Many briefs are too long and often seem to be disorganized. You are free, of course, to pursue alternative arguments, but identify them as such. Often, I see alternative arguments presented without such identification, and it makes the brief appear to be internally inconsistent. I urge you to think about and outline a logical chain of argument before writing. Generally, it is best to present your strongest arguments first. Once a brief is drafted initially, your first editing tool should be the delete button. Cutting extraneous materials adds to clarity. In this regard, pursuing obviously losing arguments detracts from the advocacy of the remainder of the brief. Refusing to concede a point where that point does not really matter undermines your credibility. Conceding points is so rare in briefs before me that I find it refreshing when I see it. Do not present any argument that matters in a footnote. If it is at all important, include it in the body of the brief.

Argue the case - not your feelings. Do not make this a personal matter. Avoid sniping at your opposition or showing any disrespect to your opponent or to opposing counsel. Doing so seems petty to me, and detracts from the effectiveness of your advocacy. Avoid sarcasm or purposely insincere compliments in your briefs – this tactic almost never translates well and in my opinion, has no legitimate place in formal writing. For the same reasons, avoid colloquialisms. Humor is difficult to use effectively in a formal written product like a post-hearing brief. If you are not very skilled at it, play it straight. I also think it is better practice to avoid legalese and Latin phrases where possible.

Also, again keeping in mind that through your brief you are speaking directly to the judge, avoid issues that are not before the Board – like discovery disputes that were not raised previously. Complaining in your brief that had your opponent been more cooperative in

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Brief Perspectives (cont’d):

responding to discovery requests, you would have been able to prove or disprove a point – (while it may cause you to feel better) can result in me thinking that you are being petty and appear desperate. By the post-hearing brief, it is far too late to raise such issues.

In my experience, case quotations are vastly overused. Avoid long quotations entirely, paraphrase case holdings, and use short quotations sparingly and only for emphasis. Try to avoid the commonplace adverb “clearly” or its synonyms where used without citation. When I read a brief that says something is clear without citing to a case or to the record, I am inclined to believe the opposite – that the point is not clear. Otherwise, the author would have cited something.

In a case in which conflicting testimony presents issues of credibility, address directly why the judge should consider your witness more credible, perhaps even in a separate section of the brief. While credibility issues are not uncommon in Board practice, arguments in briefs about relative credibility of witnesses are rare.

Sophisticated brief writers recognize that the active voice is more powerful than the passive voice. Use the active voice routinely and try to use the passive voice intentionally only. While this may seem like odd advice coming from a judge, as judicial opinions are notorious for overusing the passive voice, the active voice simply is more persuasive. Consider which is more persuasive:

It is contended that when the contracting officer issued his decision, it did not represent his independent judgment but was the judgment of a superior procurement official. --- passive

The contracting officer’s decision was compelled by a superior procurement official. The contracting officer’s decision was not independent as required. --- active

Many cases involve mathematical calculations. Simplify these as much as possible and be sure to explain all calculations. Judges often review briefs with unexplained calculations or with calculations which change. This is confusing and may be viewed as either the product of disordered thinking, conflicting evidence or misleading presentation. If there is any complexity at all, spell out the math in a way that even a judge like me can understand. Clear, simple charts can help.

Response by Attorney Shapiro: I agree with Judge Shapiro’s suggestions in this section, and will provide further insight.

Your goal should be a well organized and succinct brief. Edit your brief repeatedly to improve the logical flow of your arguments and make them more concise. Within the argument (continued on next page)
Brief Perspectives (cont’d):

portion of your brief, clear and coherent sections and section headings are critical. When read alone, your section headings should form an outline of your argument. It is important to maintain your credibility throughout the brief, and never refer to facts not in the record. Appearing objective and being respectful of the Court as well as your adversary and his client preserves credibility. If you have a private sector client, do not permit your client to influence what to include in your brief or how to present it; you are the lawyer, and know best.

An appropriate introduction to your brief is important, and may form the judge’s first impression of how to decide the matter. Protocol dictates that your introduction describes the nature of the action. Its primary function, however, is to preview your argument. Since organization and presentation of your argument will be fine-tuned many times during the drafting process, it is best to write the introduction after finalizing the argument section. As with the Statement of Facts, strive to appear objective. Although it is more difficult to appear objective when overviewing your argument, you may be able to lessen the impact of your most controversial language by deferring to your argument section with words such as “it is demonstrated below that …”. In the introduction, you can employ advocacy by emphasizing the most important aspects of your strongest arguments. If you elect to have your brief oppose anticipated counterarguments, I suggest not previewing them in your introduction.

Regardless of the Court you appear before, it is essential to become familiar with all applicable briefing rules, and obey them. Exceeding page limits or violating other briefing rules will irritate the judge or result in rejection of your brief. Also, judges frown upon lawyers squeezing their briefs within page limits by using excessive footnotes (in number or length) or manipulating spacing, margins or font size. Judges dislike straining their eyes to read small print, so keep the font size of your footnotes to one or two steps smaller than that of the text in the body of your brief. If you cite to authority which is not officially reported or readily available, it is helpful (and customary) to append that authority to your brief, but check the rules for the extent to which doing so is permitted; if the rules are not clear, check with the Court Clerk first.

Conclusions: Board trial lawyers should take advantage of the opportunity to speak directly and effectively to the judge through post-hearing briefs. Utilizing effective brief writing techniques, as suggested in this article, serves everyone’s interest, including that of the judge.

* - Judge Gary E. Shapiro was appointed as a PSBCA judge in 2008. He presently serves as vice-president of BCABA, Inc. Judge Shapiro’s views herein expressed should be considered his personal views, and not those of the Postal Service Board of Contract Appeals, the Postal Service, or any other Board or judge.

Edward M. Shapiro is a commercial law trial attorney, licensed in New York and New Jersey, with concentrations in construction and real estate disputes.

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Brief Perspectives (cont’d):

Endnotes

1 - I wish to thank the panelists, Judges Patricia J. Sheridan, CBCA; Mark A. Melnick, ASBCA; and Monica Parchment, DCCAB, for their thoughtful contributions to the panel discussion, ultimately resulting in this article.

U.S. Foodservice v. United States: Reining in the Most Favored Customer Clause 
by 
Caitlin K. Cloonan 
and 
Peter A. McDonald*


I. Introduction

The Most Favored Customer (“MFC”) clause is a common arrangement in many commercial contracts. The clause essentially guarantees that a customer receives the best price that the company gives to any other customer. Not surprisingly, this clause plays a key role in federal solicitations, and most notably in federal supply contracts.

