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The Clause

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

The President's Column David Black

Dear BCABA Members:

We have lots going on as we hit the Fall running!

BCABA Annual Program on October 26th

When the calendar hits "September" that means that the **BCABA Annual Program** is on the horizon. This year's program is on **October 26, 2011**, at the usual location – the Renaissance M Street Hotel at 1143 New Hampshire Avenue, N.W., Washington, D.C. The program runs from 8:30 a.m. to 4:00 p.m., with the business meeting starting at 4:00 p.m.

We have a terrific luncheon keynote speaker this year in **Dan Gordon, Administrator of the Office of Federal Procurement Policy**. Program panels will cover topics such as the new organizational conflicts of interest regulations; internal investigations pitfalls and best practices; fraud and related counterclaims in CDA litigation at the U.S. Court of Federal Claims; the BCA Judges' Panel, and the future of contingency contracting. My thanks to Annual Program Chair Chip Purcell (Cooley LLP) for putting together such a strong program.

Enclosed in this issue is the **Annual Program Flyer and Registration Form**. The **registration deadline is October 21st**.
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President's Column (cont'd):

The tuition is \$185 for BCABA members; \$175 for BCABA members at Gold Medal Firms; \$150 for government employees; and \$200 for non-BCABA members. ***Space is limited, so please register early.*** We look forward to seeing you there!

Annual Membership Renewal

It's also that time of year to renew your BCABA membership! Annual dues are \$45.00 (\$30.00 for government employees). If you haven't done so already, please renew your membership by September 30th. You can send a check payable to "BCABA, Inc." to:

BCABA, Inc.
c/o Thomas H. Gourlay, Jr.
P.O. Box 66612
Washington, DC 20035

You can also pay online using PayPal at **<http://www.bcaba.org/user/register>**. Thank you for your continued support of the BCABA!

Other Upcoming Events

We also have several other exciting events planned for this fall, including:

- the **Executive Policy Forum in early October** (chaired by John Pachter and Steve Knight (Smith Pachter McWhorter PLC));
- the **BCABA Quarterly Networking Event in mid-November** (chaired by Daniel Strouse (Wittie, Letsche & Waldo, LLP)); and
- the annual **BCABA Trial Advocacy Program** (chaired by Pete Pontzer (Army), Don Yenovkian (Army), Shelly Ewald (Watt, Tieder, Hoffar & Fitzgerald), and Jennifer Zucker (Wiley Rein LLP)).

Look for emails or check our website for updates.

Shout Outs!

My thanks to Susan Ebner (Buchanan, Ingersoll & Rooney PC and immediate BCABA Past-President) for hosting a successful "Summer Social" with the BCA Judges on July 13. We had a big turnout, including many young attorneys and summer associates. A good time (and great gelato) was had by all.

Thanks as well to Daniel Strouse for organizing our inaugural BCABA Quarterly Networking Event on August 15. We had a nice early evening crowd of BCABA members for some professional relationship building.

Thanks to Ryan Roberts (Sheppard, Mullin, Richter & Hampton LLP) for his continued work leading and editing the new BCABA Case Digest in *The Clause*. This issue features expanded coverage of cases issued by the various BCAs in the past three months.

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President's Column (cont'd):

As always, my thanks to Pete McDonald (Navigant Consulting, Inc.) for, well, just being Pete . . . and for doing a fabulous job putting together this issue of *The Clause* and being a wonderful mentor to me. (With Pete's help, I may finally learn the position of BCABA President by the time my term is up.)

We are always looking for volunteers to support our activities. If you have any interest in getting involved with the BCABA, please contact me at david.black@hklaw.com or 703-720-8680.

Our quarterly Board of Governors meetings this year will be held at the office of Holland & Knight LLP, 2099 Pennsylvania Avenue, NW, Suite 100, Washington, D.C. Our next meeting is on September 15, 2011, starting at noon.

Finally, I recently came upon an old government contracts case that may be of interest to our members. It concerns a firm-fixed price contract for beef in support of a contingency operation of the U.S. Army. Although the firm-fixed price for the 30 barrels of beef was only \$3,000, the contractor incurred \$14,000 in additional transportation costs related to delivery because of the aggressive troop movements of the Army unit that had ordered the beef. Moreover, before the beef could be delivered, it was stolen by a certain local national population, and the contractor was killed during the altercation. The Army later recovered only one of the 30 barrels for its use and consumption. The contractor's heirs (and the heirs of these heirs) later pursued a claim for payment of the entire firm-fixed price of all 30 barrels of beef as well as the additional costs of performance incurred because of the changes in the place of delivery.

The issues posed by this case are stimulating grist for government contract attorneys. Is the contractor entitled to his increased delivery costs under a "constructive change" theory even though this was a firm-fixed price contract? Which party bore the risk of loss from theft that occurred prior to delivery? Does the Anti-Assignment Act prevent the contractor's heirs (and the heirs of these heirs) from pursuing a claim for payment? Was the claimant required to certify its claim for a sum certain?

But this case is notable and highly entertaining for a different reason. It was written by Mark Twain. (Who knew that the man famous for the adventures of Tom Sawyer and Huckleberry Finn along the Mississippi River also wrote about federal procurement?) I highly recommend *The Facts in the Case of the Great Beef Contract*, which was first published in 1870 and is available at <http://www.twainquotes.com/Galaxy/187005b.html>. If the response of the Clerk to the Commissioner of Odds and Ends of the Corn-Beef Division of the Department of Treasury does not surprise you, it will definitely amuse you.

Best regards,

David Black
President
BCABA, Inc.



BCABA ANNUAL PROGRAM

October 26, 2011

Renaissance M Street Hotel
1143 New Hampshire Avenue, NW
Washington, D.C.

8:30-9:00 am

Registration*

Welcoming Remarks: David S. Black (Holland & Knight LLP), President, BCABA, Inc.
Francis F. Purcell, Jr. (Cooley LLP), Vice-President and Program Chair

9:00 - 10:15 a.m. NEW RULES ON CONFLICTS OF INTEREST: ARE THEY GOING TO BE GAME-CHANGERS OR JUST THE SAME OLD THING WRAPPED UP IN A DIFFERENT PACKAGE?

We've been talking about proposed changes in the rules on organizational conflicts of interest (OCI) for a number of years. In a landscape where contractor services comprise an integral part of the tools needed to accomplish the business of Government, changes in these longstanding OCI rules may have a profound effect. Join us as we explore the meaning and impact of the new OCI rules issued by AOD to implement WSARA requirements and the proposed FAR OCI rules that might really change what and how interests are considered in an OCI analysis.

Panelists: James A. "Ty" Hughes, Deputy General Counsel for Acquisition, Office of the Air Force General Counsel; Marcia A. Hudson, Partner and Chair Homeland Security Practice Group, Mayer Brown; Michael W. Mulek, Vice President and General Counsel, Raytheon Intelligence and Information Systems

Moderator: Susan Warsaw Kliner, Counsel, Buchanan Ingersoll & Rooney PC

10:15 - 11:15 a.m. UPDATE ON INTERNAL INVESTIGATION ISSUES

[TBD]

Panelists: [TBD]

Moderator: John Brownlee, Partner, Holland & Knight LLP

11:30-12:15 p.m. ENFORCEMENT PITFALLS IN THE MODERN PROCUREMENT MARKETPLACE: FRAUD AND RELATED COUNTERCLAIMS BEFORE THE COFC

The last few years have seen an increase in government malpractice and activity dedicated to oversight and investigation of government contractors. At the same time, CDA claims by contractors are on an upward, albeit a long, decline. These two trends interact to produce more litigation and more frequent pursuit of fraud and related counterclaims by lawyers defending the government. Government lawyers observe that they are obliged to seek available remedies where they are indicated, while the contractor community objects to the DOJ's aggressive interpretations of counterclaim statutes as unreasonable.

Panelists: Judge Francis Allegra, Court of Federal Claims; Edward Rich, Associate, Hogan Lovell, LLP; Stephen Kinsley, Managing Partner, LDCm Group; David Robbins, Director, Office of Procurement Fraud Research, Office of the Air Force General Counsel; Matt Solomon, Counsel, Sicley & Attala, Senior Trial Attorney, DOJ Commercial Litigation Branch;

Moderator: Stuart Turner, Associate, Arnold & Porter, LLP

12:15 - 1:15 p.m. LUNCHEON

Speaker: Daniel F. Gordon, Administrator, OMB Office of Federal Procurement Policy

1:30 - 2:45 p.m. BCA JUDGES PANEL

Judges will discuss key issues and best practices in the prevention of damages claims in BCA litigation, including pre-litigation claim presentation, discovery and evidentiary issues related to damages, and practical considerations in damages presentation.

Panelists: Judge Mark Melnick, Armed Services Board of Contract Appeals; Judge Patrick Sheridan, Civilian Board of Contract Appeals; Judge Monica Parchment, District of Columbia Contract Appeals Board

Moderator: Judge Gary Shapiro, Postal Service Board of Contract Appeals

3:00 - 4:00 p.m. THE FUTURE OF CONTINGENCY CONTRACTING

[TBD]

Panelists: [TBD]

Moderator: Michael Littlejohn, Counsel, Day & Zimmerman, Past President of the BCABA

4:00 - 4:30 p.m. BCABA, INC. ANNUAL MEETING

Approval Requested for 5.0
Hours of Virginia CLE Credit



BCABA ANNUAL PROGRAM REGISTRATION FORM

Registration Deadline: October 21, 2011

Name: _____

Title: _____

Company/Agency: _____

Address: _____

City, State, Zip: _____

Telephone: _____ Fax: _____

Email Address: _____

BCABA Member: _____ Gold Medal Firm* Member: _____ Total Paid: \$ _____

Questions?

Contact **Chip Purcell**

202-842-7841

cpurcell@cooley.com

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Educational Program Tuition

Non-Members:	\$200
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BCABA MEMBERSHIP DISCOUNT!

Add just \$10 to the tuition price, and you will receive BCABA membership for 2011-2012. (Regular membership for those not attending program is \$45 for private practice attorneys and \$26 for government employees.)

*A Gold Medal Member Firm is a law firm or organization in which all of its government contracts lawyers are members of the BCABA, Inc.. Gold Medal Firms as of 2010-2011 or those signing up all attorneys for the 2011-2012 year will be eligible for this discount. We appreciate the support of our Gold Medal Firms.



BCABA ANNUAL PROGRAM CREDIT CARD PAYMENT FORM

Registration Deadline: September 30, 2011

If you wish to pay for the BCABA Annual Program registration fee(s) and/or membership due(s) by credit card (VISA or Master Card only) *in lieu of check*, please provide the following information:

(1) Name(s) of Registrant(s): _____

[Please attach a separate list, if necessary.]

(2) Name on the Credit Card: _____

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(4) Name of your Firm or Agency: _____

(5) Total Dollar Amount to be charged – breakdown:

a. For Annual Program Registration Fee(s) \$ _____

b. For Membership Dues* \$ _____

(6) Credit Card Number: _____

(7) Credit Card Expiration Date: _____

(8) CBC (three digit) Code – on reverse of the credit card: _____

(9) USPS Zip Code for the location to which your card is billed: _____

* Please fill out a separate Registration Form for each individual.

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 that Ryan Roberts assembled and expertly edited (I'm trying to persuade him to replace me, and flattery is part of my crude strategy). Members should also note the new CBCA electronic filing rule. Dave Nadler and Justin Chiarodo provide an insightful analysis of a 4th Circuit decision involving the 'government knowledge' defense to FCA actions. Don Carney's article assesses the nuances of the new DFARS Ground & Flight Risk clause, while Jerry Alfonso Miles provides a comprehensive review of issues related to overseas construction contracts. Caitlan Cloonan's well-written article addresses the emerging topic of cybersecurity investigations, while Oliya Zamaray provides sage advice on bid protests.

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 some articles that were simply unsuitable for publication, such as: "Pete & Demi: The Rumors Persist . . ."; "CBCA Clears Docket by Haruspicy!!"; and "IGs Heap Praise on Acquisition Corps!!"



Annual Dues Reminder

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

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

BCA Case Digests

by
*Ryan E. Roberts**

BCABA members – Welcome to the first full edition of the BCA Case Digests. The boards were relatively quiet over the summer months, but we’ve still summarized the most interesting and relevant decisions from the months of May through July below.

The most interesting decision was the ASBCA’s ruling in the *Appeal of Free & Ben*. There, the ASBCA not only discussed whether parties are permitted to file electronically, but whether these submissions may be made after hours.

In addition to the usual variety of contract interpretation and performance appeals, the boards took up cost issues in the *Appeals of Thomas Associates* (allowability of certain insurance costs), *General Dynamics* (estimating future pension costs), *Todd Pacific* (allocability of facility repair and upgrade costs), and *Kearfott Guidance* (inadvertent omission of allowable costs).

Furthermore, the boards addressed jurisdictional questions in the *Appeals of Winston* (tort claims), *Public Warehousing* (new legal theories on appeal), *Public Warehousing* (rescission of a unilateral purchase order), and *Navigant SatoTravel* (ripeness of a claim).

As we mentioned last issue, the Case Digests are still a work in progress. Should you have any comments or suggestions, please feel free to contact me at the email address listed below.

CASE INDEX

ARMED SERVICES BOARD OF CONTRACT APPEALS DECISIONS

Todd Pacific Shipyards Corp., ASBCA Nos. 55126 , 56910, (May 12, 2011)
Thomas Assocs., Inc., ASBCA No. 57126 (May 17, 2011)
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FastLinks, Inc., ASBCA No. 57150 (May 25, 2011)
General Dynamics Ordnance & Tactical Sys., Inc., ASBCA Nos. 56870, 56957 (May 26, 2011)
Kearfott Guidance & Navigation Corp., ASBCA No. 55626 (June 10, 2011)
Tawazuh Commercial & Constr. Co. Ltd., ASBCA No. 55656 (June 13, 2011)
General Dynamics Corp., ASBCA No. 56744 (June 21, 2011)
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Case Digests (cont'd):

CIVILIAN BOARD OF CONTRACT APPEALS DECISIONS

Navigant SatoTravel v. GSA, CBCA No. 449 (May 26, 2011)

Ryll Int'l, LLC v. Dep't of Transportation, CBCA No. 1143 (June 30, 2011)

Red Gold, Inc. v. Dep't of Agriculture, CBCA No. 2259 (July 6, 2011)

POSTAL SERVICE BOARD OF CONTRACT APPEALS DECISIONS

Wesley Winston, Jr., PSBCA No. 6341 (June 17, 2011)

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Appeals of Todd Pacific Shipyards Corporation

ASBCA Nos. 55126 , 56910, May 12, 2011 – Judge Scott

by Eugene Scott, Federal Aviation Administration

The issue before the ASBCA was whether Todd Pacific Shipyards Corporation (“Todd Pacific”) was entitled to change its accounting treatment of facility repair and upgrade costs from indirect to direct. Todd Pacific had performed three predecessor contracts for the same services for the Navy going back to 1986 and its established accounting practice had been to treat repair and upgrade costs as indirect costs allocable to all government and commercial contracts that used the site, not as direct costs to the Navy cost-reimbursement contract. The contractor didn't request a change in accounting treatment until months after award of the contract in dispute.

Todd Pacific argued that it should be allowed to reclassify its repair and upgrade costs from indirect to direct costs chargeable to the contract in dispute because it would not have incurred the costs “but for” the requirements of the disputed contract. Its position was that the proper test for determining whether the repair and upgrade costs should be direct or indirect is not whether the costs benefit multiple cost objectives, but whether the contractor would have made the investments but for the contract. According to the Government's expert witness, Todd Pacific's argument, if successful, would have resulted in the Navy paying approximately \$10 million for services that would have cost \$320,000 to \$325,000 under the prior method of accounting.

The ASBCA rejected the contractor's “but for” test. It determined that the appellant bears the burden of proof on allocability issues and that it failed to meet its burden that it was entitled to reclassify the costs in question from indirect to direct. The ASBCA concluded that the costs incurred pertained to more than one cost objective and accordingly, under FAR 31.201-4 and FAR 31.203(a) and (b), were to be treated as indirect costs and allocated to Todd Pacific's contracts on the basis of the relative benefits received.

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Case Digests (cont'd):

A few of the facts that the ASBCA relied on were: (i) the contractor's own documents indicating that the repairs and upgrades at issue would benefit multiple contracts, even though there was some testimonial evidence that Todd Pacific would not have made the repairs but for the disputed contract; (ii) the disputed contract's requirements were not unique; and (iii) Todd Pacific made the intentional business decision to make the investments even though it knew that the Navy's requirements were not firm and might not result in enough activity to recoup the investment.

A contractor should not expect the ASBCA to compensate it for business decisions that don't pan out. Prior to contract award, the contractor's CEO acknowledged to his Board of Directors that there was risk that there could be few requirements under the contract but the risk was mitigated by the ability to recoup the investment through other government and commercial contracts. In this case, the contractor should have secured an advance agreement with the Contracting Officer ("CO") that the repairs and upgrades would be treated as direct charges.

Appeal of Thomas Assocs., Inc.

ASBCA No. 57126, May 17, 2011 – Judge James
by *John Sorrenti, McKenna Long & Aldridge LLP*

In Thomas Associates, the two issues before the ASBCA were (1) whether cost items related to life insurance and an automobile for two of the contractor's employees were "expressly unallowable;" and (2) whether the Government was required to waive the penalties for any of the expressly unallowable costs in dispute. DCAA disallowed eight of the contractor's proposed indirect costs and recommended that the contracting agency impose penalties on six of them. Of the six penalized costs, the contractor agreed that four were expressly unallowable, but argued that penalties should not be imposed. After concluding that that these four cost items were expressly unallowable, the ASBCA then examined whether two costs – for an employee's life insurance premium and another employee's automobile – could be categorized as allowable costs.