A recent foray into this area by the Defense Logistics Agency (“DLA”) is instructive for contractors performing under the MFC clause. This was the decision of the United States Court of Federal Claims (COFC) in U.S. Foodservice Inc. v. United States.¹

II. Background

For many years, contractors have been subjected to Government audit scrutiny (and sometimes prosecution) regarding their compliance with the MFC clause. In the commercial world, a breach of this contractual obligation could expose a company to contract damages, litigation costs and loss of business. However, in government contracts the stakes are even higher. Many contractors have learned the hard way that non-compliance with MFC provisions can also result in severe penalties arising under the False Claims Act.

III. MFCs in Federal Supply Schedule Contracts

a. MAS Background

Since its inception in 1949, the General Services Administration’s (“GSA”) Multiple Award Schedule Program (“MAS”) has enabled government agencies to purchase a wide array of commercial products and services under Federal supply schedule contracts. Today, the MAS program is the largest interagency Government contracting program and represents a significant part of the government’s annual budget. In fiscal year (FY) 2010 the Government issued 18,396 MAS contracts totaling $38.9 billion.² GSA directs and manages the MAS program, and provides federal agencies with a simplified process for obtaining commercial supplies and services at prices associated with volume buying.³

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The MAS program leverages the Government’s purchasing power to secure volume discounts for commercial supplies and services. MAS implementation is governed by Federal Acquisition Regulation (“FAR”) Part 8.4 - Federal Supply Schedule. This provision authorizes government buyers to place orders directly with GSA MAS contractors and pay for items using the government-wide commercial purchase card.

MAS program purchases are designed to mirror commercial buying practices. Specifically, GSA MAS orders do not require the use of the competitive evaluation processes found in FAR Parts 13, 14 or 15, because such deliveries “are considered to be issued using full and open competition.” In this regard, GSA’s primary goal is to obtain the best price a contractor offers its most favored customer for any particular schedule item.

b. Pre-Award: MAS Contract Negotiations

Before accepting the item for inclusion on GSA MAS, the Government requires contractors to list their items at or below their lowest available price to an identified category of customers. The Government then compares the price or discounts that a company offers with the price or discounts that the company offers to commercial customers. Thus, before awarding a MAS contract the contracting officer and the Offeror will agree upon: (1) the customer (or category of customers) that the Government will use as the “basis of award”; and (2) the Government's price or discount relationship to the identified customer (or category of customers). The agreed-upon category may include various categories of customers including end users, dealers, distributors, or buyers with different contract provisions.

The GSA contract negotiation process also requires contractors to disclose their commercial pricing and discounting practices provided to all of its customers. The scope of this disclosure is vast, and includes every discount ever granted to any commercial customer, including standard discounts, catalog discounts, volume discounts, discretionary discounts, exceptional discounts, and so on. Identifying all discounts is often challenging, as many contractors lack procedures to track every commercial transaction - let alone the unique discounts and terms related to every sale. Not surprisingly, this is fertile ground for compliance violations.

The FAR grants the Government pre-award audit authority to “examine, at any time before initial award, books, records, documents, papers, and other directly pertinent records to verify the pricing, sales and other data related to the supplies or services proposed in order to determine the reasonableness of price(s).” The intent of these audits is to verify that the contractor’s pricing disclosures are current, accurate and complete, and that internal controls are sufficient to ensure compliance.

After reviewing the contractor’s disclosures, and related supporting information, GSA’s discount and schedule contract pricing are negotiated by the agency contracting officer. In the negotiations, the Government’s primary goal is to obtain a price that is better than, or at least
U.S. Foodservice v. United States (cont’d):

equal to, the best price applicable to a contractor’s “most favored customer.” This does not mean, however, that Government buyers won’t seek additional discounts. As GSA’s own website states:

It is a proven best practice that ordering activities should seek additional price reductions/increased discounts and/or concessions when placing an order under a GSA Schedule contract. Contractors will often ‘sharpen their pencils’ to obtain a large Schedule contract order.8

c. Post-Award: Effect of the Price Reductions Clause

After the contractor and Government have negotiated the lowest price for the commercial items, the Government can occasionally obtain still lower prices through the contract’s price reductions clause (“PRC”). The PRC is included in all MAS contracts and plays an integral role in MAS contract pricing.

The PRC first requires the contracting officer and contractor to agree upon the “basis of award” for GSA’s price (or discount relationship) to the identified category of customers. Should this discount relationship be disturbed after contract award (i.e., if the contractor reduces the prices or increases the discounts applicable to a “basis of award” customer), this clause mandates price reductions.9 The price reductions are triggered because contractors are required to report any such discounts within 15 days of their effective date. Through this clause, contractors are not permitted to lower their commercial prices -- i.e., change the “basis of award” -- without informing GSA.10

GSA is exceptionally vigilant about enforcing the PRC. Because it is typically the largest volume buyer, the Federal Government insists on receiving the best prices. On this point, the General Services Administration Manual (“GSAM”) includes specific guidance to government negotiators:

If a change occurs in the contractor’s commercial pricing or discount arrangement applicable to the identified commercial customer (or category of customers) that results in a less advantageous relationship between the eligible ordering activities and this customer or category of customers, the change constitutes a ‘price reduction.’ [...] Make sure that the contractor understands the requirements of [the PRC] and agrees to report to you all price reductions as provided for in the clause.11

For example, when a contractor offers a one-time discount of 50% to a commercial customer, the contractor must apply that same discount to all subsequent Government orders for the same item(s). Obviously, being able to track every discount poses a significant administrative burden on a contractor’s sales force. Nevertheless, the cost of non-compliance is even greater.

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**U.S. Foodservice v. United States (cont’d):**

Few government contract practitioners have familiarity with recoupment actions brought under the Price Reductions Clause (PRC). On the other hand, there are many Government auditors that have developed an expertise in this area. As a result, contracting officers frequently have access to better legal and accounting expertise than is generally available to contractors. That said, the application of the PRC, and the concomitant price reduction calculations, are highly dependent on the facts of particular transactions. In short, not every discount provided to a contractor’s customer will trigger the application of the Price Reduction Clause, nor will the price reductions due under the PRC always be the same as those calculated by the government auditor.

d. Tailoring MFC Clauses

In addition to the standard PRC clause, the FAR permits the Government to tailor certain contract provisions and clauses when acquiring commercial items. However, such custom, non-standard clauses must be rational and reasonable, and when they are not such terms may be challenged as part of a pre-award protest either before the Court of Federal Claims or the Government Accountability Office. In practice, however, such tailoring is infrequently done.

**IV. The Perils of GSA Schedule Pricing**

Both the MFC negotiations and the operation of the PRC can profoundly affect a commercial contractor. If a pre- or post-award audit raises questions regarding a contractor’s compliance, or a relator brings a qui tam suit challenging contractor compliance, the contractor may be subject to a parade of horribles, including but not limited to contract claims, prosecution under the FCA, termination for cause, suspension or debarment.

For instance, if the Government believes a contractor knowingly failed to comply with the PRC or submitted false information during price negotiations, it might investigate a contractor. If there is sufficient proof that the company offered a single discount outside of the contract’s PRC, the Government may seek damages under the FCA. The FCA allows the Government to recover up to three times the damages incurred and penalties of up to $12,000 per claim.

Together, the MFC and PRC constructs impose significant compliance risks on any contractor holding a GSA schedule contract. Contractors that run afoul of the federal regulations and guidelines run significant financial risks. A single non-compliance can result in large payouts to the government. Even instances of suspected non-compliance can generate significant costs, either in defending against a government claim or in settlement costs.

Recent cases reinforce the fact that MFC episodes are fraught with risk, and even perceived non-compliance can be extremely costly. For instance, in January 2011 the U.S. Department of Justice (“DOJ”) announced a $6.25 million settlement with Fastenal Company, (continued on next page)
U.S. Foodservice v. United States (cont’d):

a national hardware store distributor, following an investigation of alleged false claims in connection with Fastenal’s GSA contract. Specifically, the Government alleged that the contractor had provided better discounts to its identified nongovernmental customers than it had to its GSA MAS customers, in violation of the PRC present in every GSA MAS contract.

Prior to this, in May 2010 EMC Corporation paid the United States $87.5 million to settle a lawsuit alleging that the information technology company violated the FCA and the Copeland Anti-kickback Act. In that case, the Government alleged that the company represented during contract negotiations that, for each government order under the contract, EMC would conduct a price comparison to ensure that the Government received the lowest price provided to any of the company’s commercial customers making a comparable purchase. According to the Government’s complaint, EMC knew that it was not capable of conducting such a comparison, and so EMC’s representations during the negotiations – as well as its subsequent representations to GSA that it was conducting the comparisons – were alleged to have been false or fraudulent.

Similarly, in 2009 the DOJ reached a $128 million FCA settlement with NetApp, Inc. (“NetApp”) regarding its GSA Schedule Contract. There, a former NetApp employee indicated that the company had knowingly failed to meet its GSA MAS contractual obligations to provide GSA with current, complete and accurate information about its commercial sales practices, and had knowingly made false statements to GSA about its sales practices and discounts.

These cases demonstrate the Government’s ever-growing attention on the PRC. In addition, when pursuing FCA cases DOJ may assert any number of different legal theories interpreting the PRC. For instance, in October 2011 DOJ settled a $200 million FCA case in which the PRC played an integral role. Review of the publicly-available pleadings in that case reveals that the Government pursued a theory that, if a contractor takes proactive steps to avoid triggering the PRC, this itself violated the PRC. Although the court never decided the merits of this particular legal theory, this case nevertheless serves as a cautionary reminder regarding the Government’s increasingly broad, and expansive interpretation of the MFC clause, and contractors’ reasonable application of the PRC.

Given these significant risks, it is no surprise that the protester in U.S. Foodservice sought to challenge the Government’s use of an even more expansive MFC provision in a solicitation, lest they too become another target of a Government audit or inquiry.

V. U.S. Foodservice Inc. v. United States

a. Case Background

Despite the already significant regulatory obligations imposed on contractors by the MFC, the U.S. Army Defense Logistics Agency Troop Support (hereafter “DLA” or “Agency”)

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U.S. Foodservice v. United States (cont’d):

sought to increase those requirements. On October 27, 2010, DLA issued Solicitation No. SPM-300-10-R-0047 (the “Solicitation”). The solicitation called for food and beverage support to be provided to military and civilian customers in the Texas and New Mexico region of the United States. The awardee was to serve as a prime vendor and provide a full line of food service items. The solicitation estimated the projected contract value at $9,300,000 over a fourteen month period.

The solicitation incorporated a “customized” MFC clause. DLA asserted that this expanded approach would promote transparency, increase pricing integrity and protect taxpayers. Potential offerors, however, evidently thought otherwise. Even though the Solicitation was amended twelve times, DLA did not receive a single responsive proposal. Instead, on February 9, 2011 U.S. Foodservice (“USF”) filed an initial pre-award protest at the Government Accountability Office (“GAO”) that challenged the Agency’s more expansive MFC provisions.

b. Protest

This pre-award bid protest involved a MAS contract for food supply and distribution, but the MFC clause (the basis for the protest) is widely used in other government supply contracts such as pharmaceutical acquisitions. Even before the COFC protest, this procurement experienced a lengthy and complex history. Prior to releasing the Solicitation, DLA issued a Class Waiver to tailor the Solicitation with customary commercial practices. The Waiver justified the use of a “Rebates/Discount and Price Related Provisions” clause, although such a provision was inconsistent with standard commercial practices in the food industry. Because of chronic price volatility in the food distribution industry, DLA could not develop a single index for its economic price adjustment clause. For this reason, DLA instead developed a “weighting factor” applicable to the fixed-distribution price.

A second change made by DLA, and one that was also inconsistent with standard commercial practices, involved tailored provisions dealing with “Rebates / Discounts and Price-Related Provisions, Socioeconomic Support, and Ability One Evaluation.” DLA’s rationale was that such tailoring was necessary to “promote pricing transparency and place integrity into the commercial pricing process.”

c. Decision

GAO summarily rejected USF’s bid protest, and determined that essential basis of the protest was mere disagreement with DLA’s decision to deviate from customary commercial practices. On that point, GAO found that the Agency reasonably deviated from customary commercial practices. Undaunted, USF subsequently filed a pre-award protest at the U.S. Court of Federal Claims (“COFC”).

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In a lengthy opinion, the COFC rejected GAO’s findings. The COFC decision stated:

Unlike the GAO, however, whose cursory opinion seemed to take for granted that once DLA Troop Support had established that it was reasonable to depart from customary commercial practices, any methodology then implemented was itself reasonable, *see id.* at *4-*6, this court takes the view that the actual procedures implemented by the agency in place of the deemed inadequate commercial practices must also be reasonable in-and-of themselves.