FAR Part 31 cost principles provide guidance on whether costs are allowable. Specifically, FAR 31.205-19(e)(2)(v) allows the costs of insurance on contractor employees only if the insurance is considered additional compensation. Because the contractor did not treat the cost of insurance as compensation for its employee, the ASBCA held that the life insurance premium paid by the contractor was expressly unallowable.

In contrast, the contractor argued that the cost of the automobile was a fringe benefit under FAR 31.205-6(m), and properly included it as part of the employee's compensation. Accordingly, the ASBCA rejected the Government's argument that the car was a gift or donation to the employee and held that the costs of the automobile were allowable as a fringe benefit.

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Case Digests (cont'd):

Finally, the ASBCA reviewed whether the CO was required to waive the penalties on the remaining expressly unallowable costs. Pursuant to 10 U.S.C. §2324(c), FAR 42.709-5 provides that penalties “shall be waived” when: (1) the contractor submits a revised proposal for indirect costs before an audit of these costs is initiated; (2) the unallowable costs are insignificant in amount; or (3) the contractor proves it has internal policies and controls to avoid inclusion of unallowable costs in its proposals and the penalized costs were included inadvertently in the proposal. Pursuant to the second reason for waiver, the ASBCA found that the CO must waive the penalty on the four expressly unallowable costs that were under \$10,000. For the one remaining disputed cost in excess of \$10,000 the ASBCA found that the contractor had not met any of the other waiver situations and thus this cost was properly subject to penalty.

Although contractors must maintain detailed accounting systems to track allowable costs, a DCAA finding that a particular cost has been wrongly charged should not necessarily discourage a contractor from fighting the penalty. This decision reminds contractors to carefully consider whether to challenge any penalties assessed against expressly unallowable costs as they could be eligible for a waiver.

Appeal of Sundt Construction, Inc.

ASBCA No. 57358, May 24, 2011 – Judge Grant

by Jeffery M. Chiow, Blank Rome LLP

This was a contract interpretation case involving the construction of military housing decided on cross-motions for summary judgment with each side contending its plain reading of the contract’s liquidated damages terms was correct. The parties negotiated an extension for the overall project and specifically negotiated longer performance extensions for two General Officers Quarters (“GOQs”). For clarity, the contractor specifically requested the incorporation of language in the modifications stating that the amended GOQ deadlines did not apply to other units, and the modifications expressly indicated that the deadlines for all but the GOQs “remained unchanged.”

The contractor argued that a clause in the basic contract provided a single project deadline and urged that extensions to any element of the project automatically amended that single deadline for purposes of liquidated damages. Its principals also averred that in discussions with the Government they had “reserved the right to claim there was only one completion date” and that the Government “did not respond or indicate disagreement” when the contractor asserted this position. The contractor offered declarations and other extrinsic evidence in support of its proffered interpretation.

The ASBCA held that the unambiguous contract language was only susceptible to one reasonable interpretation, and therefore it would not consider extrinsic evidence. Reading the language as a whole in order to give meaning to every provision, the ASBCA held that the

(continued on next page)

Case Digests (cont'd):

parties agreed to extend only the GOQs' deadlines, and liquidated damages were to be applied according to the contract formula for other units from their respective deadlines until completion. It would not accept an interpretation that the original liquidated damages clause prevented the parties from negotiating other unit-specific deadlines during performance.

Like many plain meaning cases, it is difficult from the decision to understand how the contractor found itself in the position of agreeing to a written modification that is so hard to reconcile with its proffered interpretation. This decision proves once again that a contractor's contractual "position" is not worth the paper it should have been written on.

Appeal of FastLinks, Inc.

ASBCA No. 57150, May 25, 2011 – Judge Paul

by Tara L. Ward, Wiley Rein LLP

In this case, the ASBCA considered an appeal of a CO's decision terminating the contractor for default.

The Government contracted for the installation of an amplified antenna system in an Army hospital in Kansas to facilitate the use of hand held radios. The contractor failed to meet either the contract completion deadline of January 15, 2010, or the revised completion deadline – agreed upon after the contractor provided assurances to the Government – of February 19, 2010. On March 1, 2010, the CO issued a cure notice. On March 9, 2010, the contractor stated that it was ready to begin work with a tentative final installation date of March 17, 2010. Hospital staff worked with the contractor to coordinate access to work areas in the hospital, but on March 16, informed the Government that FastLinks had not complied with infection control requirements. On March 17, 2010, the CO terminated the contract for default. The termination notice identified several reasons for termination: (1) failure to complete installation by January 15, 2010; (2) failure to meet the revised February 19, 2010 deadline; (3) failure to comply with the cure notice; and (4) unsatisfactory performance. The CO reprocured the antenna system and, on 28 July 2010, entered into a contract with a replacement contractor that installed a properly functioning antenna system in only five days.

In defending its failure to perform, the contractor argued that the amplifier specified by the Government was defective because it did not match the operating frequencies of the antennas. The ASBCA rejected this argument because the follow-on contractor installed the same antenna, and it worked properly. FastLinks also argued that it could not complete the contract because the Government withheld contractually required technical information from it. The ASBCA also rejected this argument, crediting the CO's testimony that the contractor could have installed the antenna system without the referenced documents.

Contractors (and counsel) take note – the performance of follow-on or replacement contractors may prove dispositive in the ASBCA's assessment of the workability of specifications and/or the feasibility of performance.

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Case Digests (cont'd):

Appeal of General Dynamics Ordnance & Tactical Systems, Inc.

ASBCA Nos. 56870, 56957, May 26, 2011 – Judge Delman

by Jessica Madon, Booz Allen Hamilton

The issue before the ASBCA was whether the agreement between the parties was a “requirements contract” for the manufacture and delivery of small munitions or a “basic ordering agreement” (“BOA”). General Dynamics Ordnance and Tactical Systems, Inc. (“General Dynamics”) argued that the contract in question was a requirements contract and claimed an equitable adjustment in contract price cause the Army’s allegedly inaccurate quantity estimates. The Army moved for summary judgment in this case and argued that the August 2005 award document was a non-binding BOA, citing to terms in the solicitation and the contract document to support its position. General Dynamics countered by arguing that the award document, while labeled a BOA, was more appropriately a binding requirements contract.

The ASBCA explained that requirements contracts and BOAs are fundamentally different documents in that a requirements contract is a binding contract; while a BOA is not. A requirements document creates a binding contractual obligation upon the Government to order and for the contractor to furnish all the Government’s needs for a particular product or service for a specified duration. A BOA, however, is a written understanding that provides the terms and conditions between the parties that will apply to future contracts between the parties – with no obligation on either party.

The ASBCA determined that the August 2005 contract document was ambiguous as to whether it was a requirements contract or a BOA. It found that the solicitation and award documents contained references to the document being a requirements contract, but that it was labeled a BOA. Because of the internal inconsistency in the documents, the ASBCA determined that summary judgment on the record was inappropriate.

The Army also argued that even if the award was a requirements contract, such a contract allocated the risk of variations in the mix of products ordered to the contractor. The ASBCA rejected this argument also because contractors only assume the risk when the Government’s quantity estimates are not negligently prepared and the ASBCA could not determine from the evidence presented whether the Government’s estimates were properly prepared because the Government refused to disclose to the contractor certain documents that were used by the Government to develop its estimates.

The lesson learned here is to make sure your contract documents are clear and clarify early whether it is a requirements contract or a BOA – these documents may look similar, but the parties’ obligations are very different under each.

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Case Digests (cont'd):

Navigant SatoTravel v. GSA

CBCA No. 449, May 26, 2011 — Judge Kullberg

by Gregory Hallmark, Holland & Knight

This appeal presented the CBCA with the questions of whether a Government claim must be certified and whether a Government claim issued before the amount in question came due was premature.

The contractor informed the Government on January 23, 2006 that it would not pay industrial funding fee ("IFF") payments until it had exhausted its legal remedies. The IFF was set at \$1.50 per transaction. The order's period of performance was to expire on March 31 and the due-date for reporting IFF on transactions through the end of the order was May 1. On March 21—prior to the end of the period of performance and prior to the due-date for reporting IFF—the CO issued a decision directing the contractor to pay unpaid IFF on transactions through January 31. In discovery, the contractor acknowledged an additional number of transactions during the period of February 1 through March 31. In the entitlement phase of this appeal, the CBCA held that the contractor was liable for IFF payments. In the quantum phase, the Government argued that it was entitled to recover IFF payments through the end of the order, March 31. Before the hearing on quantum, the contractor moved to dismiss for lack of jurisdiction.

The contractor made two jurisdictional arguments. First, it argued that the CBCA lacked jurisdiction over the Government's claim because the Government had not certified its claim. The CBCA rejected this argument, holding that the CDA's certification requirements apply only to claims brought by contractors. 41 U.S.C. §7103 ("For claims of more than \$100,000 made by a contractor, the contractor shall certify that . . ."). The CBCA held that the certification requirement does not apply to claims by the Government against a contractor.

Second, the contractor argued that the Co's decision was premature and speculative, as it was issued prior to the end of performance and prior to the due-date for reporting the amount due in IFF. The CBCA held that when the contractor advised the Government that it would not pay IFF until it exhausted its legal remedies, the contractor's non-payment of IFF became a matter in dispute. Because the contractor had provided the Government with data on the number of transactions through January 31, the facts were sufficiently developed at the time of the CO's decision to warrant the CBCA's jurisdiction. The CBCA also asserted jurisdiction over the claim for IFF on transactions from February 1 through March 31 on the grounds that that claim arose from the same set of facts as the original claim for the earlier period. The CBCA ordered the contractor to pay the IFF on transactions in all periods, plus interest.

In sum, by proactively informing the Government that it will seek legal remedies, a contractor may invite an immediate claim by the Government against it.

(continued on next page)

Case Digests (cont'd):

Appeal of Kearfott Guidance & Navigation Corp.

ASBCA No. 55626, June 10, 2011 – Judge Freeman

by Townsend Bourne, Sheppard, Mullin, Richter & Hampton LLP

At issue in this case was whether costs omitted from the calculation of indirect cost rates and facilities capital cost of money factors could be included in such calculation following the parties' execution of a letter agreement confirming the stated rates and factors.

The contractor's tangible and intangible assets were appraised when it was acquired by a new company in 1988. Its identifiable intangible assets included software, business backlog, and a three year covenant not to compete with the contractor's former owner. Costs associated with these intangible assets were included in an income statement account that was overlooked when the contractor prepared its indirect cost rate calculations and incurred cost submissions for its government contracts. The contractor and the Government later entered into a letter agreement, which provided a schedule of indirect cost rates and cost of money factors "including asset write-up costs." Subsequently, the contractor learned that the rates and factors identified in the letter agreement did not include the intangible asset write-up amortization costs.

The Government argued before the ASBCA that the contractor's omission of the intangible asset write-up amortization costs resulted from a deliberate established accounting practice, that the costs were not allowable, and that the rates and factors established by the parties in the Government's letter agreement were final and could not be revised.

The ASBCA disagreed, finding the omitted costs allowable and the omission inadvertent. Further, the ASBCA found that the proper remedy was reformation of the letter agreement under the doctrine of mutual mistake. The ASBCA agreed with the contractor that its assignment of identifiable intangible asset write-up amortization costs was a bookkeeping mistake based on a one-time decision such that the omission of the costs from the contractor's submissions could not be considered deliberate. Further, the ASBCA stated that it could identify no cost principle disallowing the costs at issue. Finally, it was determined that both parties believed that the rates and factors identified in the letter agreement included the contractor's intangible asset write-up amortization costs. The rates and factors were not identified as "final" in the letter agreement and the letter agreement did not contain a release that would prohibit modification of the terms of the agreement. The ASBCA found that the parties' belief regarding the costs included in the letter agreement was a mutual mistake and that reformation of the letter agreement was proper.

Thus, while it is always important for contractors to assign correctly and monitor diligently all contract costs, it seems that sometimes the ASBCA does allow for second chances.

(continued on next page)

Case Digests (cont'd):

Appeal of Tawazuh Commercial and Construction Co. Ltd.

ASBCA No. 55656, June 13, 2011 – Judge Williams

by Christine Roushdy, Vincent & Elkins LLP

Tawazuh Commercial and Construction Co. Ltd.'s ("Tawazuh") contract to pave a road in Afghanistan was terminated for default. The contractor challenged the propriety of the termination and requested an equitable adjustment for costs incurred from: (1) work completed prior to the termination; (2) the value of equipment destroyed by an attack on its base camp; and (3) costs incurred as a result of the government-ordered suspension of work.

Tawazuh was awarded a contract for, and had commenced work on, constructing a paved road through portions of Afghanistan. Within the first month of performance, Tawazuh had requested and received two progress payments without the Government performing an on-site inspection. Such a visit was impractical because the Government lacked the necessary security. Upon requesting the third progress payment, the Contracting Officer's Representative visited the site and found major deficiencies with the completed work, in violation of the requirements of the contract. As a result, the CO issued a Suspension of Work Order.

During the suspension, the Government hired a third party expert in road design, construction, inspection, and quality assurance to evaluate the quality of Appellant's work. Also during this time, the Tawazuh's camp suffered an attack by the Taliban, during which several pieces of its equipment were destroyed. The expert identified several areas in which the contractor had failed to follow the specifications of the contract. These deficiencies were such that the road would not be structurally sound during winter weather. The expert further concluded that poor road quality was due to substandard materials. The CO terminated the contract for default and Tawazuh filed a certified claim, which the CO rejected. The Government also issued a repurchase contract to a different contractor whose scope of work included demolishing and reconstructing the portion of the road Tawazuh had completed.

The ASBCA found that the termination for default was proper, rejecting Tawazuh's argument that the Government's payment of the first two progress payments constituted acceptance of the work. The ASBCA found this to be unpersuasive since the Payments clause, which was included in the contract, explicitly states that payment does not waive the Government's right to require fulfillment of the contract terms. Furthermore, not only did the Government and third party's inspection of the work reflect a failure to adhere to the specifications, but the contractor failed to maintain an adequate inspection system.

With regard to the Tawazuh's claims, the ASBCA found that the claim for the completed road work was without merit since the road failed to comply with specifications and the Government had to pay for the demolition and reconstruction of all of Appellant's work. As to the equipment destruction claim, the ASBCA found the contractor was not entitled to payment for several reasons: (1) the contract provided that the contractor is responsible for equipment loss; (2) the contract provided that the Government was not responsible for

(continued on next page)

Case Digests (cont'd):

providing security for the Appellant; and (3) the contract specifically required that the contractor carry vehicle insurance, which the contractor did have.

Finally, the ASBCA rejected Tawazuh's claim that the CO's suspension of work was for an unreasonable period of time. The ASBCA found that the suspension went on for no more than two months and given the circumstances, which included difficulty in finding an expert to inspect the work, the numerous deficiencies in the work and the absence of the contractor's quality control documents, the duration of the suspension was reasonable.

Although it's clearly stated in the Payments clause, it's worth repeating here – the Government's issuance of progress payments will not necessarily constitute acceptance of the work.

Appeal of Wesley Winston, Jr.

PSBCA No. 6341, June 17, 2011 – Judge Campbell

by Ryan E. Roberts, Sheppard, Mullin, Richter & Hampton LLP

At issue before the PSBCA were two jurisdictional questions stemming from the Government's partial motion for summary judgment. Wesley Winston had appealed a CO's final decision finding that he was required to pay the United States Postal Service \$6,715 resulting from his alleged excess fuel usage in the performance of four contracts. The CO had previously issued three additional, but similar, final decisions stating that Mr. Winston owed approximately \$122,000 for similar overages. Mr. Winston's complaint sought over \$150,000 in damages directly stemming from contract performance (covering all four of the final decisions) as well as damages resulting from mental anguish.

The PSBCA held that its jurisdiction was limited to the one final decision formally appealed, and granted the Government's partial motion for summary judgment. The PSBCA held that it did not have jurisdiction to consider claims that were not properly submitted and certified according to the requirements of the CDA. Additionally, the PSBCA held that it does not have jurisdiction over tort claims, which included Mr. Winston's claim for mental anguish.

The basic lesson here – although appearing in a unique context – is to make sure you meet all of the requirements for submission and certifying your claim under the CDA.

Appeal of General Dynamics Corp.

ASBCA No. 56744, June 21, 2011 – Judge Peacock

by Christopher Noon, Sheppard, Mullin, Richter & Hampton LLP

The issue before the ASBCA was whether CAS 412 prohibits the use of partial-year market value data and implied rates of return to estimate future pension costs. In this case, the contractor had used "actual investment performance" of its pension fund assets (*i.e.*, intra-year

(continued on next page)

Case Digests (cont'd):

returns) in its forward pricing estimates of pension costs. The contractor argued that CAS 412 was inapplicable in this situation because CAS 412 solely addresses the measurement and assignment of pension costs to the current accounting period and does not address the estimation of those costs for future years.

The ASBCA rejected the contractor's argument, explaining that several provisions of CAS 412 "expressly or implicitly" describe the measurement process as one applicable to future years. For example, CAS 412-40(a)(1) states that a "normal cost" is an integral component of pension cost for defined benefit plans not accounted for on a pay-as-you-go basis, and "normal cost" is expressly defined in CAS 412-40(a)(18) to mean "the annual cost attributable, under the actual cost method in use, to current and *future* years as of a particular valuation date, excluding any payment in respect of an unfunded actuarial liability" (emphasis added). The ASBCA also pointed out that the measurement of pension costs under defined benefit plans necessarily involves the use of "actuarial assumptions" and CAS 412-30(a)(3) defines these to include "estimate[s] of *future* conditions" (emphasis added).

The contractor also argued that even if CAS 412 does apply to its projection of pension costs, the intra-year rates and fund returns were historical facts and not "actuarial assumptions" as defined in CAS 412-30(a)(3), and therefore its methodology was not in violation of CAS 412-50(b)(4). However, the ASBCA disagreed, pointing out that the contractor used a "composite" rate instead of the historical 8% rate, which the contractor agreed was an "assumption." The contractor assumed the "composite" rate was more likely to be accurate. The ASBCA held this assumption falls within the definition of "actuarial assumption."