The court found that when DLA decided to replace standard commercial practices with other terms in the solicitation, it used its own definitions. Specifically, in the change for “Rebates /Discounts and Price Related Provisions,” DLA included the following language in the definition:

For all items, the contractor warrants, on a continuing basis throughout the period of performance, that its delivered price under this contract is equal to or lower than its delivered price to its commercial customer accounts.

The court found that a significant problem with this requirement was as follows:

In preparing their proposals, offerors thus were required to estimate prices over which they had no control whatsoever and to factor this element into their cost estimates, despite the fact that those costs potentially could change after the contract had been awarded.

When this arrangement was questioned during oral argument, government counsel blithely (if not naïvely) justified the government’s position by explaining that this was simply a risk the awardee took in accepting the contract (!).

In the litigation, DLA acknowledged that the MFC clause, as used commercially, meant that the delivered price was equal or lower than the price given to other customers who were similarly situated, e.g. in terms of volume, location of sales, and so on. The protections of the MFC clause notwithstanding, DLA still felt that its customized clause was necessary. However, USF argued, inter alia, that DLA’s customization did not comport with FAR 12.302(c), Tailoring Inconsistent with Customary Commercial Practice.

The court found that DLA’s actions in establishing the waiver that was needed to use a customized clause were reasonable, but the customized clause itself was not:

Simply put, the explanation provided to justify this particular clause is so

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**U.S. Foodservice v. United States (cont’d):**

implausible and disconnected from what the MFC clause actually requires as to be irrational.

In other words, “[w]hile seeking transparency in pricing is certainly a legitimate procurement objective, the agency’s rationale supporting this clause is patently disconnected from that objective.”

The COFC held that DLA’s customized MFC clause “…when examining for reasonableness the methodology substituted for the displaced commercial practices, this court finds that the MFC clause crafted by DLA Troop Support exceeds the bounds of rationality and amounts to an arbitrary and capricious requirement foisted on potential offerors.”

The real lesson in this case, for the many contractors who wrestle with MFC clauses in their contracts, is offered in the Court’s decision, which states:

But the Government may never insist upon offerors conforming to irrational terms. Enjoining the Solicitation using this irrational MFC clause will not irreparably harm the Government, but will require DLA Troop Support to act within the bounds of reasonableness.

**VI. Conclusion**

In an environment of heightened procurement oversight and increasing enforcement actions, agencies will aggressively pursue cost savings as well as investigate suspicions of contractor fraud, which include misapplication of the MFC pricing provisions. Nevertheless, the decision in *U.S. Foodservice* demonstrates that, despite the usual deference offered to agency procurement officials, “reasonableness” remains the touchstone of every agency procurement action. The *U.S. Foodservice* decision is a reminder that the courts are fully prepared to rein in agencies that overstep this fundamental standard.

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**Endnotes**


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U.S. Foodservice v. United States (cont’d):

Endnotes (cont’d)

3 - See FAR 8.402(a).
4 - FAR 8.404(a).
5 - General Services Administration Acquisition Manual (“GSAM”), Section 552.238-75.
6 - GSAM Section 515.408.
7 - FAR 52.215-20.
8 - See GSA Portal at: www.gsa.gov/schedulespricereductions. The website further states: “The ability to seek additional price reductions and concessions allows the government not only to leverage its combined requirements to obtain favorable prices, terms, and conditions, but also to leverage agency requirements to take advantage of quantity or spot discounts available in a fluid, commercial pricing atmosphere.”
9 - See GSAM Section 552.238-75(a).
10 - See GSAM 552.238-75(b).
11 - See GSAM Section 538.272.
13 - See FAR 12.302, “Tailoring of Provisions and Clauses for the Acquisition of Commercial Items.”
14 - GSAR 552.215-71, “Examination of Records by GSA”: “The Contractor agrees that the Administrator of General Services or any duly authorized representative shall have access to and the right to examine any books, documents, papers and records of the Contractor involving transactions related to this contract for over billings, billing errors, compliance with the Price Reduction clause and compliance with the Industrial Funding Fee and Sales Reporting clause of this contract. This authority shall expire three years after final payment. The basic contract and each option shall be treated as separate contracts for purposes of applying this clause.”
15 - This particular case involved Oracle Corporation and Oracle America, Inc.
16 - Id.
17 - Id.
18 - Id.
19 - Id., at p. 39.
20 - Before addressing the legal issues, the Opinion first provides a lengthy background regarding the widely-held practices associated with the commercial food-service industry. While these facts are not critical to the legal issues raised in the protest, the Court goes to great lengths to explain the complex set of commercial practices that govern the food distribution industry. The Court later used these facts to show how far from these established commercial practices DLA had departed in its Solicitation.
21 - U.S. Foodservice, at 5.
24 - U.S. Foodservice, footnote 11. Regarding the government’s position on this point, the court’s decision was unambiguous: “This is nonsense. The practical implications of the MFC clause entail more than a risk factor for the offerors; it is a provision that requires an unqualified representation that carries the potential for fraud prosecutions.”
A disturbing development and deviation from regulatory guidance has been evolving in U.S. federal government contracting over the last couple of years. Contracting officers from various government procurement agencies have been espousing that requests for equitable adjustments (REAs) are no different than proposals. In fact, they have opined that there is no difference between a proposal, an REA, and a claim. Contracting officers have professed on more than one occasion that these three terms are, in fact, synonymous.

Based on this interpretation of these processes, some contracting officers feel they can apply Federal Acquisition Regulation (FAR) Part 15, “Contracting by Negotiation,” rules to the contract administration process of adjudicating an REA. Contracting officers interpreting that the REA process is covered under FAR Part 15 rules are making the further assumption that the cost associated with the preparation of an REA is therefore an indirect cost (e.g., bid and proposal or general and administrative), making such REA preparation costs not directly recoverable in the sum certain damages amount being requested in the REA. By similarly characterizing a claim as a proposal, contracting officers also believe that claim preparation and adjudication costs should comply with FAR Part 15 rules, and any association to the Contract Disputes Act (CDA) is irrelevant. As hard as one may find this to be unconscionable behavior bordering on government contracting malpractice, it is going on today and becoming more prolific.

The stated purpose and scope of FAR Part 15 is to prescribe the policies and procedures governing competitive and noncompetitive negotiated acquisitions and to describe the acquisition processes and techniques that may be used to design competitive acquisition strategies suitable for the specific circumstances of the acquisition. In particular, this FAR section is prescriptive in terms of the form(s) to be used by bidders when preparing their proposals in response to a request. Noteworthy throughout FAR Part 15 is the repeated reference to the term “acquisition” and the process of “acquiring” goods and services.

Under government-awarded contracts, the government has the right to change the terms of the contract unilaterally. Most equitable adjustments are the result of the contract changes clause, which is governed by FAR Part 43, “Contract Modifications.” This FAR section prescribes the policies and procedures for preparing and processing contract modifications for all types of contracts including construction and architect/engineer contracts.
Look, Up in the Sky! (cont’d):

but does not provide specific or detailed guidance as to prescribe the format to be followed for an REA.

In accordance with the change clauses, the contractor is entitled to a price adjustment if: 1) the contracting officer changes any aspect of the general scope of the contract; and 2) the change affects the cost and/or schedule of performing the work. There is a series of change clauses from which the contracting officer can choose based on the contract type (e.g., fixed-price, cost reimbursable, time and materials, etc.) and the type of work being performed (e.g., construction, services, etc.). The various change clauses have relatively the same purpose and use. Generally speaking, a change clause serves to provide the following:

- Flexibility for the government to order unilateral changes, use technological advances, and incorporate changes in government requirements;
- A means for the contractor to propose changes to the contract that will improve efficiency and quality;
- The contracting officer authority to add or subtract work within the general scope of the contract or to accelerate or decelerate the contract schedule without going through the process of a new procurement (i.e., acquisition) or using new funds; and
- A legal means by which the contractor can attain equity through the contract administrative dispute process.

The change clauses do not incorporate every change to the contract. Changes are limited to those that are within the general scope of the contract and the types of changes described by the clause. A change falls under the general scope of the contract if the total work performed is essentially the same work or end product as called for in the original contract.

When these changes impact the cost and/or schedule of performing the contract, an equitable adjustment may be used to ensure fair treatment to both parties; the contractor and the government. The underlying legal theory focuses on the contractor being made “whole,” such that the government does not receive undue enrichment. The government is also kept “whole” if the changes result in less cost or if the contractor can deliver earlier.

A contractor seeks an equitable adjustment by filing an REA. An equitable adjustment is a written request or assertion by one of the contracting parties seeking the payment of money, the adjustment or interpretation of contract terms, or other relief arising under or relating to the contract. The FAR change clauses do not prescribe a format to be used for REAs other than to state that the contractor must assert its right to an adjustment within 30 days from when it first was notified or became aware of the change by submitting to the contracting officer a written statement describing the general nature and amount.

Contract case law has established, however, that a properly prepared REA must contain sufficient detail to permit the contracting officer to be able to give meaningful, reasoned

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Look, Up in the Sky! (cont’d):
consideration to the request, the sufficiency of which is determinable on a case-by-case basis. As long as the contractor’s assertion contains the minimum information necessary to inform the contracting officer of what is being requested and the grounds of the request, the contracting officer must act on the request and deny it if the information provided is insufficient to approve it. To meet this “sufficiency of information” requirement, an REA should contain at a minimum:

- A summary description of the cause and effect of the action;
- A basis of entitlement analysis, referencing the contract clause(s), FAR citations, and/or case law references;
- A technical analysis description (and chronology) of the cause and effect; and
- Support for the damages in terms of the sum certain amount of the request.

REAs can be filed before or after the contract modification occurs and can originate from the contractor or the government. A REA is normally resolved under the contract clause that provides for such relief.

Despite some recent opinions on the part of some procuring agency contracting officers, there is a clear distinction in the FAR with regard to what constitutes a proposal versus an REA; the former being associated with the acquisition process and the latter being associated with the performance and administration of a contract. Similarly, the FAR is prescriptive with regard to proposal format and content in response to an acquisition or procurement action, but such prescriptive guidance is not provided for REAs.

By misapplying the acquisition process (i.e., FAR Part 15) to the REA contract administration process (i.e., FAR Part 43), contracting officers have also gone one step further by declaring outside counsel and consultants costs unallowable as direct recoverable costs. Their logic (if you can call it “logic”), applied in this situation, makes the assumption that since an REA is the same as a proposal, then the costs associated with the preparation of the REA, including outside consultants and attorney’s fees, are considered bid and proposal costs, and are therefore recoverable only as allocable, indirect general and administrative expense. Quite the opposite is in fact the truth.

REA preparation costs are considered normal costs of contract administration as a single cost objective (i.e., direct cost). FAR 31.205-33, “Professional and Consultant Service Costs,” provides that costs of outside counsel and consultants are allowable costs of contract administration. This means that a contractor may recover attorney’s fees and consultants costs incurred in the connection with the administration of the contract as part of an REA. The most significant restriction on allowability of REA preparation costs appears in FAR 31.205-47(f)(1). This FAR provision prohibits recovery of professional or consulting costs incurred in connection with prosecuting or defending a claim asserted by or against the federal government. Contracting officers often incorrectly cite this FAR provision in seeking to avoid the liability

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for contractors’ attorney’s fees and consulting costs incurred for the purpose of preparing, filing, and negotiating an REA.

There are a number of case law decisions that help define whether outside counsel fees and consultant costs are to be treated as allowable costs of contract administration or unallowable claim prosecution costs. In *Bill Strong Enterprises, Inc. v. Shannon*, the decision states:

If a contractor incurred the cost for the genuine purpose of materially Furthering the negotiation process, such cost should normally be a contract administration cost allowable under FAR 31.205-33, even if negotiations eventually fails and a CDA claim is later submitted…. On the other hand, if a contractor’s underlying purpose for incurring [attorney or consultants] costs is to promote the prosecution of a CDA claim against the government, then such costs are unallowable under FAR 31.205-33 and as prescribed under FAR 31.205-47(f)(1). Costs incurred in connection with the preparation and negotiation of a request for equitable adjustment before a CDA claim is filed or certified are “presumptively allowable.”

With contracting officers taking a diametrically opposed stance (as compared to the FAR) on this cost allowability issue of REA preparation costs and seemingly treating contract administration costs as unallowable bid or proposal costs, they are taking a proactive approach to discouraging contractors from seeking expert advice and counsel in pursuit of equitable contract cost recovery by actively influencing contractors into believing that such costs are not recoverable. This tactic is most harmful to small businesses that typically would not have REA preparation expertise on staff and would be led to believe that these costs would have to come out of their profit. This ploy works to the contracting officer’s advantage whereby he or she gains the upper hand of having in-house cost analysts and legal counsel at his or her disposal, while putting the small business at a distinct disadvantage. This behavior is not only unconscionable, it is unethical and borders on malpractice when you consider the FAR is there to ensure fairness, equity, and good faith between the government and the contractor.