Nevertheless, the contractor believed it was compelled to use these returns to comply with the "fundamental" requirement of CAS 412-40 because the returns represented the contractor's "best estimate." However, the ASBCA took issue with the contractor's methodology, which used rates that were demonstrative of "short-term" fluctuations and "distortions" that CAS 412 was intended to avoid.

As this case illustrates, CAS 412 does apply to measurements in future years and contractors' actuaries must be aware of this for developing compliant cost methodologies. Furthermore, these estimating methodologies should "[take] into account past experience and reasonable expectations." As the ASBCA explained, the purpose of these estimates is to project pension costs of a long-term plan years into the future. Accordingly, the estimating methodology should attempt to be consistent with that long-term perspective.

Appeals of Matrix Research, Inc.

ASBCA Nos. 56430, 56431, June 22, 2011 – Judge Van Broekhoven

by Oliya Zamaray, Holland & Knight

Before the ASBCA was whether the Government may terminate for default and assert a

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Case Digests (cont'd):

claim for unliquidated progress payments against a small business contractor when the contractor commits material failures under a firm fixed-price supply contract.

Matrix Research, Inc. ("Matrix"), a small business, was the only bidder in a procurement conducted by the U.S. Army Communications - Electronics Command (the "Army"). The Army awarded the \$559,998.00 firm fixed-price contract to Matrix, obliging Matrix to supply certain rotary pump units, masts, and support cylinders in accordance with contract specifications, as well as certain technical and scientific data package reports. Delivery was due 210 days after award but, despite multiple extensions and contract modifications spanning a 3-year period, Matrix never delivered the masts. Matrix also failed to conduct proper testing and deliver compliant inspection reports. The Army issued a cure notice, asserting that it considered Matrix's failure to deliver accurate and complete documentation in accordance with a contract modification a condition affecting performance of the contract. Matrix failed to comply with the cure notice, causing the CO to terminate the contract for default and demand the return of \$151,028 in unliquidated progress payments.

The ASBCA found unpersuasive Matrix's defenses. Matrix's primary defense was that the Army's engineers inhibited Matrix from proceeding with the acceptance testing, that the Army imposed certain requirements not in the original contract, and that the Army withdrew the government furnished equipment it promised (also not in the original contract). Matrix also continued to disagree with the Army's engineers regarding the adequacy of the documentation supporting its inspection and testing.

The ASBCA held that the default termination, a "drastic sanction," was appropriate. There was no dispute that Matrix failed to ever deliver the masts and that it was only those masts and the required inspection and test documentation which remained outstanding at the time of the termination for default. The ASBCA recognized that the lack of progress on the masts was due to the actions of Matrix's subcontractor, but ultimately agreed with the Army that Matrix failed to make progress as of the date of termination and failed to take action in accordance with the cure notice. The ASBCA found no evidence that the Army's engineers inhibited Matrix's performance. The ASBCA also noted that obligations not incorporated into the contract were not enforceable.

Although neither party argued the question of the Army's claim for unliquidated progress payment, the ASBCA held that the contract's Progress Payment clause required the contractor to pay the Government, on demand, the \$151,028.45 in unliquidated progress payments.

Parties should be sure to incorporate changes into the contract if they expect to be bound by them. When Matrix failed to deliver following several extensions, it and the Army entered into a series of agreements which modified the parties' obligations. The Army produced a revised Statement of Work ("SOW") which contained certain new requirements. Ultimately, a

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Case Digests (cont'd):

question arose between Matrix and the Army regarding the apparent inconsistency between what was contained in the revised SOW and the original SOW in the contract. Neither the revised SOW nor the other additional performance requirements were ever incorporated into any modification of the contract.

Additionally, contractors should take note that Matrix's subcontractor, VDH, was in great part responsible for Matrix's default. The ASBCA acknowledged that "VDH did not maintain acceptable inspection reports that adequately documented the inspections," adding "assuming that it even performed such inspections." Ultimately, because a subcontractor lacks privity of contract with the Government, VDH could not be held directly liable for the resulting default. Prime contractors should beware that they will be held responsible for their subcontractor's failure to perform.

Appeal of Public Warehousing Co.

ASBCA No. 56022, June 22, 2011 – Judge Ting
by *Daniel Strouse, Wittie, Letsche & Waldo LLP*

In Public Warehousing Co., the ASBCA had to decide whether a claimant could seek relief under a new legal theory that was not presented to the CO.

The Public Warehousing Company ("PWC") entered into a contract with DLA Troop Support (the "Agency") to deliver food, beverage, and related subsistence items to U.S. and allied forces in Kuwait, Qatar, and the active combat zones in Iraq, using PWC trucks. The contract established prices for additional transport fees when PWC trucks exceeded a pre-identified time period to make a round trip. A modification placed a 29-day cap on these fees. The record reflects that the Agency knew that PWC was often unable to meet the 29-day requirement because the Army used PWC's trucks for storage or extra deliveries, rather than permitting an expeditious return as the contract required.

The Agency refused to compensate PWC for the government-caused delays. PWC submitted a request for equitable adjustment (REA) including a summary of the reasons for the delays. When the Agency did not respond to the REA, PWC submitted a certified claim, based on the legal theory of unjust enrichment, incorporating the REA. The Agency denied the claim and PWC appealed.

The Agency moved to dismiss the appeal, arguing that the ASBCA lacked jurisdiction because an unjust enrichment claim is not premised on an express contract. In response, PWC moved to amend its complaint to assert three different theories of recovery: (1) breach of contract; (2) constructive changes; and (3) breach of the Government's implied duty to cooperate with and not hinder PWC's performance. The Agency opposed PWC's motion, arguing that the ASBCA lacked jurisdiction to hear the amended complaint because the elements of the new legal theories were different from those of unjust enrichment; therefore, the complaint exceeded the scope of the claim presented to the CO.

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Case Digests (cont'd):

The ASCBA held that a claimant may seek relief under new legal theories of recovery if the theories are based on the same operative facts as the claim presented to the CO. Comparing the elements of new legal theories to those of the initial theory does not determine whether the same operative facts exist. The claimant must provide the CO a “clear and unequivocal statement” that provides adequate notice of the basis and amount of the claim. Additionally, the ASBCA states that it will not rigidly adhere to the exact language or structure of the claim. Here, the ASBCA examined the claim and the totality of the correspondence between the parties. The ASBCA found that the amended complaint did not exceed the scope of the claim presented to the CO because the operative facts underlying the legal theories in the amended complaint were derived from common or related facts, which had been presented to the CO in the REA and the claim, and which had been the subject of numerous emails between the parties. This case presents an important litigation strategy lesson for contractors – be sure that any claim submitted to a CO includes all operative facts, regardless of the stated legal theory, to permit revisions to legal theories upon appeal.

Appeal of Ryll International, LLC

CBCA No. 1143, June 30, 2011 - Judge Steel

by Katherine Allen, Buchanan Ingersoll & Rooney

In Ryll International, the CBCA had to determine whether the contractor's failure to perform was excusable, therefore converting the termination for cause into one for the convenience of the Government.

The Federal Highway Administration ("FHWA") awarded a \$1,085,250 firm fixed-price commercial services contract to Ryll International, LLC ("Ryll") on July 13, 2007. The contract required Ryll to crush and stockpile 5750 cubic yards of select borrow and 12,700 cubic yards of course aggregate in the very remote and difficult to access Katmai National Park, Alaska. Ryll, a non-Alaskan company, won the contract without conducting a site visit or securing any subcontract agreements before bidding. Lengthy and contentious negotiations with subcontractors pushed back the start of work until early October, when weather made performance very difficult. All work was required to be completed by October 31, 2007, but the subcontractor abandoned the project for a variety of reasons on October 6, 2007. Negotiations between Ryll and the difficult subcontractor, brokered by the FHWA, led to discussion of a potential contract extension. The contract was terminated for cause when those negotiations fell through.

Ryll alleged the termination was improper, claiming: (1) the specifications were defective; (2) Ryll's delays were excusable due to unusually severe weather and FHWA's failure to provide permits, delaying access to the site; (3) FHWA failed to share its superior knowledge about access and that a local contractor had previously bid on the project; and (4) FHWA employees, acting in bad faith, hindered Ryll's performance.

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Case Digests (cont'd):

The CBCA concluded that Ryll failed to prove any of its allegations. The CBCA held that the contract specifications were not defective as the contractor had plenty of time to complete the work within the 180 day performance period, even allowing for reasonable delays. Further, claims of unreasonably adverse weather were unfounded when compared to average weather conditions at the same site. In addition, any claims of superior knowledge were negated by the fact that Ryll elected not to make a pre-bid site visit. Finally, the FHWA acted in good faith as it worked to mend the broken subcontracting relationship with threatened contract performance. Unfortunately, terminating the subcontracting agreement after the subcontractor abandoned the project meant that Ryll could not complete the contract in a timely manner, even with an extension. Ryll's failure to perform was proximately caused by the subcontractor, not FHWA.

This case highlights the fact that the burden is on the contractor to investigate and account for the particular circumstances of contract performance before submitting a bid. A contractor is wise to find out as much as he can about the particularities of the contracting site and local conditions which may impact performance, including weather conditions. This also holds true for negotiating and locking in agreements with local subcontractors before a bid is submitted to ensure swift and successful performance after award.

Red Gold, Inc. v. Department of Agriculture CBCA No. 2259, July 6, 2011 – Judge Sheridan *by Raja Mishra, Crowell & Moring LLP*

In Red Gold, the CBCA dismissed a contractor's appeal for lack of jurisdiction because the contractor did not first submit a valid claim under the CDA. The decision serves as a stark reminder of that failing to meet certain requirements for filing a CDA claim will be fatal to the contractor's appeal.

Red Gold won a fixed-price contract with the U.S. Department of Agriculture ("USDA") to deliver canned salsa for certain domestic food assistance programs. Several months after the contract award, Red Gold notified USDA that its bid mistakenly used the unit price for tomato sauce, which was a less-expensive product. In the series of communications that followed, Red Gold explained to the CO that its standard salsa price was \$6.10 higher per case than the price in its bid and that, while Red Gold did not expect to recover that full difference in price, it hoped to engage in discussions with USDA and to get a "remedy price" that would "at least" cover its variable costs of \$3.63 per case.

In response, the CO informed Red Gold that it would not agree to Red Gold's higher pricing, but offered to cancel all of the unshipped orders. When Red Gold only reiterated its desire to "settle at a price that at least covers . . . material costs, [if not] total variable costs," the CO sent a letter stating her "final decision" that USDA would not adjust the contract price upward. Red Gold appealed that final decision at the CBCA, seeking \$240,000 from the Government.

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Case Digests (cont'd):

The CBCA held that it had no jurisdiction to hear the appeal, because Red Gold never submitted a valid CDA claim to the USDA. First, the CBCA found that Red Gold's correspondence to the CO did not communicate a desire for a final decision – instead, indicating only an intent to engage in negotiations with the Government. Second, while Red Gold suggested pricing that might cover its “variable costs” or perhaps its “material costs,” Red Gold never demanded payment of a “sum certain” as required by the Contract Disputes Act (“CDA”). Third, Red Gold's appeal sought \$240,000 from USDA, but Red Gold never submitted the CDA certification, which is required for all claims exceeding \$100,000. This, the CBCA noted, was a defect that could not be cured. The CBCA acknowledged that the CO specifically identified her final letter to Red Gold as her “final decision,” but held that “without a valid claim, the contracting officer's ‘final decision’ . . . cannot confer jurisdiction on the Board.”

Appeal of Connectec Company, Inc.

ASBCA No. 57546, July 12, 2011 – Judge Clarke
by Ben Kohr, Wiley Rein LLP

The appeal in this case concerned whether a modification withdrawing a contractor's unilateral purchase order constituted a termination for default, and thus whether the contractor was required to submit a claim for jurisdiction to vest under the CDA.

Under the contract, the contractor was issued a unilateral purchase order for manual control levers but, despite multiple attempts, was unable to deliver products that could pass the requisite product verification testing. The CO gave the contractor notice that the unilateral order would be withdrawn absent justification, but the contractor failed to respond in the required five-day period and the purchase order was withdrawn via subsequent contract modification. The contractor argued that the modification withdrawing the purchase order constituted a termination for default, and, as such, the contractor was not required to file a claim with the CO for the ASBCA to exercise its jurisdiction under the CDA. The ASBCA held that the modification did not assert a claim for money or affirmatively terminate the contract for default, and therefore the canceling of the unilateral purchase order was not a Government claim or final decision. As such, the modification merely allowed the purchase order to “lapse,” and the CDA required the contractor to submit a claim to the CO for the ASBCA to exercise jurisdiction. The ASBCA granted the Government's motion to dismiss for lack of jurisdiction.

The lesson from this case is narrow but important. Unless the Government specifically states that a contractor is being terminated for default, or makes a claim for monetary damages, a contractor should first file a claim with the CO before proceeding to a Board of Contract Appeals.

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Case Digests (cont'd):

Appeal of Free & Ben, Inc.

ASBCA No. 56129, July 18, 2011 – Judge Ting

by Ryan E. Roberts, Sheppard, Mullin, Richter & Hampton LLP

At issue before the ASBCA was an issue near and dear to the hearts of government contracts counsel – whether an after-hours email submission is timely under the procedural rules of the ASBCA.

Upon issuing its decision in the initial appeal (finding against Ben & Free, Inc. (“B&F”)), the ASBCA mailed a copy to F&B’s place of business in Brussels, Belgium. At 10:23 p.m. local time in Falls Church, Virginia, on the 30th day after receipt of the decision, F&B sent an email to the ASBCA attaching its motion for reconsideration. The email was not opened by an ASBCA employee until 6:51 a.m. the following morning, at which time the document was officially stamped as received. The Government moved to dismiss the motion as untimely under ASBCA Rule 29.

Rule 29 requires that a motion for reconsideration “be filed within 30 days from the date of receipt of a copy of the decision of the Board by the party filing the motion.” The Government argued that the rule required “meaningful receipt” by an agent authorized by the ASBCA to receive filings. Under the Government’s rationale, the filing was not received until the morning of the 31st day and was therefore untimely.

The ASBCA disagreed, holding that Rule 29 does not limit the means by which a party can make a filing. The ASBCA noted that their fax machines and computers are able to receive transmissions at any time of the day or night. Therefore, Judge Ting concluded that “an electronic filer should have until midnight, local time, on the 30th day, to file its motion for reconsideration under Rule 29.”

This case is an obvious victory for contractors (not to mention members of the 21st century and procrastinators). Not only will the ASBCA accept electronic filings, their receipt will be considered timely until midnight of the date due.

* - Ryan Roberts is an associate at Sheppard Mullin Richter & Hampton LLP in Washington, DC. While at GWU Law School, he was the Editor-in-Chief of the *Public Contract Law Journal*. He may be contacted at reroberts@sheppardmullin.com.

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GENERAL SERVICES ADMINISTRATION

48 CFR Parts 6101, 6103, 6104, and 6105

[GSA BCA Amendment 2011-01, BCA Case 2011-61-1; Docket Number 2011-001,
 Sequence 1]
 RIN 3090-AJ16

Civilian Board of Contract Appeals; Rules of Procedure of the
 Civilian Board of Contract Appeals--Electronic Filing of Documents

AGENCY: Civilian Board of Contract Appeals, General Services
 Administration (GSA).

ACTION: Final rule.

SUMMARY: This document revises the rules governing proceedings before the Civilian Board of Contract Appeals (Board). The rules are amended to provide procedures for the electronic filing of documents in proceedings before the Board. Electronic filing is increasingly available in judicial and administrative tribunals to provide parties with a faster, more efficient, and less costly way to submit their documents. In addition, although electronically filed documents will be docketed as received only during Board working hours, they may be transmitted at any time from any location with Internet access. This amendment is a non-substantive change to the Rules that is intended to improve the efficiency and effectiveness of the Board's programs by providing parties with an additional option for filing their documents with the Board. It does not affect any of the other methods currently available, including the delivery of documents in person, by courier or United States Postal Service, or by facsimile transmission.

DATES: Effective Date: August 17, 2011.

FOR FURTHER INFORMATION CONTACT: Mr. J. Gregory Parks, Chief Counsel, Civilian Board of Contract Appeals, telephone (202) 606-8800, e-mail address Greg.Parks@cbca.gov for clarification of content. For information pertaining to status or publication schedules, contact

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the Regulatory Secretariat at (202) 501-4755. Please cite BCA Case 2011-61-01.

SUPPLEMENTARY INFORMATION:

A. Regulatory Information

The Board is issuing this final rule without prior notice and opportunity to comment pursuant to authority under section 4(a) of the Administrative Procedure Act (APA) (5 U.S.C. 553(b)). This provision authorizes an agency to issue a rule without prior notice and opportunity to comment when the agency for good cause finds that those procedures are "impracticable, unnecessary, or contrary to the public interest." Under 5 U.S.C. 553(b)(B), the Board finds that good cause exists for not publishing a notice of proposed rulemaking (NPRM) with respect to this rule because publishing a NPRM would be unnecessary. This amendment is a non-substantive change to the Rules, intended to improve the efficiency and effectiveness of the Board's programs by providing parties with an additional option for filing their documents. This option of electronic filing does not affect any of the other methods currently available to parties for the delivery of documents, including in person, by United States Postal Service or other courier service, or by facsimile transmission.