Another possible hypothesis for this aberrant contracting officer behavior may be the result of poor training and lack of sufficient knowledge transfer through attrition. As more seasoned contracting officers have retired, and administrative personnel were promoted to the ranks of warranted contracting officers in order to quickly fill the voids, these personnel have not received the thorough FAR training when it comes to the administration of contracts and the use of the proper associated regulatory citations in administering their duties.

This increasingly prevalent behavior raises yet another concern: What latent liability is the government creating for itself if what has been portrayed here has merit? While that is a

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possible topic for a future discussion, it certainly makes one think just how widespread might this behavior be and how large a liability could this be creating? Is this just the tip of the iceberg? Has the Titanic already set sail? Is it a time bomb waiting to explode?

Conclusion

Contractors large and small should not be intimidated by contracting officers trying to influence them into thinking that an REA, a proposal, and a claim are one and the same thing for the purpose of trying to disallow REA preparation costs in order to gain an unfair advantage in a contracting officer’s pursuit of inequity. With the added value that outside counsel and subject matter expert consultants bring to the contract administration, modification, and dispute resolution processes, and as fully supported by the FAR, the decision as to how best to proceed should be a simple one.

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Endnotes

1 - Public Law 95-563, 92 Stat. 2383.
2 - 49F.3d 1541, 1550 (Fed. Cir. 1995).
GAO Prods DCAA on Internal Audits

by

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I. Introduction

The Government Accountability Office (GAO) recently released a report that essentially chastised the Defense Contract Audit Agency (DCAA) for failing to obtain access to the internal audit reports of defense contractors. For reasons set forth below, this Report will undoubtedly spawn litigation when DCAA issues subpoenas to obtain contractors’ internal audit reports.

This article addresses many of the problems with GAO’s Report and the likely consequences of such an initiative, consequences that GAO failed to mention and may have failed to consider. In particular, the GAO either did not understand or chose to ignore established case law that unambiguously denies DCAA access to companies’ internal audit reports.

II. Background

In response to earlier GAO criticisms, DCAA imposed rigorous new timelines for companies responding to auditor requests for records and deprived field auditors of discretion. DCAA’s audit guidance now includes procedures to quickly escalate pressure on contractors who either fail to immediately comply with record requests, or who deny auditors access to personnel (despite the fact that auditors have no discernable legal basis to demand access to personnel). Recent DCAA guidance also provided a problematic rule in the audits of contractors’ internal control systems, whereby an auditor may not find a contractor system inadequate “in part,” but must find the entire system inadequate and take action to suspend payment of invoices where a single internal control objective is not met.

These policies manifest a fundamental policy shift away from cooperatively resolving contract administration matters with government contractors, to a more adversarial posture that will be exacerbated by GAO’s insistence on DCAA’s access to contractors’ internal audit reports.

III. Audits

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a. DCAA Audits

Audits of defense contractors are performed by DCAA. There are a wide variety of audits, depending on their scope and purpose. For example, there are incurred cost audits, compensation reviews, Cost Accounting Standards (CAS) compliance reviews, audits of pricing proposals, audits of claims, and so on.

Unlike the Securities and Exchange Commission (SEC) or other investigative government auditors, DCAA auditors do not perform an audit to render an opinion on the contractor’s financial statements. While the nature and scope of government audits vary widely, most DCAA audits are in the nature of compliance audits, i.e., verification of compliance with applicable government cost accounting requirements, such as the exclusion of unallowable costs, allocations in accordance with CAS, compliance with agency recordkeeping and reporting requirements, and so on.

b. Internal Audits

Internal audits are done by larger corporations that have internal audit departments. (As a practical matter, few government contract practitioners have even met an internal auditor.) Because internal audits generally involve sensitive financial information related to the contractor’s performance, the reports are invariably restricted to upper management and the board of directors. As a rule, internal audit reports are not intended to be shared outside a company. Moreover, internal auditors are employees of the company so they are not independent. Because independence is a fundamental requirement for outside auditors, this is a major difference between internal auditors and CPAs with accounting firms. This lack of independence notwithstanding, where government contracts are involved, GAO wants government auditors to avail themselves of the work internal auditors have performed, and that is the genesis of the issue the GAO Report addressed.

An internal auditor does not need a CPA license to practice and therefore most do not have such a license. Rather, many internal auditors are members of the Institute of Internal Auditors (IAA), a large non-profit international professional organization. Among its many activities, the IAA establishes industry guidance and administers the Certified Internal Auditor’s (CIA) examination.

The scope of internal audits spans the activities of an organization. While internal audit reports frequently involve questions of economy and efficiency in various departments or programs, since the Sarbanes-Oxley Act internal audit departments have had their responsibilities expanded to include routine compliance with requirements related to financial statement reporting. While infrequent, it does happen that internal auditors may uncover a case of suspected embezzlement or other wrongdoing. As discussed more fully below, where government funds are involved, a contractor must self-disclose material misconduct in a report

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GAO Prods DCAA on Internal Audits (cont’d):

to the government. After receiving this disclosure, a federal fraud investigation may be initiated. When this occurs, government investigators will normally begin where the internal audit left off and use their law enforcement powers to uncover the full scope of the fraudulent conduct.

As the GAO Report noted, many defense contractors “have internal audit departments to monitor policies and procedures established by their management to ensure the integrity of their business systems, including those related to their government contracts.” However, the focus of an audit performed by internal auditors is quite different from an audit done by DCAA. To begin with, because of the expense, only the larger government contractors even have an internal audit department. Second, internal auditors receive training specifically related to their field. Third, the reports of internal auditors go to company management, and are not intended for use outside an organization. Finally, internal audits traditionally concern matters of economy and efficiency, and do not normally consider questions of cost allowability and/or cost allocability specific to government contracts. Nonetheless, since the passage of the Sarbanes-Oxley Act, some internal audit departments have also been tasked to gauge the operation of business systems, with a view toward financial statement valuation and disclosure issues, not compliance with government cost accounting requirements. In other words, the focus of concern is the ability of the business system to support the creation of periodic financial statements. This work would be outside the scope of a DCAA audit because, to repeat, DCAA audits are compliance audits.

c. Internal Investigations

Internal investigations are significantly different from the work routinely performed by internal auditors. Since at least 1981, the Supreme Court has recognized that effective corporate governance requires companies to be able to conduct internal investigations at the direction of counsel, in order to provide legal advice and to allow companies to ensure their compliance with applicable laws. Records of a corporate investigation into potential wrongdoing under the direction of counsel are protected by the attorney-client privilege, barring some action that forfeits the privilege. As such, reports of internal investigations are clearly beyond DCAA’s subpoena authority, and Department of Justice attorneys’ arguments notwithstanding, they are also unavailable to other government investigators.