B. Background

The Civilian Board of Contract Appeals was established within the General Services Administration (GSA) by Section 847 of the National Defense Authorization Act for Fiscal Year 2006, Public Law 109-163 (now codified at 41 U.S.C. 7105(b)). In March 2011, the Civilian Board of Contract Appeals began accepting filings submitted by electronic mail (e-mail) under Section 6101.1(b)(5) of the Board's Rules of Procedure. However, appeal files submitted pursuant to Section 6101.4 of the Board's Rules of Procedure may not be submitted by electronic mail due to the size and complexity of these filings, and classified documents and files submitted in camera or under protective order pursuant to Section 6101.9(c) of the Board's Rules of Procedure may not be submitted by electronic mail due to the need to ensure their security. This final rule updates section 6101.1(b)(5) to include information regarding the filing of documents by e-mail and to provide direction concerning requirements for their submittal. Sections 6101.1(f), 6101.2(a)(1)(ii)(C), 6101.2(a)(1)(ii)(D), 6101.2(a)(2)(ii)(C), 6101.5(c), 6103.302(a)(1), 6103.302(b), 6104.402(a)(1)(i), 6104.402(a)(1)(ii), 6104.402(a)(3), 6105.502(a)(2)(iii)(A), 6105.502(a)(2)(iii)(B), and 6105.502(a)(2)(iv) are also amended to provide the e-mail address for receipt of filings for the Clerk of the Board and to request additional contact information for parties and their agents or representatives. Sections 6101.25(a)(1), 6103.306, 6104.406, and 6105.505 are amended to provide the current Internet address for the Board. In addition, section 6101.5(c) is amended to correct an error in printing by the Code of Federal Regulations.

C. Regulatory Flexibility Act

The General Services Administration certifies that this final rule will not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, et seq., because the rule does not impose any additional costs on large or small businesses.

D. Executive Orders 12866 and 13563

Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. This is not a significant regulatory action and, therefore, was not subject to review under Section 6(b) of Executive Order 12866, Regulatory Planning and Review, dated September 30, 1993. This rule is not a major rule under 5 U.S.C. 804.

E. Paperwork Reduction Act

The Paperwork Reduction Act does not apply because the changes do not impose recordkeeping or information collection requirements, or otherwise collect information from offerors, contractors, or members of the public that require approval of the Office of Management and Budget under 44 U.S.C. 3501, et seq.

List of Subjects in 48 CFR Parts 6101, 6103, 6104, and 6105

Administrative practice and procedure, Agriculture, Freight forwarders, Government procurement, Travel and relocation expenses.

Dated: August 4, 2011.

Stephen M. Daniels,
Chairman, Civilian Board of Contract Appeals, General Services
Administration.

Therefore, GSA amends 48 CFR parts 6101, 6103, 6104, and 6105 as set forth below:

PART 6101--CONTRACT DISPUTE CASES

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1. The authority citation for 48 CFR part 6101 is revised to read as follows:

Authority: 41 U.S.C. 7101-7109.

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2. Amend section 6101.1 by adding paragraph (b)(5)(iii); and by adding a new sentence at the end of paragraph (f) to read as follows:

6101.1 Scope of rules; definitions; construction; rulings, orders, and directions; panels; location and address [Rule 1].

* * * * *

(b) * * *

(5) * * *

(iii) Filings submitted by electronic mail (e-mail) are permitted,

with the exception of appeal files submitted pursuant to 6101.4 (Rule 4), classified documents, and filings submitted in camera or under protective order pursuant to 6101.9(c) (Rule 9(c)). Filings by e-mail shall be submitted to: cbca.efile@cbca.gov. Filings must be in PDF format and may not exceed 18 megabytes (MB) total. Filings that are not in PDF format or over 18 MB will not be accepted. The filing of a document by e-mail occurs upon receipt by the Board on a working day, as defined in 6101.1(b) (9) (Rule 1(b) (9)). All e-mail filings received by 4:30 p.m., Eastern Time, on a working day will be considered to be filed on that day. E-mail filings received after that time will be considered to be filed on the next working day.

* * * * *

(f) * * * The Clerk's e-mail address for receipt of filings is: cbca.efile@cbca.gov.

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3. Amend section 6101.2 by revising paragraphs (a) (1) (ii) (C), (a) (1) (ii) (D), and (a) (2) (ii) (C) to read as follows:

6101.2 Filing cases; time limits for filing; notice of docketing; consolidation [Rule 2].

(a) * * *

(1) * * *

(ii) * * *

(C) The name, address, telephone number, facsimile machine number, and e-mail address, if available, of the contracting officer whose decision is appealed and the date of the decision;

(D) If the appeal is from the failure of the contracting officer to decide a claim, the name, address, telephone number,

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facsimile machine number, and e-mail address, if available, of the contracting officer who received the claim;

* * * * *

(2) * * *

(ii) * * *

(C) The name, address, telephone number, facsimile machine number, and e-mail address, if available, of the contracting officer whose decision is sought.

* * * * *

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4. Amend section 6101.5 by revising paragraph (c) to read as follows:

6101.5 Appearances; notice of appearance [Rule 5].

* * * * *

(c) Withdrawal of appearance. Any person who has filed a notice of appearance and who wishes to withdraw from a case must file a motion which includes the name, address, telephone number, facsimile machine number, and e-mail address, if available, of the person who will assume responsibility for representation of the party in question. The motion shall state the grounds for withdrawal unless it is accompanied by a representation from the successor representative or existing co-counsel

that the established case schedule will be met.

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5. Amend section 6101.25 by adding two new sentences at the end of paragraph (a) (1) to read as follows:

6101.25 Decisions; settlements [Rule 25].

(a) * * *

(1) * * * In addition, all Board decisions are posted weekly on the Internet. The Board's Internet address is: <http://www.cbca.gov>.
* * * * *

PART 6103--TRANSPORTATION RATE CASES

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6. The authority citation for 48 CFR part 6103 is revised to read as follows:

Authority: 31 U.S.C. 3726(i) (1); 41 U.S.C. 7101-7109; Sec. 201(o), Pub. L. 104-316, 110 Stat. 3826.

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7. Amend section 6103.302 by revising paragraph (a) (1); and by adding a new sentence after the fifth sentence in paragraph (b) to read as follows:

6103.302 Filing claims [Rule 302].

(a) * * *

(1) The name, address, telephone number, facsimile machine number, and e-mail address, if available, of the claimant;
* * * * *

(b) * * * The Clerk's e-mail address for receipt of filings is: cbca.efile@cbca.gov. * * *
* * * * *

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8. Amend section 6103.306 by revising the fourth sentence to read as follows:

6103.306 Decisions [Rule 306].

* * * The Board's Internet address is: <http://www.cbca.gov>.

PART 6104--TRAVEL AND RELOCATION EXPENSES CASES

0

9. The authority citation for 48 CFR part 6104 is revised to read as follows:

Authority: Secs. 202(n), 204, Pub. L. 104-316, 110 Stat. 3826; Sec. 211, Pub. L. 104-53, 109 Stat. 535; 31 U.S.C. 3702; 41 U.S.C.

7101-7109.

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10. Amend section 6104.402 by revising paragraphs (a)(1)(i) and (a)(1)(ii); and by adding a new sentence after the fifth sentence of paragraph (a)(3) to read as follows:

6104.402 Filing claims [Rule 402].

(a) * * *

(1) * * *

(i) The name, address, telephone number, facsimile machine number, and e-mail address, if available, of the claimant;

(ii) The name, address, telephone number, facsimile machine number, and e-mail address, if available, of the agency employee who denied the claim;

* * * * *

(3) * * * The Clerk's e-mail address for receipt of filings is: cbca.efile@cbca.gov. * * *

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11. Amend section 6104.406 by revising the fourth sentence to read as follows:

6104.406 Decisions [Rule 406].

* * * The Board's Internet address is: <http://www.cbca.gov>.

PART 6105--DECISIONS AUTHORIZED UNDER 31 U.S.C. 3529

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12. The authority citation for 48 CFR part 6105 is revised to read as follows:

Authority: 31 U.S.C. 3529; 31 U.S.C. 3702; 41 U.S.C. 7101-7109; Secs. 202(n), 204, Pub. L. 104-316, 110 Stat. 3826; Sec. 211, Pub. L. 104-53, 109 Stat. 535.

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13. Amend section 6105.502 by revising paragraphs (a)(2)(iii)(A) and (a)(2)(iii)(B); and adding a new sentence after the fifth sentence of paragraph (a)(2)(iv) to read as follows:

6105.502 Request for decision [Rule 502].

(a) * * *

(2) * * *

(iii) * * *

(A) The name, address, telephone number, facsimile machine number, and e-mail address, if available, of the official making the request;

(B) The name, address, telephone number, facsimile machine number, and e-mail address, if available, of the employee affected by the specific payment or voucher; and

* * * * *

(iv) * * * The Clerk's e-mail address for receipt of filings is:
cbca.efile@cbca.gov. * * *
* * * * *

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14. Amend section 6105.505 by revising the fourth sentence to read as follows:

6105.505 Decisions [Rule 505].

* * * The Board's Internet address is: <http://www.cbca.gov>.

[FR Doc. 2011-20874 Filed 8-16-11; 8:45 am]
BILLING CODE 6820-AL-P



Fourth Circuit Reinforces Significance of ‘Government Knowledge’ Defense in FCA Cases

by
David M. Nadler
and
Justin A. Chiarodo*

[Note: Reprinted from *The Government Contractor*, Vol. 53, No. 23, June 15, 2011, with permission of Thomson Reuters.]

U.S. ex rel. Ubl v. IIF Data Solutions, 2011 WL 1474783 (4th Cir. April 19, 2011)

On April 19, 2011, the U.S. Court of Appeals for the Fourth Circuit affirmed the complete defense verdict in *U.S. ex rel. Ubl v. IIF Data Solutions*. The appeal followed a trial in the Eastern District of Virginia in which the jury found for the defendant on all counts in a False Claims Act lawsuit brought in connection with the award and performance of the defendant’s General Services Administration schedule contracts. *Ubl* provides useful guidance on the enforceability of settlement agreements in FCA actions if the Government does not intervene. More notably, *Ubl* reinforces the significance and viability of the “Government knowledge” defense in FCA cases.

Under the “Government knowledge” defense or inference, the Government’s awareness of the facts underlying an alleged false claim or statement can negate the scienter required to establish that a defendant knowingly submitted a false claim. Because the FCA is not designed to punish “honest mistakes,” courts have looked to Government officials’ knowledge to evaluate whether a defendant acted with requisite intent—the knowing submission of what is known to be false. The Court in *Ubl* thoughtfully summarized one illustration of the defense:

if the government with full knowledge of the relevant facts directed a contractor to file a claim that was later challenged as false, the fact that the contractor did what the government told it to do would go a long way toward establishing that the contractor did not knowingly file a claim known to be false.

Ubl shows that the defense remains viable for contractors accused of FCA violations.

IIF Data Solutions was a small GSA contractor with a Federal Supply Schedule contract for information technology services. Its contract included six labor categories, including positions for analysts, programmers and related IT functions. As is typical of GSA schedules for services, the labor categories included descriptions of the education, experience and skills required for employees to be assigned to the categories. IIF received millions of dollars in task orders under its IT schedule, the majority coming from the National Guard Bureau (Guard Bureau).

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‘Government Knowledge Defense’ in FCA Cases (cont’d):

Relator Thomas Ubl, a former IIF employee, filed an FCA action alleging a variety of frauds perpetrated by IIF both before and after obtaining its GSA schedule contracts. Ubl alleged that IIF misrepresented its pricing and discounting practices as part of its initial schedule application (for example, by fabricating its commercial price list). Ubl further alleged that IIF billed for employees in labor categories that were not consistent with their education and experience, and improperly billed the Government for work not performed. The Government declined to intervene in the case.

After two years of discovery, IIF and Ubl agreed to settle the case in May 2008, with IIF to pay \$8.9 million dollars to Ubl over several years. The settlement agreement stated that it was void without Government approval. Unfortunately for Ubl, the Government raised numerous objections to the proposed settlement. The Government objected to the percentage of the relators’ share, the allocation of proposed settlement proceeds to the relator’s so-called “personal claims,” and the defendant’s ability to pay. Two days after communicating its initial concerns, the Government informed the parties that it “would never consent” to the initial agreement.

The parties continued to work towards a settlement. In a mediation before a magistrate judge, IIF offered to settle Ubl’s claims for \$2.7 million. Ubl rejected that offer, and continued to seek the Government’s approval for the initial \$8.9 million offer. In September 2009, Ubl ultimately obtained the Government’s agreement in principle to the May 2008 settlement agreement. IIF maintained that the Government had clearly repudiated the May 2008 settlement, and the agreement was void by its terms. Ubl was unable to enforce the settlement agreement with the district court and lost at trial on all counts.

On appeal, Ubl argued that the district court erred in refusing to enforce the initial \$8.9 million settlement agreement. Ubl maintained that he had satisfied the condition in the agreement—Government consent—that was necessary to bind IIF. The Fourth Circuit rejected Ubl’s argument, noting that the settlement agreement was contingent on Government approval, consistent with the FCA requirement that the Government consent to the dismissal of an FCA claim brought by a private party. See 31 USCA §3730(b)(1). The Court found that the Government definitively rejected the agreement in correspondence with the parties in July 2008, citing the Government’s statement that it “would never consent” to the May agreement as originally drafted. This meant that the Government no longer had the power to accept the May agreement and it was void by its own terms.

More notable than the Court’s ruling on the repudiated settlement was its decision on evidence admitted at trial supporting a “Government knowledge” defense. At the start of the trial, Ubl sought unsuccessfully to preclude evidence that the Guard Bureau could alter the terms of GSA contracts or that the Guard Bureau approved of the personnel assigned to its projects and was satisfied with their performance. Ubl argued that the personnel IIF provided did not meet the labor category requirements in IIF’s schedule, and that the Guard Bureau was

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‘Government Knowledge Defense’ in FCA Cases (cont’d):

unable to alter the terms of that schedule as a matter of law. Ubl further argued that any “Government knowledge” defense was not available to IIF because no GSA personnel were aware of the facts related to IIF’s labor billing practices and claims. Only GSA officials were sent (and paid) invoices for IIF’s work for the Guard Bureau.

The Fourth Circuit rejected Ubl’s narrow interpretation of the Government knowledge defense. The Court found “no reason” why the Government’s knowledge would be irrelevant simply because the Government employees with knowledge did not happen to pay the contractor’s invoices. Further, IIF’s close working relationship with Guard Bureau employees on its various contracts meant that the Bureau’s knowledge was relevant to whether IIF acted with the requisite intent. In support of its finding, the court cited *U.S. ex rel. Bulbaw v. Orenduff*, 548 F.3d 931, 951–54 (10th Cir. 2008), in which the Tenth Circuit considered the knowledge of Department of Education employees in its analysis of the Government knowledge defense related to a Defense Department contract. *Ubl* suggests that the Government knowledge defense should be construed broadly, based on the totality of the facts related to contract award and performance.

Ubl underscores the significance and viability of the Government knowledge defense in an FCA case. *Ubl* sought to prevent the jury from hearing evidence that the Government approved of the employees assigned to Guard Bureau task orders, and evidence that the Government was pleased with the defendant’s work. The total defense verdict following *Ubl*’s unsuccessful efforts to exclude such evidence demonstrates how strongly Government knowledge resonates with fact-finders, and how helpful Government knowledge can be to a defense against FCA allegations. The Fourth Circuit’s decision not to limit the Government knowledge defense to only those individuals who pay claims is sensible and consistent with the fact that the FCA was not designed to punish “honest mistakes” with punitive FCA liability. *Ubl* serves as a continued reminder that the Government knowledge defense is alive and well.

* - This Feature Comment was written for *The Government Contractor* by David M. Nadler, a partner, and Justin A. Chiarodo, an associate, with Dickstein Shapiro LLP, specializing in government contracts matters, including the False Claims Act and compliance matters. Mr. Nadler may be contacted at NadlerD@dicksteinshapiro.com, and Mr. Chiarodo may be contacted at ChiarodoJ@dicksteinshapiro.com.



The Revised and Updated DFARS Ground and Flight Risk Clause

by
*Donald J. Carney**

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On June 8, 2010, the United States Department of Defense (DoD) implemented significant changes to the DoD Federal Acquisition Regulation Supplement (DFARS) provisions and clauses implementing DoD's longstanding policy of limited self-insurance for the risk of contractor military aircraft operations. The Defense Contract Management Agency (DCMA) initiated these changes, which included merging the DFARS 252.228-7001 (Sept. 1996) Ground and Flight Risk Clause and the DFARS 252.228-7002 (Sept. 1996) Aircraft Flight Risk Clause (AFRC) into one clause applicable to all aircraft contracts "for clarity and consistency."¹ The result was the new DFARS 252.228-7001 (June 2010) Ground and Flight Risk Clause (GFRC).

DoD also took the opportunity to make other changes relevant to aerospace contractors. It increased contractors' deductibles under most fixed-price contracts, required prime contractors to flow down the GFRC to lower-tier contractors, and highlighted the fact that several categories of insurance costs connected with contractor operation of military aircraft under cost-reimbursable contracts are unallowable.² The new GFRC also recognized and addressed developments in the aerospace industry, such as the increased use of commercial item and service contracting in military aircraft operations and the increased use of unmanned aerial vehicles (UAVs).

This article discusses some of the key changes in the new GFRC compared to the prior contract clauses, and identifies some of the compliance and contract administration issues relevant to aerospace government contractors.

DoD's Policy of Limited Self-Insurance

For several decades, DoD's contracting policy has been to self-insure for the risk of loss of contractor aircraft ground and flight operations, based on the premise that the self-insurance risk of loss presented is less than the costs of commercial insurance.³ The comptroller general explained that this policy is based on the proposition that "the Government is financially able to absorb its maximum probable loss and the fact that its risks are spread so widely as to result in a minimal statistical probability that losses will exceed insurance premiums over a reasonable period of time."⁴ It therefore should be "less costly" for the government to assume the risk of loss than to purchase insurance, since purchased insurance costs would include not only policyholder losses, but selling, administrative, and other expenses as well.⁵

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The Revised and Updated DFARS Clause (cont'd):

The DFARS currently implements this policy by including a prescriptive provision directing the contracting officer to use the GFRC in “all solicitations and contracts for the acquisition, development, production, modification, maintenance, repair, flight, or overhaul of aircraft,” subject to certain exceptions discussed further below.⁶ According to DoD, there is a “fairly even split” between fixed-price and “flexibly priced” contracts involving military aircraft.⁷ Most of the contracts for aircraft repair, overhaul, and maintenance are flexibly-priced, and those contracts are “typically where the bulk of damage arises that results in liability assessments” against contractors.⁸

The government assumes the risk of loss in contracts including the GFRC for aircraft “to be delivered to the Government,” including aircraft in the process of being manufactured, disassembled, or reassembled, “provided that an engine, portion of a wing, or a wing is attached to a fuselage of the aircraft.”⁹ It also applies to aircraft furnished by the contractor to the government under the contract, either before or after government acceptance.¹⁰ Since the GFRC results in government assumption of the risk of loss of property prior to delivery to the government under a fixed-price contract, the GFRC differs from the general Federal Acquisition Regulation (FAR) policy that the risk of loss remains with the contractor until acceptance.¹¹ Even where a progress payment is made by the government, and results in title to progress payment inventory vesting in the government, the government typically does not bear the risk of loss.¹² This variance from the general FAR policy of risk of loss on the contractor is traceable back to the perceived economy associated with self-insurance. As the Government Accountability Office (GAO) has explained: “We believe it is also appropriate to apply self-insurance . . . in some circumstances, to property being manufactured by contractors for the Government, where the cost of insurance would be passed to the Government through the contract price.”¹³ In other words, the government self-insures aircraft that are the property of the contractor prior to delivery so as to avoid the inclusion of potentially exorbitant insurance costs in the price paid.¹⁴

The GFRC also applies to aircraft furnished by the government to the contractor under the contract, whether in a state of disassembly or reassembly.¹⁵ It includes all government property installed, in the process of installation, or temporarily removed, provided that the aircraft and property are not covered by a separate bailment agreement.¹⁶ For example, in *Vought Aircraft Co.*, the Armed Services Board of Contract Appeals (ASBCA) held that the GFRC covered a “Low Altitude Night Attack” electronic system preliminarily installed on a government-furnished aircraft intended to be delivered with the aircraft following completion of tests.¹⁷ Finally, the GFRC also applies to nonconventional “aircraft” as may be specified in the contract.¹⁸

Contractor Obligations

By accepting the GFRC in its contract, a contractor agrees to be bound by the aircraft operating procedures contained in the combined regulation/instruction entitled *Contractor's*

(continued on next page)

The Revised and Updated DFARS Clause (cont'd):

Flight and Ground Operations in effect on the date of contract award.¹⁹ As the ASBCA has explained, the government assumes risks “which generally entail unusually high insurance premiums if the risk were to be assumed by the contractor. In turn the Government goal was to reduce its risks by exercising certain controls,” most notably the combined regulation/instruction.²⁰

To comply with the combined regulation/instruction, the contractor must develop procedures that are approved by the government flight representative (GFR).²¹ The contractor’s procedures are to be “separate and distinct from industrial or quality procedures” and are to “describe aircraft flight and ground operations at all operating facilities.”²² If the GFR discovers a noncompliance with approved procedures or discovers the use of unsafe practices, the GFR is required to notify the contractor and the administrative contracting officer.²³ A noncompliance may be considered grounds for withdrawal of the government’s assumption of risk for loss or damage to government aircraft.²⁴ The government reserves the right to take such other action as may be necessary to preserve the safety and security of the aircraft.²⁵ Additionally, the government does not assume any risk of loss under the GFRC for any flight that has not received prior written approval of the GFR.²⁶

Government’s Assumption of Risk of Loss

Subject to certain conditions, under the GFRC, the government assumes the “risk of damage to, or loss or destruction of aircraft”: (1) in the open; (2) during operation; and (3) in flight.²⁷ The GFRC defines “in the open” to mean wholly outside of the buildings on the contractor’s premises or other places described in the schedule.²⁸ While aircraft to be delivered by the contractor are “in the open” only when outside of the contractor’s buildings, such as hangars, aircraft furnished by the government to the contractor are treated differently, and are “in the open” at all times when in the contractor’s care, custody, or control, regardless of location, whether assembled or disassembled.²⁹ “During operation” means operations and tests of the aircraft and its installed equipment, accessories, and power plants, while in the open or in motion.³⁰ “Flight” means any flight demonstration, flight test, taxi test, or other flight made in the performance of the contract, or for safeguarding the aircraft, or previously approved in writing by the contracting officer.³¹

The government’s assumption of the risk of loss for aircraft “in the open” continues unless the contracting officer finds that (1) the contractor has failed to comply with the combined regulation/instruction, or (2) that the aircraft is in the open under unreasonable conditions and the contractor fails to take prompt corrective action.³² If the government finds a contractor noncompliant, certain notice procedures apply.³³ If the contracting officer finds that the contractor failed to promptly correct the cited conditions or failed to correct the conditions within a reasonable time, the government may terminate its assumption of risk.³⁴ If the government terminates its assumption of risk, the contractor assumes the risk of loss, will not be paid any insurance costs by the government, and the “liability provisions of the Government

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The Revised and Updated DFARS Clause (cont'd):

Property clause of [the] contract are not applicable to the affected aircraft.”³⁵ In other words, the FAR 52.245-1 Government Property Clause implementing the government’s policy that contractors generally, with certain exceptions, are not held liable for losses for government property under cost-reimbursement, time-and-material, labor-hour, and fixed-price contracts awarded on the basis of submission of cost or pricing data, would not apply.³⁶ Moreover, even if the government terminates its assumption of risk under the GFRC, the contractor remains obligated to comply with all GFRC provisions, including the combined regulation/instruction.³⁷

The government’s assumption of risk is subject to the contractor’s share of loss and deductible under the current GFRC. As discussed below, the contractor assumes and is responsible for its share of the loss, which is the lesser of the first \$100,000 of loss or damage to the aircraft resulting from each separate event, except for reasonable wear and tear and to the extent damage is caused by negligence of government personnel, or 20 percent of the price or estimated cost of the contract.³⁸ The deductible applies to each “event,” which the ASBCA has interpreted to mean loss or damage resulting from “one proximate, uninterrupted and continuing cause.”³⁹

Exclusions from the Government’s Assumption of Risk of Loss

Several exclusions apply to the government’s self-insurance policy. Like the Government Property Clause, the GFRC clause makes the contractor liable for any damage, loss, or destruction of aircraft resulting from willful misconduct or lack of good faith of any of the contractor’s managerial personnel to maintain and administer a program for the protection and preservation of aircraft.⁴⁰ This standard requires more than mere negligence. For example, in *Fairchild Hiller Corp.*,⁴¹ the ASBCA sustained a contractor’s appeal of a contracting officer’s denial of a contractor’s request to be relieved of liability for damage to a USAF C-130 aircraft that burned when in the contractor’s custody for inspection and repair. While the ASBCA agreed that the contractor was negligent on the day of the fire, and that its safety program was less consistent, careful, and effective than was necessary, the record did not support a finding that the contractor failed to meet sound industrial safety procedures. The government also failed to prove that contractor management subordinated responsibility for safety to other goals to an extent that one could find willful misconduct or lack of good faith in regard to safety concerns.

The government’s assumption of risk also does not extend to losses sustained during flight if either the flight or flight crew members have not been approved in advance by the GFR.⁴² Under the GFRC, the government also does not assume the risk for wear and tear, unless the wear and tear is the result of other loss, damage, or destruction covered by the clause.⁴³ The wear and tear exclusion does not apply to government-furnished property if the damage is reasonable wear and tear or “results from inherent vice, *e.g.*, a known condition or design defect in the property.”⁴⁴

The GFRC excludes losses covered by insurance.⁴⁵ It also excludes losses sustained

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The Revised and Updated DFARS Clause (cont'd):

while the aircraft is being worked on where the damage or loss is a direct result of the work unless such damage, loss, or destruction would be covered by insurance that would have been maintained by the contractor but for the government's assumption of the risk.⁴⁶ Also excluded are damages during the course of transportation by rail, or via public streets, or highways, except for government-furnished property.⁴⁷

Prior DoD Ground and Flight Risk Clauses

From the early 1960s⁴⁸ until the new rule in June 2010, DoD implemented the contractor aircraft operations self-insurance policy through two separate clauses that addressed two different circumstances.⁴⁹ According to DCMA, the government's intention was to have one or the other clause apply to any particular contract, except in very limited circumstances, presumably when a military aircraft contract contained both fixed-price and cost-reimbursement contract line items, or "CLINs."⁵⁰

The pre-2010 GFRC applied only to negotiated fixed-price contracts for aircraft production, modification, maintenance, repair, or overhaul.⁵¹ A second clause, the AFRC, applied to cost-reimbursable contracts.⁵² While the GFRC dealt with contractor property, the AFRC was primarily intended to be used in contracts involving the furnishing of aircraft to the contractor by the government, particularly cost reimbursement contracts.⁵³ The AFRC could also be used in fixed-price contracts where the GFRC was not used and contract performance involved the flight of government-furnished aircraft.⁵⁴

The two clauses had three major differences. First, while the GFRC applied to aircraft in the open, in operation, or in-flight, the AFRC applied only in-flight.⁵⁵ Second, the clauses contained different deductibles. Under the GFRC, with the exception of damage, loss, or destruction in flight, the contractor assumed the risk of the first \$25,000 of loss or damage to aircraft in the open or during operation.⁵⁶ By contrast, the AFRC included a provision that the "loss, damage, or destruction of aircraft during flight in an amount exceeding \$100,000 or 20 percent of the estimated cost of this contract, whichever is less, is subject to an equitable adjustment when the contractor is not liable" under the Government Property Clause and the flight crew members had been approved by the GFR.⁵⁷ The equitable adjustment was to be made to the estimated cost, delivery schedule, or both, and in the amount of fee to be paid to the contractor.⁵⁸ The AFRC was also a limited deviation from FAR policy, which as described above generally states that contractors are not held liable for loss of government-furnished property unless certain exceptions apply.⁵⁹ This policy is implemented contractually in the Government Furnished Property Clause.⁶⁰ The AFRC included a deductible to share some of the risk of contractor flight operations.

Third, the clauses differed regarding how to handle contractor insurance costs. In the GFRC, the contractor warranted that the contract price "does not and will not include, except as may be authorized in this clause, any charge or contingency reserve for insurance covering damage, loss, or destruction of aircraft."⁶¹ The AFRC contained no requirement regarding the

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The Revised and Updated DFARS Clause (cont'd):

contractor insurance costs.

DCMA Identified Several Problems Under the 1996 GFRC and AFRC

By 2007, DCMA perceived several material problems with DoD's implementation of the self-insurance policy through the 1996 versions of the GFRC and AFRC. DCMA is constantly involved in administering contracts for military aircraft subject to the self-insurance policy, since DCMA normally administers contracts at sites not physically located on a military base, such as contractor facilities.⁶² DCMA concluded that the GFRC and AFRC were, among other things, not being correctly included in aircraft contracts, contained deficient language, did not operate properly, and did not impart the obligations on military aerospace contractors as DCMA intended.⁶³ On April 5, 2007, the DCMA put before the Defense Acquisition Regulations Council a proposal to eliminate the separate AFRC and to update and combine its provisions into a single, consistent, and clear GFRC.⁶⁴

DCMA indicated that DoD itself was confused as to the applicability of the GFRC and AFRC clauses. Specifically, DCMA found that the military services were "inconsistent in their application of the clauses to Government contracts."⁶⁵ Even though DCMA believed that the government's intention was to include one or the other clause in military aircraft contracts but not both, "both clauses have, at times, been included in the same contract," apparently without justification.⁶⁶ Moreover, DCMA and the military services were repeatedly confronted with "numerous questions on clause interpretation and collateral compliance-related matters."⁶⁷ One feature of the existing clauses contributing to the questions was the "different coverage and deductibles."⁶⁸ DCMA therefore concluded that the GFRC and AFRC and their prescriptive regulation, DFARS 228.370, needed clarification and revision.

DCMA was particularly concerned with the possibility that contractors were actually better off if the government found contractors noncompliant with the combined regulation/instruction.⁶⁹ If, as a result, the government withdrew its assumption of the risk of loss, all damage to government-furnished aircraft "arguably" fell under the Government Property Clause.⁷⁰ The DCMA observed that the Government Property Clause treats contractor damage to government aircraft "much more favorably than either the GFRC or AFRC."⁷¹ In the revised regulatory provision, the government revised the clause to make inapplicable the liability provisions of the Government Property Clause if the government terminates its assumption of risk.⁷²

DCMA also had three other major concerns. First, DCMA was concerned with the differing deductible amounts under the GFRC and AFRC, and the perceived insufficiency of the \$25,000 GFRC deductible to deter unsafe contractor practices associated with aircraft manufacture, maintenance, and overhaul.⁷³ DCMA also stated that the standard might be too costly for some smaller contracts, such as contracts for paint or minor repairs, unless the rule was revised to allow the deductible to be capped at 20 percent of the contract cost.⁷⁴

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The Revised and Updated DFARS Clause (cont'd):

Second, DCMA perceived that prime contractors were not consistently requiring subcontractor compliance with the clauses or the combined regulation/instruction.⁷⁵ In the absence of a mandatory flowdown, DCMA concluded that government aircraft were at unnecessary risk of damage because of the absence of the requirement to comply with the combined regulation/instruction.

Third, DCMA was concerned about the potential for contractor claims for reimbursement of insurance costs under cost-type contracts where the government was already acting as the self-insurer under the contracts. This raised the possibility that the government was paying contractor costs for insurance regarding risks already covered by the government. To “reap the benefits of the self-insurance program, the costs of commercial insurance that duplicate the government’s self insurance and the contractor’s deductibles under the GFRC and AFRC” had to be borne by the contractor, according to DCMA.⁷⁶ Even though FAR 31.205-19 arguably already precluded contractor recovery of certain of these costs from the government, DCMA perceived the need to highlight the unallowability of these costs. Otherwise, DCMA feared, the benefits to the government of the self-insurance program would be undercut.

DCMA forwarded proposed revised DFARS language to the DAR Council that included proposed revisions to the clauses intended to address these concerns and combining the AFRC into the GFRC, revisions to the prescriptive provision, and other updates and revisions to the terms of the newly combined contract clause.⁷⁷ On December 7, 2007, DoD published the new GFRC clause as a proposed rule in the *Federal Register* and received comments from DCMA field offices and the Aerospace Industries Association.⁷⁸

DoD implemented some of the suggestions offered by commenters and published a final rule on June 8, 2010.⁷⁹ The final rule adopted the single GFRC, revised the prescriptive DFARS provision, and added a new DFARS provision recognizing that the cost limitations in FAR 31.205-19, Insurance and Indemnification, on self-insurance and purchased insurance costs are subject to the requirements of the new DFARS 252.228-7001 (June 2010) GFRC.⁸⁰

The final rule implementing the DFARS 252.228-7001 GFRC (June 2010) included several relatively uncontroversial, yet important, provisions limiting the applicability and scope of the clause. For example, the prescriptive DFARS provision added certain new exceptions to the clause’s applicability. The new GFRC clause does not apply to activities incidental to the normal operations of aircraft (e.g., refueling operations, minor nonstructural actions not requiring towing, such as replacing aircraft tires due to wear and tear).⁸¹ It also does not apply to contracts awarded under FAR Part 12 procedures nor to commercial derivative aircraft that are to be maintained to Federal Aviation Administration (FAA) airworthiness standards when the work will be performed at a licensed FAA repair station.⁸² Like the prior provision, the GFRC also does not apply where a non-DoD customer (including a foreign military sale customer) has not agreed to assume the risk of loss or destruction of, or damages to, aircraft.⁸³

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The Revised and Updated DFARS Clause (cont'd):

The final rule also contained several new provisions reflecting DCMA's concerns with the complexity, consistency, and effect of the GFRC. These provisions are of varying degrees of significance to aerospace government contractors and are discussed in detail below.

Increase in Fixed-Price Contract Deductible from \$25,000 to \$100,000

One significant change for aerospace contractors in the revised GFRC is the deductible level of \$100,000 for all DoD aircraft contracts, including fixed-price contracts that previously were subject to a \$25,000 deductible. The regulatory history of this specific provision suggests that the DoD placed simplicity over well-founded economic analysis when it adopted this provision for all aircraft contract types.