Since November 2008, government contractors are required to report to the Government, in connection with a government contract or subcontract, credible evidence of criminal violations involving fraud, conflict of interest, bribery or gratuities under Title 18 of the U.S. Code, violations of the Civil False Claims Act (FCA), and significant overpayments. Failure to comply with this mandatory reporting obligation can have serious consequences, including debarment. Obviously, this reporting obligation is at tension with the protections afforded to internal corporate investigations. Accordingly, it is important to understand that records of such internal investigations are not audits, and corporate counsel should ensure that the internal audit and internal investigation functions are clearly separate.

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IV. GAO Report

As a threshold observation, the GAO Report noted: “Both DCAA and company internal auditors have the critical responsibility of assessing the quality of company internal controls.”7 One significant distinction, however, is that DCAA audits examine internal controls or business systems as they are used in the execution of government contracts. On the other hand, internal audits review internal controls and business systems for purposes of financial statement reporting. This crucial difference is nowhere mentioned in the GAO Report. To the contrary, GAO noted that DCAA’s audit manual requires “an evaluation of internal controls, which includes internal audits, to provide a basis for efficiently and effectively planning an audit.”8 Because DCAA and internal auditors both examine internal controls, GAO simplistically concluded that such internal audit reports automatically contain information relevant to DCAA audits. The GAO Report then said that defense contractors had performed hundreds of internal audits that it conclusorily stated were “related to,” “associated with,” or “pertained to” defense contracts. Whether this determination was accurate or not, GAO’s real point was that DCAA had been lax in its requests for access to these internal audit reports.

The most glaring deficiency in the GAO Report was its cursory treatment of the fundamental legal obstacle that DCAA auditors face in this area. Specifically, in 1988 the Fourth Circuit Court of Appeals determined in no uncertain terms that “internal audits are not the type of documents that fall within the scope of DCAA’s subpoena power.”9 Unfortunately, in a two-page Appendix to its Report, GAO misquoted and mis-cited the two key Newport News cases which analyzed the scope of DCAA’s authority to review contractor records. GAO read these cases as creating some ambiguity that could support DCAA review of contractor internal audits. However, the Newport News I and II decisions provide no justification for GAO’s insistence that DCAA ignore what has been settled law for nearly a quarter century.

GAO attributed DCAA’s lack of aggressiveness in making requests for access to the Newport News decisions, and this conclusion was probably correct. But GAO apparently believed that the DCAA could obtain access to internal audit reports despite the Newport News decisions, judging by how the cases were dismissively summarized in Appendix IV of the GAO Report as follows:10

DCAA’s use of its access authority has been addressed in at least two court decisions, generally known as Newport News I and Newport News II, both decided in 1988. In both cases, DCAA sought to enforce subpoenas for access to internal documents of Newport News Shipbuilding and Drydock Company. In the first case (Newport News I), Newport News challenged the scope of DCAA’s subpoena power as it related to Newport News’ internal audits [footnote omitted]. The court held that the statutory subpoena power of DCAA extends to cost

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GAO Prods DCAA on Internal Audits (cont’d):

information related to government contracts but that DCAA does not have unlimited power to demand access to all internal corporate materials of companies performing cost type contracts for the government. Because the materials sought by DCAA were not within the scope of its statutory authority, the court affirmed the district court’s order denying enforcement of the subpoena.

In the second case (Newport News II), DCAA subpoenaed the company’s tax returns, financial statements, and supporting schedules [footnote omitted]. The court decided to uphold enforcement of the Subpoena, concluding that the requested material was relevant to an audit and provided evidence of the consistency of costing methods and the reconciliation of costs claimed for tax purposes. Further, the court decided that access to the documents would allow DCAA to corroborate the company’s computation of direct and indirect costs. The court contrasted the two cases, stating the subpoena at issue in the first case did not expend to internal audits, which contain the subjective assessments of Newport News’ internal audit staff. In the second case, DCAA requested production of objective financial and cost data and summaries, not the subjective work product of Newport News’ internal auditors. To the extent that the materials subpoenaed would assist DCAA in verifying and evaluating the cost claims of the contractor, the court determined they were within DCAA’s statutory subpoena authority.

The GAO Report leaves readers with the misimpression that the two cases created some ambiguity about whether DCAA may rightfully demand access to internal audit reports. Newport News II certainly provides DCAA auditors a basis to request tax returns and raw cost and pricing data which may have been used by internal auditors, and it established that DCAA may investigate the funding of internal audit functions. But, as discussed below actual internal audit reports are beyond DCAA’s subpoena authority.11

V. The Newport News Cases

In the first of two cases brought by Newport News Shipbuilding and Dry Dock Company, the Fourth Circuit Court of Appeals determined that Congress intended to limit the DCAA's subpoena power to those materials which were related to costs incurred in the negotiations, proposals and performance of particular contracts.12 The Fourth Circuit upheld the lower court’s decision, which had found that Congress did not license the DCAA for any "fishing expeditions through corporate records."13 In addition to examining the legislative history of DCAA’s subpoena power, the lower Court cited pertinent excerpts from a Presidential Commission Report that said:

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GAO Prods DCAA on Internal Audits (cont’d):

Government action should not impede efforts by contractors to improve their own performance…. [O]verzealous use of investigative subpoenas by Defense Department agencies may result in less vigorous internal corporate auditing. Government actions should foster contractor self-governance. DOD should not, for example, use investigative subpoenas to compel such disclosure of contractor internal auditing materials as would discourage aggressive self-review.¹⁴

The Court also found that the relevant FAR implementing regulations limited DCAA's subpoena authority to cost-related data. The Court then noted that internal audit reports were used mainly for internal management control and were not actually pricing data subject to DCAA's subpoena. Because the government pays for these internal audits through indirect cost allocations, the payments were not related to any specific government contract.

The Court finished its analysis by noting that the DOD Inspector General was empowered by statute with virtually unlimited investigatory power - including the power to subpoena. In fact, the DOD Inspector General could even tap DCAA personnel in initiating, conducting or supervising audits and other investigations.¹⁵ Comparing DCAA's statutory purpose and subpoena power to the Inspector General's statutory purpose and subpoena power, the Fourth Circuit found that the DCAA’s subpoena power was necessarily limited and did not include access to internal audit reports.