In January 2007, prior to recommending the proposed revised GFRC, DCMA looked into current industry practices regarding deductibles for aircraft liability, hangarkeeper's liability, and similar insurance coverages under the GFRC in the form of a contractor insurance/pension review by the DCMA Contractor Insurance/Pension Division (deductibles CIPR).⁸⁴ DCMA noted that the deductible applicable to fixed-price contracts increased from \$1,000 in the 1991 version of the GFRC to \$25,000 in 1996. DCMA's review concluded that "\$25,000 seems to be the median of deductibles for property damage under hangarkeeper's insurance policies that are very roughly comparable to the terms" of the GFRC clause, aside from certain outlier examples.⁸⁵ Based on this initial assessment, DCMA's insurance experts did "not see any compelling reason to change the amount at this time" of the fixed-priced deductible.⁸⁶ Moreover, DCMA concluded that the \$100,000 deductible under the AFRC "if anything, seems to be higher than that typically seen in our samples" of insurance policies.⁸⁷

Notwithstanding the findings of the deductibles CIPR, DCMA's initially proposed rewrite of the GFRC in April 2007 included a deductible of \$50,000, or 20 percent of contract costs for all military aircraft contracts. As discussed above, DCMA justified the amount to deter unsafe contractor practices on fixed-price contracts. When DoD published the proposed rule, however, the proposed deductible increased to \$100,000 for all aircraft contracts.⁸⁸

While an industry representative commended DoD's efforts to streamline the DFARS in general, it protested the increase to \$100,000 as potentially too high. It noted that while "historically most contractors engaged in the types of contracts that would utilize the Ground and Flight Risk Clause have been large business concerns," the revised GFRC could negatively impact small businesses.⁸⁹ Specifically, small subcontractors, which "do not have program resources to absorb an increased share of loss," could effectively be excluded from these contracts.⁹⁰ The result would be that only large companies willing to assume a greater share of loss would compete for these contracts, and small businesses with innovative solutions and lesser financial means would be excluded. Industry therefore recommended modifying the maximum share of loss to \$50,000, "so as not to exclude small businesses with which a prime contractor may wish to partner."⁹¹

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The Revised and Updated DFARS Clause (cont'd):

DoD rejected the \$50,000 maximum deductible as “inequitable and counter-productive.”⁹² With only very general references to its review of military aircraft contracts, DoD disagreed that raising the liability limit would disproportionately disadvantage small businesses. In specific, DoD contended that “most of the small businesses participating in these contracts do so as [cost-type contract] repair, overhaul, and maintenance prime contractors,” and therefore were already subject to the \$100,000 maximum limitation.⁹³ DoD alternatively noted that small businesses were commercial subcontractors that DoD apparently concluded would not be subject to the revised GFRC in the future.⁹⁴ During internal deliberations, DoD also noted that “DoD aircraft tend to be much more expensive than those in private industry,” and that the \$100,000 deductible “adjusts the deductible to recognize the magnitude of the contract to which the deductible relates.”⁹⁵

DoD’s application of a \$100,000 maximum deductible to fixed-price contracts under the revised GFRC does not appear sufficiently justified based on the regulatory record. First, the size of the deductible was not supported by the deductibles CIPR. The deductibles CIPR included government contractors, and no basis was given to conclude that the risks assessed for these contractors did not include more expensive military aircraft. Second, there did not appear to be a principled basis for assessing the maximum amount necessary to deter unsafe contractor practices. Industry proposed a meaningful maximum deductible of \$50,000. The government provided nothing beyond speculative assertions of necessity in support of its contention that a \$100,000 deductible was necessary to deter unsafe practices. In increasing this threshold to \$100,000, DoD’s position should have been supported by more specific evidence establishing the reasonableness of the amount. Nevertheless, contractors, particularly small contractors, must now assess whether participating in fixed-price military aircraft contracts is worth the risk of a potential unreimbursable loss of \$100,000 under the revised GFRC.

Mandatory Flowdown Provision

Another material change is the new requirement that the GFRC be flowed down in all subcontracts. In specific, paragraph (m) states that the “[c]ontractor shall incorporate the requirements of [the GFRC], including this subparagraph(m), in all subcontracts.”⁹⁶ After DoD published the proposed rule including the flowdown requirement, an aerospace industry group objected that the mandatory flowdown requirement was overbroad, and needed to provide more flexibility in requirements imposed on subcontractors.⁹⁷ The commenter pointed out that there “may be requirements within the clause that are inappropriate for some small subcontractors under certain conditions,” and proposed that “some flexibility on imposing all of the requirements of this clause on all subcontractors be recognized” in the mandatory flowdown requirement.⁹⁸ The industry concern regarding the flowdown provision was perhaps not specific enough to persuade DoD.

DoD rejected this industry concern, and in so doing appeared to miss the point of the comment. DoD responded to the comment by noting that the combined regulation/instruction

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The Revised and Updated DFARS Clause (cont'd):

itself provides “adequate flexibility to address the commenter’s concern.”⁹⁹ Furthermore, stated DoD, “the Instruction’s standard for contractor procedures is simply that they be ‘safe and effective,’” and that any subcontractor “in possession or control of a government aircraft should have ‘safe and effective’ procedures in place.”¹⁰⁰ DoD apparently failed to realize that the commenter was addressing the entirety of the somewhat complex GFRC, not simply the combined regulation/instruction. Industry was therefore not arguing with the need for safe and effective procedures, but rather with the inflexibility of application of a DFARS clause that, as DMCA has agreed, has both safety *and* contract components.¹⁰¹

The new GFRC not only compels the requirements of the clause to be flowed down to subcontractors; it also changes the liability arrangement for damages when covered aircraft are in the possession or control of a subcontractor. Under the 1996 GFRC, when an aircraft was in the possession or control of a subcontractor and the subcontract did not, with the written approval of the contracting officer, provide for relief from each liability, the subcontractor was not relieved of liability for any resulting damage, loss, or destruction.¹⁰² In the absence of the contracting officer’s written approval, the subcontract was required to contain provisions requiring the return of the aircraft in as good condition as when received or for the utilization of the property in accordance with the provisions of the prime contract.¹⁰³ The clause required the prime contractor to enforce liability against the subcontractor pursuant to the subcontract’s terms for the benefit of the government.¹⁰⁴

By contrast, the new GFRC does not relieve a contractor from liability for damage, loss, or destruction of aircraft while in the possession or control of a subcontractor, absent the contracting officer’s approval of such relief. New GFRC paragraph (g) entitled “Subcontractor possession or control,” states that the “Contractor shall *not* be relieved from liability for damage, loss, or destruction of aircraft while such aircraft is in the possession or control of its subcontractors, except to the extent that the subcontract, with the written approval of the Contracting Officer, provides relief from each liability.”¹⁰⁵ It states in a second sentence that, absent the contracting officer’s written approval of relief, “the subcontract shall contain provisions requiring the return of aircraft in as good condition as when received, except for reasonable wear and tear or for the utilization of the property in accordance with the provisions of this contract.”¹⁰⁶ Thus, the new GFRC makes a contractor liable to the government for damage, loss, or destruction occurring while aircraft are in the possession of a subcontractor, unless a contractor obtains advance, written approval from the contracting officer for relief of liability under the subcontract.¹⁰⁷

The new paragraph (g) appears to create an overly narrow scope of contractor relief from liability while aircraft are in the possession or control of a subcontractor. Relief should also extend to a contractor that has flowed down the GFRC to the extent that the conditions for the government’s self-insurance identified in paragraph (d) are satisfied by a subcontractor while aircraft are in the subcontractor’s possession or control. Revision of paragraph (g) in this manner would maintain the contractor’s liability for damages to the government if a

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The Revised and Updated DFARS Clause (cont'd):

subcontractor caused damage, loss, or destruction to an aircraft, but not where a subcontractor has (1) maintained compliance with the combined regulation/instruction and (2) not held aircraft in the open under unreasonable conditions (i.e., circumstances where the government's general policy is to agree to assume the risk as described in paragraph (d)).

Additionally, the second sentence of paragraph (g) appears to be a vestige of the 1996 GFRC that did not include the flowdown provision and therefore should be deleted. The paragraph (m) flowdown provision now necessitates the incorporation of the GFRC requirements in all subcontracts, including the requirement to be bound by the combined regulation/instruction governing flight and ground operations. Given the new GFRC's emphasis on flowing down the GFRC to subcontractors, paragraph (g) should more clearly and effectively address liability for damage occurring while aircraft are in the possession or control of subcontractors.

In summary, aerospace contractors must ensure that they flow down the GFRC in their subcontracts to both comply with paragraph (m) and to impose the contractual requirement of compliance with the combined regulation/instruction, among other terms, on subcontractors.

Unallowability of Insurance Costs

The 2010 version of the GFRC includes new provisions emphasizing that certain costs relating to insurance against the contractor's share of loss under cost-reimbursement government contracts are unallowable. This provision relates directly to the DCMA's intent that duplicative contractor insurance costs be borne by the contractor, not the government, to avoid undercutting the benefits that should be accruing to the government under its self-insurance policy.¹⁰⁸ Aerospace contractors need to be aware of this restriction and to ensure that their operations and disclosure statements comply with this restriction.

The new GFRC identified five separate types of unallowable aircraft operation insurance costs. In relevant part, the clause states as follows:

The costs incurred by the contractor for its share of loss and for insuring against that loss are unallowable costs, including but not limited to –

- (i) The Contractor's share of loss under the Government's self-insurance;
- (ii) The costs of the Contractor's self-insurance;
- (iii) The deductible for any Contractor-purchased insurance;
- (iv) Insurance premiums paid for Contractor-purchased insurance; and
- (v) Costs associated with determining, litigating, and defending against the Contractor's liability.¹⁰⁹

This provision is in stark contrast to the prior AFRC clause, which did not expressly address the allowability of these types of costs relating to cost-reimbursement contracts. As discussed above, however, FAR 31.205-19 arguably already made these costs unallowable. In

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The Revised and Updated DFARS Clause (cont'd):

any event, since these insurance costs are plainly now unallowable, they cannot be included in costs for reimbursement and are subject to disallowance by the cognizant contracting officer.¹¹⁰ Moreover, to the extent a contractor includes these costs as an indirect cost in cost rate proposals or statements of costs, the contractor risks exposure to penalties.¹¹¹ Specifically, where an indirect cost is expressly unallowable under a FAR cost principle or executive agency supplement like the DFARS, the penalty under FAR 42.709-1 is equal to the amount of the disallowed costs allocated to the cost-reimbursement contracts, plus interest.¹¹² If the indirect cost was determined to be unallowable “for that contractor” before proposal submission, the penalty is two times the amount of disallowed allocated costs plus interest.¹¹³ The inclusion of unallowable costs is also potentially subject to other administrative, civil, and criminal penalties.¹¹⁴

It is therefore incumbent upon aerospace government contractors to ensure that the types of insurance and other costs identified as unallowable under the new GFRC do not appear either in direct cost submissions or indirect cost rate proposals or statements of costs. While the rules applicable to the reimbursement of insurance costs under cost-type contracts have received new emphasis under the new GFRC, the GFRC rule requiring contractors to promise not to include insurance charges to fixed-price contracts have remained unchanged. Under fixed-priced contracts, contractors warrant that the price of these contracts will not include any charge or contingency reserve for insurance.¹¹⁵

UAVs Included at Contracting Officer's Discretion

One of the policy issues relating to the GFRC is the inclusion of unmanned aerial vehicles (UAVs) under the clause. Unmanned aerial systems (referring to both UAVs and their supporting systems) programs of the military services have experienced significant growth in recent years.¹¹⁶ DCMA included UAVs in the list of aircraft with contracts that should include the GFRC and that are covered by the terms of the revised GFRC.¹¹⁷ The revised GFRC also revised the definition of “flight crew member” to include “any pilot or operator of an unmanned aerial vehicle.”¹¹⁸

One of the DCMA's own field representatives raised a concern regarding the inclusion of UAVs in the proposed revised GFRC. The representative suggested that the clause should not be applied to smaller UAVs, stating:

228.370 appears to require the Ground and Flight Risk Clause for all aircraft including unmanned aerial vehicles without taking into account size, cost, or ceiling which vary tremendously. The use of the GFRC appears to be a costly overkill in cases of small/micro unmanned aerial vehicles.¹¹⁹

This somewhat conclusory comment did not explain what it meant by “costly overkill.” It is unclear whether the commenter meant that it was an error to include micro-UAVs among aircraft that would require costly insurance, or that it was overly burdensome administratively

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The Revised and Updated DFARS Clause (cont'd):

and contractually to track such aircraft pursuant to the GFRC, or that the costs of compliance were otherwise unjustified. The question of coverage of micro-UAVs under the GFRC does not appear to be inconsequential based on the numbers of these systems alone. For example, as of March 2010 the GAO reported that the military services have acquired more than 6,100 Group 1 unmanned aircraft (aircraft weighing 20 pounds or less).¹²⁰

The DoD did not share the commenter's concern because of the flexibility afforded to the contracting officer under the DFARS. More specifically, in responding to the comment DoD stated that "DFARS 228.370(b)(2)(i) allows tailoring of the definition of 'aircraft' to appropriately cover atypical and 'nonconventional' aircraft" but also allowed contracting officers to omit small/micro UAVs from that definition, in coordination with the program office.¹²¹ DoD acknowledged that, while the respondent's concerns could be legitimate in some cases, these concerns should be addressed during the preaward phase on an individual contract basis. There is sufficient flexibility in the approval process for the clause to recognize unique requirements or the absence of standard ground and flight operation requirements for small/micro UAVs.¹²²

While DoD's response appears to recognize that the GFRC may indeed be more than is reasonably required for small/micro UAVs, it is unclear by what standard contracting officers should evaluate whether to include the GFRC in contracts for such systems.

Since it appears that the importance of UAVs will continue to grow based on recent trends, DCMA may have to revisit this issue in the future to provide more concrete guidance on the applicability of the GFRC to these systems. For the time being, aerospace contractors whose contracts cover UAVs will need to be aware of how the government is dealing with the risks of such aircraft in their contracts on a case-by-case basis.

Conclusion

DoD's revisions to the GFRC and its prescriptive provision have simplified how DoD implements its limited self-insurance policy for contractor operations involving military aircraft, while at the same time imposing increased obligations on contractors. DoD's approach also increases potential contractor exposure to ground and flight risks. At the same time, DoD has highlighted the unallowability of certain risk-related costs under cost type contracts where the GFRC applies. Aerospace government contractors need to be aware of these changes and respond accordingly in their proposals and compliance plans. Moreover, aerospace contractors should be aware of these risk-shifting issues as the industry continues to evolve and increasingly uses new technologies such as UAVs.

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Endnotes

1. 75 Fed. Reg. 32645 (June 8, 2010).
2. DFARS 252.228-7001 (June 2010). Under the current GFRC, deductibles are the lesser of \$100,000 or 20 percent of the estimated contract cost. DFARS 252.228-7001(f)(1) (June 2010). Previously, deductibles were \$25,000. *See* 75 Fed. Reg. 32645 (June 8, 2010).
3. DCMA, Memorandum for Director, Defense Acquisition Regulations Council (Apr. 5, 2007), “Proposed Defense Federal Acquisition Regulation Supplement (DFARS) Case—Revision of the Ground and Flight Risk, and Aircraft Flight Risk Clauses” (DCMA Memo) at 1.
4. Letter from Comptroller General of the United States to the Honorable William Proxmire, Chairman, Joint Economic Committee, Congress of the United States (June 21, 1972) (B-114811) (Comptroller General Letter) at 2.
5. *Id.*
6. DFARS 228.370(b)(1) (June 8, 2010).
7. 75 Fed. Reg. 32642, 32644 (June 8, 2010).
8. *Id.*
9. DFARS 252.228-7001(a)(1)(i) (June 2010) (defining “aircraft”) and DFARS 252.228-7001(c) (June 2010) (providing that, subject to the conditions in paragraph (d) of the clause, the Government “self-insures and assumes the risk” of damage, loss, or destruction of aircraft “in the open,” during “operation” and in “flight”). This aspect of the definition of “aircraft” was reportedly added at the suggestion of an industry group to “indicate the point at which an aircraft being manufactured becomes an aircraft, ‘otherwise even some raw materials in the open might be thought by some to be aircraft in the course of manufacture.’” Vought Aircraft Co., ASBCA No. 47357, 00-1 BCA ¶30,721.
10. DFARS 252.228-7001(a)(1)(iii) (June 2010).
11. *See* FAR 46.505(b) (2007). The risk of loss passes to the Government upon delivery of the supplies to a carrier if transportation is free-on-board (FOB) origin. *See* FAR 46.505(b)(2).
12. FAR 52.232-16(e) (Aug. 2010).
13. Comptroller General Letter at 2.
14. Post-delivery risk of loss is generally addressed under the FOB clauses in the FAR 52.247 grouping, and at FAR 52.246-23, Limitation of Liability (Feb. 1997) and FAR 52.246-24, Limitation of Liability—High Value Items (Feb. 1997).
15. DFARS 252.228-7001(a)(1)(ii) (June 2010).
16. *Id.*
17. *Vought, supra* note 9 (sustaining contractor appeal for system lost in crash of Government-furnished aircraft, and denying government defense that the 1975 version of the GFRC did not cover contractor-owned property).
18. DFARS 252.228-7001(a)(1)(iv) (June 2010).
19. DFARS 252.228-7001(b) (June 2010). The combined regulation/ instruction is jointly issued as Air Force Instruction 10-220, Army Regulation 95-20, NAVAIR Instruction 3710.1 (Series), Coast Guard Instruction M13020.3, and Defense Contract Management Agency Instruction 8210.1, and is published by the DCMA.
20. McDonnell Aircraft Corp., 66-1 BCA ¶5382, 1966 WL 359 (Feb. 16, 1966) (allowing a contractor’s appeal of a contracting officer’s decision denying the contractor’s request for reimbursement under the GFRC because the radar operator, rather than the pilot, was landing the aircraft, because the radar operator was a qualified flight crew member under the GFRC in effect at the time).
21. Contractor’s Flight and Ground Operations Instruction §3. For a discussion of the role of DCMA personnel in monitoring contractor ground and flight operations, *see* Statement of Lt. Col Michael J. Tremper, USAFR, GFR, DCMA, before the Committee on Science and Technology, Subcommittee on Investigations and Oversight, U.S. House of Representatives (June 12, 2007).
22. Contractor’s Flight and Ground Operations Instruction, §3.3.
23. *Id.* §3.13.

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The Revised and Updated DFARS Clause (cont'd):

Endnotes (cont'd)

24. *Id.*
25. *Id.*
26. *Id.* §4.1.3; DFARS 252.228-7001(e)(2) (June 2010).
27. DFARS 252.228-7001(c) (June 2010).
28. DFARS 252.228-7001(a)(6) (June 2010).
29. *Id.*; *see also* DFARS 252.228-7001(a)(1)(ii) (June 2010).
30. DFARS 252.228-7001(a)(7) (June 2010). *See also* Contractor's Flight and Ground Operations Instruction, §1.26—Ground Operations—Aircraft operations without the intent of flight.
31. DFARS 252.228-7001(a)(4) (June 2010).
32. DFARS 252.228-7001(d) (June 2010).
33. *Id.*
34. *Id.*
35. DFARS 252.228-7001(d)(4)(iii) (June 2010).
36. FAR 52.245-1(h) (Aug. 2010) (contractor not liable absent insurance coverage, willful misconduct or lack of good faith, or the Government's revocation of assumption of the risk of loss).
37. DFARS 252.228-7001(d)(6) (June 2010).
38. DFARS 252.228-7001(f)(1) (June 2010).
39. The Boeing Co., ASBCA No. 18916, 74-2 BCA ¶10,976 (where six aircraft on a contractor's flightline were damaged by one event, a severe hailstorm, the ASBCA concluded that the deductible applied to the total damage to all aircraft, rather than to the loss or damage for each aircraft individually).
40. DFARS 252.228-7001(e)(1) (June 2010).
41. Fairchild Hiller Corp., ASBCA No. 14387, 72-1 BCA ¶ 9202.
42. DFARS 252.228-7001(e)(2) (June 2010).
43. DFARS 252.228-7001(e)(5) (June 2010).
44. *Id.*
45. DFARS 252.228-7001(e)(4) (June 2010).
46. DFARS 252.225-7001(e)(6) (June 2010).
47. DFARS 252.228-7001(e)(3) (June 2010).
48. Office of the Undersecretary of Defense, Acquisition, Technology and Logistics, DoD Contract Pricing Committee, Memorandum for Director, Defense Acquisition Regulation Council, 2007-D009, Ground and Flight Risk Clause (May 23, 2007), at 3.
49. NASA has a limited self-insurance policy for contractor operation of government aircraft similar to the DoD policy. NASA still maintains two contract clauses. First is the NASA FAR Supplement 1852.228-70, Aircraft Ground and Flight Risk (October 1996) Clause prescribed in the NASA FAR Supplement at 1828.370(a). The second is the NASA FAR Supplement 1852.228-71, Aircraft Flight Risks (December 1988) Clause prescribed in the NASA FAR Supplement at 1828.311-270.
50. DCMA Memo at 2.
51. DFARS 228.370(b)(1) (effective Dec. 15, 1998; superseded June 8, 2010).
52. DFARS 228.370(c)(1) (effective Dec. 15, 1998; superseded June 8, 2010).
53. *Id.*
54. DFARS 228.370(c)(2) (effective Dec. 15, 1998; superseded June 8, 2010).
55. *Compare* DFARS 252.228-7001 (Sept. 1996) *and* DFARS 252.228-7002 (Sept. 1996).
56. DFARS 252.228-7001(e) (Sept. 1996).
57. DFARS 252.228-7002(d)(1) (Sept. 1996).
58. DFARS 252.228-7002(d)(2) (Sept. 1996).
59. FAR 45.104. The contractor does assume the risk of loss on fixed-price contracts not requiring cost or pricing data. FAR 45.107(a)(1)(ii), (a)(2)) and FAR 52.245-1 (Alternate I) (Aug. 2010).
60. FAR 52.245-1 (Aug. 2010).
61. DFARS 252.228-7001(g) (Sept. 1996).

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The Revised and Updated DFARS Clause (cont'd):

Endnotes (cont'd)

62. NAVAIR, Contractor Flight Operations web page, http://www.navair.navy.mil/safety/flight_ops.cfm.
63. DCMA Memo at 1.
64. *Id.* at 3.
65. *Id.* at 1.
66. *Id.* at 2.
67. *Id.*
68. *Id.*
69. *Id.*
70. *Id.*
71. *Id.*
72. DFARS 252.228-7001(d)(4)(iii) (June 2010).
73. DCMA Memo at 2.
74. *Id.*
75. *Id.*
76. *Id.* at 1.
77. *Id.*
78. 72 Fed. Reg. 69177 (Dec. 7, 2007) (proposed rule); 75 Fed. Reg. 32642 (June 8, 2010) (final rule with descriptions of comments).
79. 75 Fed. Reg. 32642 (June 8, 2010).
80. 75 Fed. Reg. 32642, 32645 (June 8, 2010), citing new DFARS 231.205-19.
81. DFARS 228.370(b)(1)(i)(June 8, 2010).

82. DFARS 228.370(b)(1)(ii), (iv) (June 8, 2010).
83. DFARS 228.370(b)(1)(iii) (June 8, 2010).
84. DCMA, Special Consulting Contractor Insurance/Pension Review on Aircraft and Hangarkeeper's Liability, Industry Survey of Deductibles (Jan. 17, 2007).
85. *Id.* at 2.
86. *Id.*
87. *Id.*
88. 72 Fed. Reg. 69177, 69178 (Dec. 7, 2007).
89. Letter from Aerospace Industries Association (AIA) to DARS (Feb. 4, 2008).
90. *Id.* at 1–2.
91. *Id.* at 2.
92. 75 Fed. Reg. 32642, 32644 (June 8, 2010).
93. *Id.*
94. *Id.*
95. DoD Contract Pricing Committee Report, DFARS Case 2007-D009 (Dec. 24, 2008), at 3.
96. DFARS 252.228-7001(m) (June 2010).
97. Letter from AIA to DARS at 3.
98. *Id.*
99. 75 Fed. Reg. 32642, 32644 (June 8, 2010).
100. *Id.*
101. DCMA Memo at 2.
102. DFARS 252.228-7001(f) (Sept. 1996).
103. *Id.*
104. *Id.*
105. DFARS 252.228-7001(g) (June 2010) (emphasis added).
106. *Id.*

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The Revised and Updated DFARS Clause (cont'd):

Endnotes (cont'd)

- 107. This analysis of the GFRC subcontracting-related provisions also reflects discussions with Dr. Douglas N. Goetz, CPPM, CF, GP Consultants, Inc. (former Defense Acquisition University professor).
- 108. DCMA Memo at 1.
- 109. DFARS 252.228-7001(f)(5)(v) (June 2010).
- 110. FAR 42.801, 42.803 (Apr. 2011).
- 111. FAR 42.709(a)(1),(2) (Apr. 2011).
- 112. FAR 42.709-1(a)(1) (Apr. 2011).
- 113. FAR 42.709-1(a)(2) (Apr. 2011).
- 114. FAR 42.709-1(b) (Apr. 2011).
- 115. DFARS 252.228-7001(h) (June 2010).
- 116. U.S. Gov't Accountability Office, GAO-10-331, Unmanned Aircraft Systems: Comprehensive Planning and a Results-Oriented Training Strategy Are Needed to Support Growing Inventories (2010).
- 117. DFARS 228.370(b)(2)(i)(June 2010); DFARS 252.228-7001(a)(1)(iv) (June 2010).
- 118. DFARS 252.228-7001(a)(5) (June 2010).
- 119. Comment on DARS-2007-0077, DCMA Springfield, Picatinny, NJ.
- 120. GAO-10-331 at 6.
- 121. 75 Fed. Reg 32642 (June 8, 2010).
- 122. *Id.* at 32642-43.



An “Inside-Out” Manual: Conducting Construction Overseas

*by
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1.0 Executive Summary

Federal overseas construction is a critical, albeit below the radar, component of United States foreign policy, geopolitical positioning, emergency response and humanitarian relief. Even as the U.S. military presence in Iraq and Afghanistan wanes, the government will increasingly² rely on construction contractors’ overseas experience to cut costs associated with rebuilding the physical infrastructure of those distressed countries and to secure U.S. interests worldwide. Ironically, however, few observers have discussed the ways in which federal contractors can be prepared to operate in high-risk and otherwise uncertain circumstances abroad in a manner that is relatively comprehensive, yet practical, and informed both from the vantage point of an in-house practitioner and outside legal advisors. Accordingly, while much of this article identifies best practices and considerations in Middle East and Africa construction, many of the points raised here can also be applied to help companies that are performing U.S. service contracts, domestically³ and abroad, comply with the complex federal acquisition legal regime, ensure timely payments, and realize profits.

2.0 Federal Overseas Construction Programs

The distinctions among overseas military, diplomatic, emergency and humanitarian-response construction projects are often hard to discern, and the agencies responsible for overseeing and funding these projects periodically have overlapping jurisdiction. This complex, overlapping jurisdiction is either explained by or accounted for, in part, by federal appropriations law. Indeed, when it comes to federal appropriations law, determining which agency has been authorized to do what and when is not always readily apparent.⁴ What is clear, however, is that the Department of State (“DoS”), the U.S. Army Corps of Engineers (“USACE”), and the U.S. Agency for International Development (“USAID”) are three agencies that are authorized to meet U.S. military and civil construction objectives overseas, whether directly for the U.S. government or, equally important, for foreign governments (*e.g.*, Iraq and Afghanistan) on behalf of the U.S. government. An understanding of each of these programs is fundamental to representing federal overseas construction contractors.

2.1 USACE: Military and Civil Construction Management

Although several entities manage reconstruction activities in places like Iraq and Afghanistan, the U.S. Army Corps of Engineers is the “world’s largest public engineering, design and construction management agency,” and it performs these functions through its

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Military and Civil Works Programs.⁵ The Military Program provides “engineering, construction, and environmental management services to the Department of Defense (“DoD”), other U.S. government agencies, and *foreign governments*.”⁶ Through the Civil Works Program, the USACE plans and manages construction of, among other things, projects relating to water resources, hydroelectricity and environmental restoration.⁷ The USACE’s management of construction contracts is subject to the Federal Acquisition Regulation (“FAR”),⁸ the Army Federal Acquisition Regulation Supplement (“AFARS”),⁹ the Department of Defense Federal Acquisition Regulation Supplement (“DFARS”),¹⁰ and the Engineering Federal Acquisition Regulation Supplement (“EFARS”),¹¹ with the latter containing contracting requirements issued by the Corps.

2.2 DoS: Diplomatic Construction on Behalf of the U.S. Government Overseas

In conjunction with other Department of State components, the Bureau of Overseas Building Operations (“OBO” or “Bureau”) establishes, manages and maintains the U.S. physical presence on foreign territory via the design and construction of secure embassies and other overseas posts. Prior to awarding design and construction contracts, the Bureau’s Facilities Design and Construction Division (“FDCD”) pre-qualifies architectural and engineering firms (often abbreviated together as “A-E”), using criteria specified in the Brooks Architect-Engineer Act,¹² and construction firms, by considering their ability to meet the sensitive and classified information security requirements of the National Industrial Security Program Operating Manual (“NISPOM”), DoD 5220.22-M (Feb. 2006).¹³ The acquisition and performance of OBO design and construction contracts are governed by the FAR and the DoS Acquisition Regulations (“DOSAR”).¹⁴

In addition to focusing on security requirements, the OBO is committed to “green” building. This is evidenced in OBO’s Guiding Principles, Design Excellence Program, and the “Green Guide,” all of which promote integration of “green” and sustainable design and construction into OBO’s overseas facilities.¹⁵ Indeed, it is now OBO policy to apply for Leadership in Energy and Environmental Design (“LEED”) certifications for all newly constructed embassies.¹⁶ Although these green reforms and managerial and operational enhancements to OBO’s overseas diplomatic construction programs are promising developments, contracting with the OBO has, historically, presented additional risks to contractors, especially regarding substantially delayed project completion and cost overruns that arguably relate to inadequate planning and unclear requirements on the part of DoS.¹⁷

2.3 USAID: Humanitarian Relief and Disaster Response on Behalf of the U.S. Government Overseas

The U.S. Agency for International Development provides foreign assistance to “friendly foreign countries”¹⁸ for construction and infrastructure projects. These projects are either implemented by USAID or the country receiving aid (the host country) and are established by procurement assistance agreements and economic development grants.¹⁹ Regardless of

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whether the project is implemented by USAID or the host country, USAID helps ensure that foreign aid dollars “reflow” back into the U.S. by including in their contracts a domestic preference requirement that favors qualified U.S. construction service providers, whether administered directly by USAID or through a USAID-funded host country contracting programs.²⁰

In order to be eligible to compete for these overseas construction contracts, any offeror, including the parent companies of a joint venture, must be qualified as citizens of an eligible nation under the “Rules on Source, Origin, and Nationality for Commodities and Services Financed by USAID,”²¹ and must meet other criteria,²² which are somewhat similar to a responsibility determination under the FAR.²³ “Nationality” of a construction contractor is determined by its legal organization under the laws of an eligible country and its eligibility to contract is determined largely by its ability to meet certain ownership, performance, employment and technical/financial capability requirements.²⁴ In the event that no U.S. firms are both capable and qualified to perform in the locale, a foreign-owned firm can receive an award from USAID or can operate as a subcontractor under such a contract; provided that the estimated project cost does not exceed \$5 million, only local firms will be solicited, and the foreign-owned firm is an integral part of the local economy.²⁵

3.0 Considerations Regarding Federal Construction Overseas

As a practical matter, we have not attempted to address every possible issue in federal construction; rather, our goal is to provide insight into the unique aspects of the federal construction legal regime that may be implicated when doing business abroad. While many of these principles readily apply to all construction, whether domestic or performed outside the continental United States (“OCONUS”), we note that overseas federal construction often occurs in high-risk conditions. Therefore, we have addressed situations specific to emergency, contingency, humanitarian and disaster relief construction projects overseas that typically arise during the pre-construction, construction, and post-construction phases. A common thread between each of these phases includes the fact that best practices that may seem natural are not always implemented in practice, especially due to the substantial and regular employee turnover rates in high-risk conditions. In order to operate effectively, contractors should not only adopt the managed risk strategies presented in this section wholesale but should also consult with company attorneys in order to *adapt* these strategies to the contractor’s unique culture of risk acceptance and operations.

3.1 Preconstruction

3.1.1 Risk Identification, Clarification and Mitigation

The various types of overseas construction contracts — design-build, design-bid-build, architect-engineer, and construction management — each come with their own set of risks. Acclimating to these risks may be especially challenging for companies that are just entering

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the overseas construction market.²⁶ As a result, the early identification of the type of construction project and related requirements in the solicitation provides company attorneys with an idea of the risks associated with the project. Given the often uncharted and substantial risks associated with a corporate move into overseas federal construction, company attorneys should be closely integrated with the project pursuit team and, to the greatest extent possible, with the relevant contracting program representatives. This high level of integration will best shape the potential end-user relationship and requirements, along with promoting a corporate culture of compliance, from the outset of any emergency or other construction contracting effort.

A standardized, but flexible, process for reviewing requests for proposals is a way to bring potential risks to the attention of company attorneys and executives. This review process should be informed by the company's ever-evolving policy positions regarding acceptable programmatic risks. After receiving insight from management, company attorneys might develop mitigation strategies that could include, among other things, distilled questions for clarification or talking points for any forthcoming discussions with the program representatives. *Indeed, given the often urgent, unusual, and compelling²⁷ requirements associated with supporting contingency, emergency and humanitarian efforts, there may be much more room to negotiate performance terms and to partner with the government in addressing requirements than in a standard acquisition.*

Prior to submitting a proposal, company attorneys should review any certifications for accuracy and determine the extent to which risks that are specific to overseas federal construction can be mitigated and accepted by the company. Key areas of risk identification, mitigation and acceptance might relate to the following:

3.1.1.1 Delivery Systems

As a result of the often uncertain conditions and requirements associated with high-risk overseas construction contracting for the Federal Government, indefinite-delivery/indefinite-quantity ("ID/IQ") contracts incorporating both fixed-price and cost-reimbursable task orders, are commonly used for construction, construction incidental to logistical support operations, and construction-related services (*e.g.*, operations and maintenance for existing construction). Further, agencies may utilize and waive requirements for undefinitized contract actions in emergencies because specific contract requirements and costs may not be determinable.²⁸

In addition to developing a robust system for receiving, rejecting, responding to, formalizing and recording incidental oral work orders that may arise under these conditions, contractors that regularly perform fixed-price construction should integrate cost principle considerations, along with necessary tracking and allocation requirements, into their business systems and should encourage agencies to definitize interim contract actions as soon as accurate estimates can be assessed.²⁹ If single- or sole-source bridge contracts are anticipated, construction contractors should not only ensure that the appropriate justifications and approvals³⁰ are in place, but should also develop a public relations strategy that involves the

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government customer in the promotion and communication to the public of the associated benefits of the contracting action and protections for the taxpayer.

3.1.1.2 Government Furnished Reporting, Site Data, Designs and Verification

Government-furnished data regarding the site conditions will not always be available or wholly accurate in high-risk overseas construction. If the government does furnish site conditions information, the contractor must consult with counsel to gauge the extent to which the data may contain language and other disclaimers of liability that could effectively shift the risk of liability for certain site conditions to the contractor following the contractor's site visit and investigation. Depending on the type of services provided, if an Architect-Engineering firm has not verified its designs and there is any language that can even be remotely construed as requiring the contractor to verify the accuracy of any government-furnished designs, the contractor must decide whether to accept the risk of the designer's errors and omissions associated with any forthcoming verification decision under the timing/operational circumstances or to forego the pursuit.

3.1.1.3 Schedule Delays and Liquidated Damages

Any contract review for high-risk operational conditions should assess the likelihood of delays, including whether the government has made promises related to facilitating and enforcing its transition timeline from any incumbent contractor. If liquidated damages will be assessed for delays, then the contractor should determine whether the specified rate is acceptable and should consult with company attorneys when developing a mitigation strategy for any anticipated delays prior to commencing performance.

3.1.1.4 Managing Oral Change Orders

If a contracting officer issues an oral request for "unprogrammed" work, whether within or outside the scope of an awarded contract vehicle, then contractor should determine whether it will, respectively, risk breach by refusing to perform altogether or indicate the circumstances under which it will perform should it choose to do so. While these circumstances could include a decision to perform under protest pursuant to any included Changes³¹ clause, the contractor should also attempt to leverage the urgent need to negotiate for a waiver of liquidated damages and consequential damages; favorable limitations on liability; reciprocal indemnification; and, warranty provisions that take into account the performance conditions. In any event, the contractor should always insist upon having any agreement related to additional work memorialized at earliest possible date and, if possible, prior to beginning performance.