In the second Newport News case¹⁶, the Fourth Circuit began by affirming the holding of Newport News I, stating: “We affirmed the district court's refusal to enforce the subpoena and held that DCAA's statutory subpoena power extends to objective cost information related to government contracts, but not to all corporate materials such as the internal, subjective evaluations at issue there.” Then the court went on to conclude: “The scope of DCAA's statutory subpoena authority also must be read against a practical understanding of the defense procurement process and sound auditing practice. Reviewed in this light, we disagree with the district court's conclusion that NNS's federal income tax returns, financial statements, and supporting schedules must fall outside the scope of DCAA's subpoena power.”

VI. Analysis

In response to the GAO Report’s findings, DCAA was “skeptical” that implementing GAO’s recommendations would lead to greater access to internal audit reports, because companies place limits on access to internal audit information based on interpretations’ of DCAA’s access authority and related court cases.¹⁷ Surely, DCAA well knows that defense contractors will not respond to its requests for access with unbounded enthusiasm. DCAA may have believed that it could not say no inasmuch as it had recently endured harsh criticism from GAO. Specifically, two recent GAO evaluations of DCAA audits found massive noncompliance with applicable audit standards.¹⁸ As a result, DCAA did not pass its required

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peer review and cannot now issue unqualified audit opinions. DCAA’s inability to issue unqualified audit reports is a significant problem in government contracts, and possibly the most significant problem facing DCAA today.\(^\text{19}\) Although these earlier GAO Reports did not concern the issue of access to internal audit reports, these developments may be related to the GAO Report that is the subject of this article, i.e., they may have contributed to DCAA’s unwillingness to challenge GAO’s recommendations.

To illustrate the likely consequences DCAA’s demands for access to internal audit reports would have, assume a defense contractor is trying to determine whether to replace its timekeeping and reporting system. Assume further that replacing the current system would be administratively burdensome and expensive. Under these circumstances, management may task the internal audit office to study the operation of the timekeeping system, with a view toward using that information to decide whether the current system needs to be replaced, and if so, with what. Shortly after the internal audit report is submitted, assume that a DCAA auditor arrives to perform an audit of labor charging. He subsequently learns of the internal audit report, and, spurred on by the GAO Report, requests a copy of both the report and the work papers of the internal auditors. Should the contractor release the internal audit report and the work papers? If the contractor decides to deny the request for access, it might be inviting costly and protracted litigation. But if the contractor grants the request, DCAA may use some of the information contained in the report to initiate adverse actions against the contractor (current argot calls these dilemmas lose-lose situations). Either way, experienced practitioners know that the contractor’s decision is fraught with significant risks. At least the contractor has favorable law on its side.

VII. Conclusion

GAO’s view of the two Newport News decisions was incorrect. Certainly, its conclusion that internal audit reports may be available to DCAA would require considerably more legal analysis than Appendix IV of the GAO Report provided. Also, the GAO Report apparently sought to foster the view that troves of contractor data are available merely for the asking. In fact, there are substantial legal and policy issues in this area that the GAO Report entirely ignored. Congress had these issues in mind when it accorded DCAA limited subpoena authority, as explained in *Newport News I*.

The government contracting environment has significantly changed since 1988 when the *Newport News* holdings were decided. As noted above, the roles and responsibilities of internal audit departments have considerably expanded since the Sarbanes-Oxley Act of 2002. Since 1988, there have also been numerous other legislative, regulatory, and judicial developments affecting the compliance regime in which government contractors operate. If GAO believes these changes call into question the rationale or findings of the *Newport News* decisions, it might advocate such a position in Congress or the courts, but may not simply ignore the state of the law. Moreover, while the government has a legitimate interest in ferreting out waste, fraud

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GAO Prods DCAA on Internal Audits (cont’d):

and abuse in government contracts, this initiative to seek access to internal audit reports will ironically lead to less contractor introspection.

While DCAA may try to obtain greater access to internal audit reports (as a result of the GAO Report), these actions will undoubtedly result in litigation with affected contractors. Consequently, activity in this area will lead to increased friction between DOD and its contractors at a time when business relationships are already strained (e.g., budget retrenchment, increased regulatory oversight, the lengthening shadow of self-disclosure requirements, and so on). In short, it will be necessary for the courts (or Congress) to resolve the significant legal issues arising from such DCAA requests, issues the GAO Report ignored.

Finally, should the Newport News decisions be either legislatively or judicially overturned, it would surprise no one if defense contractors simply scaled back the scope of their internal audits. Obviously, internal audits can no longer be beneficial to management when their reports may be used punitively by DCAA. Indeed, defense contractors that have a choice may choose to scale back or eliminate their internal audit departments. Where this occurs, contractors would operate more and more inefficiently, and in the award of its contracts DOD would continually subsidize that inefficiency (read: DOD loses).

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Endnotes

2 - In its audit guidance DCAA provided no authority for a demand for access to contractor personnel, and relevant statutes and regulations suggest there is no legal support for this position. See FAR 52.215-2, 10 USC §2313 and 41USC §254(d), which provide only for the examination of records.
6 - See FAR 9.406-2(b)(vi); FAR 52.203-13(b)(3)(i).
7 - GAO Report, p. 4.
8 - GAO Report, p. 15.
10 - GAO Report, p. 35.
11 - A single case from the United States Court of Appeals for the District of Columbia Circuit has questioned the result in Newport News I. See Director of the Office of Thrift Supervision v. Ernst & Young, 786 F.Supp. 46, 50-51

(continued on next page)
Endnotes (cont’d)

(D.C. Cir. 1992). But that case acknowledged that the Department of Defense is unique in that DCAA auditors have a discrete purpose which is different from the Department of Defense Office of Inspector General.

12 - Federal courts will enforce an administrative subpoena duces tecum if: (1) the inquiry is within the authority of the agency and is for a proper purpose; (2) the matter requested is reasonably relevant to the inquiry; and (3) the demand is not unreasonably burdensome or broad. See e.g., United States v. Powell, 379 U.S. 48, 57-58, 13 L. Ed. 2d 112, 85 S. Ct. 248 (1964); United States v. Morton Salt Co., 338 U.S. 632, 652-63, 94 L. Ed. 401, 70 S. Ct. 357 (1950); see also United States v. Westinghouse Electric Co., 788 F.2d 164, 170 (3d Cir. 1986) (subpoena must be relevant to agency's lawful purpose) (citing Endicott Johnson Corp. v. Perkins, 317 U.S. 501, 509, 87 L. Ed. 424, 63 S. Ct. 339 (1943)).


15 - Id. (citing United States v. Westinghouse Electric Corp., 615 F. Supp. 1163, 1180, aff'd, 788 F.2d 164 (3d Cir. 1986)).