3.1.1.5 Standards of Performance and Applicable Building Codes

In addition to reviewing any applicable design and performance specifications for

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conformance with the anticipated work, the construction contractor should determine in advance whether it is capable of adjusting to any specified international building code standards given that those standards may be more strict than other federal and state agency codes with which contractors are accustomed to complying with domestic operations. If the contract specifies any “green” standards that the prime contractor is not familiar with then the prime contractor should consider employing or subcontracting with consultants that are experienced with the application of these standards to international requirements on federal contracts.

3.1.1.6 Environmental Requirements

The duty of care associated with handling hazardous materials (“HAZMAT”) associated construction activities, along with complying with extraterritorial environmental regulations and adequately managing potential liability for environmental remediation efforts can subject contractors to substantial risk. While environmental regulatory compliance is a mandatory cost of conducting federal business domestically or abroad, contractors should strongly consider whether any contracted level of responsibility for environmental remediation and HAZMAT duties, both within and beyond their control, is acceptable for the company to assume in the event that such provisions are nonnegotiable and related concerns are not adequately addressed during any pre-bid questions and discussions periods. Further, contractors should determine whether subcontracting these responsibilities can adequately address the attendant risks in the event that the contractor is unwilling or unable to perform remediation and HAZMAT handling requirements.

3.1.1.7 Payment Provisions

In high-risk overseas construction, federal agencies may refrain³² from making payments via electronic fund transfer in the event of unusual and compelling circumstances and may also authorize advance payments.³³ An agency decision to waive the electronic payment provisions can create considerable audit and disallowance risk for contractors in the event agencies resort to temporary cash payments to ensure and expedite construction objectives during the early stages of an emergency. Sourcing resources during the early stages of an emergency will likely result in the purchase of goods at costs that may be questioned, regardless of the circumstances in which those costs were incurred. As a result, it is important to establish an effective accounting system and set of controls that ensure costs are adequately tracked, payments are recorded, and written receipts are signed by the contracting officer.

3.1.1.8 Waivers and Exceptions to Domestic Acquisition Requirements

3.1.1.8.1 Bonding Waivers and Exceptions

Bonding on overseas construction can be difficult, if not impossible, to obtain given the risk presented to a given surety. Bonding, when available, can also be extremely costly when used to provide assurance for the government regarding the prime contractor’s performance and payment obligations in high-risk overseas conditions. In emergencies, the relevant contracting

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office can waive a bid bond requirement even though a performance and payment bond may be required.³⁴ That said, the contracting officer can also waive³⁵ Miller Act³⁶ performance and payment bond requirements because it may be impracticable for a construction contractor who is performing work in a foreign country to obtain the required bonding.³⁷

3.1.1.8.2 Selected Waivers and Exceptions

Agencies are provided various waivers and can utilize exceptions to meet the requirements of high-risk overseas construction projects.³⁸ These waivers and exceptions are often difficult to track in the aggregate, unless a provision is implicated by operational conditions. Construction contractors entering the federal market overseas should note that the prevailing wage requirements of the Davis-Bacon Act³⁹ do not apply to overseas federal construction. Further, neither the Buy America Act⁴⁰ nor the Berry Amendment⁴¹ applies to overseas federal construction.

3.1.1.9 Security Clearances

The National Industrial Security Program Operating Manual (“NISPOM”) “provides baseline standards for the protection of classified information released or disclosed to industry in connection with classified contracts under the NISP [National Industrial Security Program],”⁴² including standards applicable to the construction⁴³ of sensitive compartmented information facilities (“SCIFs”) and other closed areas approved for safeguarding classified materials.⁴⁴ Although it is typical for a prime contractor to complete projects through subcontractors, U.S. contractors should be prepared to perform the work themselves or subcontract to other qualified⁴⁵ companies when a project is covered by the NISP. Prospective subcontractors that are owned by non-U.S. citizens are prohibited from obtaining the facilities security clearance⁴⁶ and personnel security clearance⁴⁷ required to build secure facilities. Therefore, the only subcontractors who can undertake projects covered by the NISP are (a) owned by U.S. citizens and employing cleared, U.S. citizen personnel,⁴⁸ or (b) foreign-owned and operating in the U.S. after mitigation of Foreign Ownership, Control, or Influence (“FOCI”) concerns.⁴⁹

3.1.1.10 Insurance and Related Risk Allocation Considerations

High-risk overseas federal construction presents risks that many insurance companies have not been willing to underwrite without impracticable expense. In order to promote contractor support that would not otherwise be available — even though many of these costs are often ultimately passed⁵⁰ on to the government under a fixed price or cost reimbursable construction contract — several agencies⁵¹ have implemented special insurance incentives for insurers and programs for contractors along with clauses allocating certain risks to the Federal Government. In situations where risks are not especially high, corporate and project-specific insurance premiums provide greater coverage at lower cost. However, Defense Base Act (“DBA”) insurance,⁵² a prominent⁵³ form of federally contracted or private carrier provided⁵⁴ worker’s compensation for all contractor and subcontractor employees providing construction

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services on bases overseas,⁵⁵ has been a cost-effective⁵⁶ method of protecting contractors in the event their employees are injured in high-risk situations.

Although DBA insurance is an employee's sole⁵⁷ remedy for work place injuries where applicable, it does not insulate contractors from all third party liability and does not protect them from the other potential liabilities inherent in high-risk conditions. In order to mitigate other risks associated with wartime construction contracts, the USACE, among other agencies, has included a special clause in its contracts that, upon the occurrence of specifically covered war risks, effectively shifts the risk of loss, damage and destruction of government property to the relevant agency. In the event that contractors are not able to successfully negotiate the inclusion of a war risk clause or in the event that a war risk clause⁵⁸ is removed from subsequently competed contracts, contractors might attempt to negotiate for the inclusion of "extraordinary contractual relief" under Public Law Indemnity 85-804.⁵⁹ Also, it is likely that contractors will do their best to shift the risk to suppliers via corresponding subcontract terms, even though doing so will substantially increase the contractors' costs.

A war risks clause is just one example of a clause that shifts risk from the contractor to the government. Many other "special clauses" that are developed for and included in a specific contract at the agency's discretion, on the other hand, can create considerable risk for contractors because these clauses are not subject to public comment or prior experience. While these special clauses will likely be negotiated by the contractor and may not be mandatory, the contractor should periodically review the company's compliance with these provisions in consultation with counsel. These compliance reviews indicate a good faith attempt to meet special contract requirements and will very likely contribute to a defense, albeit limited, against disallowances or other inquiries by government auditors and other agency representatives.

3.1.1.11 International Agreements and Extraterritorial U.S. Laws

3.1.1.11.1 Bilateral Intergovernmental Agreements

Recently, high-risk overseas construction, whether performed directly under a construction contract or incidental to logistical support contracts arising from the wars in Iraq and Afghanistan, have shaped international agreements along with extraterritorial and other⁶⁰ U.S. laws that are applicable to overseas government contracts. In addition to the aforementioned special contract provisions,⁶¹ contractors should look to the Status of Forces Agreement ("SOFA")⁶² and diplomatic notes to determine what governs their overseas performance obligations, as these bilateral agreements generally govern the relationship between the parties and may even include exceptions to local, U.S. and international laws.⁶³

Because a SOFA and applicable diplomatic notes may be classified or unavailable to contractors, a company attorney should, upon receipt of the notice to proceed, be introduced to and otherwise openly communicating with the relevant contracting officer and agency counsel. This interchange is critical to preventing delays resulting from the application of local laws and exceptions to international and U.S. extraterritorial laws that may not be readily apparent (e.g.,

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criminal jurisdiction under local laws may supersede extraterritorial criminal laws).⁶⁴ In these cases, the contractor may be required to ask the contracting officer to consult with agency counsel to help determine its responsibility under the contract in view of these agreements and/or represent the contractor to request an exemption from local law requirements that do not apply under the aforementioned circumstances.

3.1.1.11.2 Extraterritorial Laws Requiring Ethical Business Conduct

The Foreign Corrupt Practices Act (“FCPA”),⁶⁵ and the prohibition against Trafficking in Persons,⁶⁶ two of the most prevalent U.S. extraterritorial laws applicable to U.S. construction contractors operating overseas, subject these contractors to U.S. ethical norms for conducting business and managing laborers overseas. Compliance with these extraterritorial statutes can be complicated because they contain principles that are often contrary to traditional business practices — whether when dealing with foreign government officials or enforcing the applicable standards upon foreign subcontractors — in many areas of the Middle East and North Africa. However, the risk of inadvertent noncompliance, whether directly by a prime contractor or imputed upon a prime contractor due to the indiscretions of a foreign subcontractor, is high given the substantial “grey” areas that characterize these laws even as applied to Western contractors. Undoubtedly, the best practice in promoting a top-down culture of compliance involves regular and good faith controls that identify potential problems before they arise and rapidly address even the most de minimis noncompliance before the underlying activity burgeons in a manner affecting the project, the company, and broader public perception.

3.1.1.11.2.1 Managing the Foreign Corrupt Practices Act

The FCPA’s anti-bribery provisions⁶⁷ prohibit construction contractors from “knowingly”⁶⁸ and “corruptly” giving anything of value (*e.g.*, gifts, gratuities or money) to a “foreign official”⁶⁹ whether to influence an official act or to gain business opportunities in the region. Importantly, the risk of noncompliance under the FCPA is not limited to what is perceivably⁷⁰ an expansive definition of what constitutes a “knowing” violation; the risk also extends to discrete and arguably inadvertent violations along with grossly negligent violations. For example, a prime contractor may be held responsible for otherwise proper payments⁷¹ made by a legitimate business partner or consultant on the prime’s behalf if the partner or consultant illegally pays a bribe to a foreign government official in order to further the prime contractor’s interests in relation to those proper payments. Further, the prime contractor may also be held responsible for a subcontractor’s indiscretions if the prime contractor’s quality controls neither identify the improper activity nor implement the appropriate corrective actions.

Public construction contractors must also keep detailed books and records (including all transactions with foreign companies) because they are subject to audit under FCPA’s

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anti-bribery provisions.⁷² Facilitating payments are also an exception⁷³ to the FCPA that must be properly recorded in order to prevent liability. Although facilitating payments under the FCPA allow de minimis payments to a foreign government official to conduct nondiscretionary acts⁷⁴ within the scope of his or her authority (*e.g.*, a negligible payment to a customs official to ensure construction materials can cross a given border), many contractors refrain from utilizing this exception.⁷⁵ The reason is that there is often substantial “grey” area regarding what exactly constitutes an acceptable facilitating payment, facilitating payments may not be allowed under the laws of the host country⁷⁶ and the fear of investigation is enough to keep most contractors from making any permitted payments to foreign government officials for routine activities. Contractors should undoubtedly consult with company attorneys⁷⁷ prior to tendering any such payments.

In order to mitigate exposure from any alleged noncompliance at a macro level, construction companies should implement robust internal policies that emphasize good faith and analytical due diligence. These policies should include the investigation of foreign companies, consultants,⁷⁸ and representatives for ties with foreign government officials; integration of legal and executive management when vetting foreign consultants; maintenance of transactional records⁷⁹ and payment approval processes (with graduated levels of internal management review that correspond to the value tendered); and periodic audits of internal compliance systems. At a micro-level, these policies should help identify potential “red flags”⁸⁰ as they arise; emphasize adequate compliance training for sales professionals and foreign subcontractors; require local contractors and consultants to certify compliance with FCPA; incorporate strategies for exercising any necessary defenses⁸¹ to FCPA and for conducting privileged internal investigations of alleged violations; and, include mechanisms for the regular enforcement of corrective actions along with procedures for determining when disclosure of potential violations is required.

3.1.1.11.2.2 Prohibiting Human Trafficking

Contractors may be subject to liability for their violations of the extraterritorial prohibition on human trafficking.⁸² They may also be subject to risk of imputed responsibility for the related and wrongful acts and/or omissions of foreign subcontractors,⁸³ whose labor policies may not be consistent with U.S. law. The media has commonly reported on foreign subcontractors’ deceptive recruitment tactics; unsanitary, unsafe, and unhealthy work and living conditions for employees; uncompensated and excessive overtime; and denial of employee wage entitlements and compensation for injury. The risks associated with potential trafficking violations are pronounced as a result of the expansive definition of prohibited activities, which includes, among other things, forced labor and recruitment and/or involuntary servitude.⁸⁴ In addition to adopting the government’s “zero tolerance”⁸⁵ anti-trafficking policy, prime contractors should regularly audit and enforce quality controls, among other subcontract terms, when dealing with subcontractors, including corrective action requirements and corresponding payment withholding provisions.

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3.1.1.11.3 Export Controls

Construction contractors responding to rapidly changing requirements in high-risk conditions cannot disregard⁸⁶ export control regulations with impunity⁸⁷ unless an exception applies.⁸⁸ The U.S. export controls regime prohibits certain unlicensed transfers — whether overseas to friendly or sanctioned countries or to non-U.S. citizens resident domestically or abroad — of controlled items (*e.g.*, products of U.S. origin, foreign products containing components of U.S. origin, and foreign products derived from products of U.S. origin). The issue of whether an item is controlled by the export regulations also largely depends on the nationality of the end user and the end destination. Construction contractors should note that, among other things, engineering designs may be controlled by the Export Administration Regulations (EAR),⁸⁹ plans incorporating military specifications may be controlled by the International Trafficking in Arms Regulations (ITAR),⁹⁰ and the Department of Treasury's Office of Foreign Assets Control may place restrictions⁹¹ on sourcing materials necessary for construction from sanctioned countries. That said, export control compliance and risk mitigation strategies for construction contractors are beyond the scope of this white paper.

3.2 Construction

In this section we will build upon the categories of performance-related construction risks that could form the basis for a request for equitable adjustment under any applicable Changes⁹² clause or a related claim by a prime contractor against the government. Unforeseeable subsurface conditions, design and construction deficiencies, project-specific risks and delays, and constructive changes are relatively standard operational risks in any construction project; however, these risks are experienced more frequently by contractors who are working on high-risk overseas federal construction contracts. Again, it is not our intent to address all possible grounds for construction contract adjustment requests and claims. Instead, we are focused on underscoring the circumstances that are encountered by overseas federal contractors most often.

3.2.1. Differing Subsurface and Site Conditions

A sizeable percentage of high-risk overseas construction will test U.S. contractors' geographical expertise because this construction must be performed pursuant to rapidly changing requirements and could subject contractors to non-traditional project risks. Contractors risk⁹³ being required to rely on government-furnished geotechnical surveys — if those documents are even available under the circumstances — that have not been vetted by the relevant contracting officer's technical representative ("COTR") and which do not provide adequate opportunity to inquire into the legitimacy of the government's representations.⁹⁴ Consequently, the tension between the allocation of liability with regard to the contractor's site investigation responsibilities and the differing site conditions looms large.

The Site Investigation and Conditions Affecting the Work clause, a mandatory clause for fixed-price construction,⁹⁵ requires a contractor to acknowledge that it has satisfactorily

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inspected ground and *reasonably ascertainable* subsurface conditions, along with all related, government-furnished documentation.⁹⁶ If the contractor fails to reasonably investigate⁹⁷ or incorrectly interprets government-furnished documentation,⁹⁸ it assumes the risk of increased costs associated with unexpected site conditions. What is considered to be a reasonable investigation by a contractor will likely be determined by the circumstances and this duty could temper a contractor's claim for Type I differing site conditions or Type II differing site conditions. A contractor's misinterpretation of government-furnished documents could prevent the contractor from bringing a claim that subsurface conditions differed materially from those furnished in the contract ("Type I"),⁹⁹ and a contractor's unreasonable investigation could preclude a claim that a physical condition was of an unknown, unforeseeable and unusual nature ("Type II").¹⁰⁰ Further complicating any overseas contractor's differing site conditions claim resulting from contingency and emergency operations is that the claim will be nullified in cases where differing subsurface conditions or latent defects, exacerbated by supervening events, do not predate¹⁰¹ the contract (*e.g.*, a subsequent tremor or enemy attack).

The potential liability presented by the Differing Site Conditions clause and the contractor's duty to investigate the site underscores the importance of substantially engaging any company attorney in the discussions associated with any impending federal construction bid in high-risk conditions overseas. In addition to raising questions related to a construction requirement or a program where construction is incidental to the requirement, it is important to determine the circumstances under which an alternative to a fixed-fee¹⁰² construction contract might prevent a contractor from assuming the risk of responding to rapidly developing and often-oral construction requirements. In the event that the simplified acquisition threshold is not exceeded, the clauses should be negotiated out of the contract because neither clause is mandatory.¹⁰³

3.2.2 Design and Construction Deficiencies

At least one court has held that contractors are required to abide by government design specifications and drawings and, therefore, are entitled to reasonably rely upon the government's defective designs even where the government has disclaimed liability for the accuracy of the designs or has required the contractor to verify the accuracy of those designs.¹⁰⁴ Generally, courts' apparent¹⁰⁵ disfavor for government attempts to shift responsibility to contractors for design deficiencies bodes well for contractors operating in high-risk overseas construction projects. Given the rapid turnaround requirements on many overseas construction projects, contractors may not have time to verify the accuracy of design specifications and, therefore, have a heightened need to defer to the government with regard to these requirements for the method and manner of the construction.¹⁰⁶

Whereas a contractor should be entitled to recover additional costs related to the government's specification of erroneous materials or measurements in government-furnished design documents, the liability for performance specifications which specify a government objective to which the contractor is entitled to deference in designing¹⁰⁷ and achieving is less

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clear in high-risk overseas conditions. For example, a government performance specification, incidental to a construction contract, requiring a given generator capable of performing at “x BTUs” may not be immediately obtainable due to security or other risks impacting the material supply chain. Indeed, whether a substitute generator that is capable of performing at “x-1 BTUs” is acceptable and, otherwise compensable, is a matter of negotiation with the contracting officer, while responsibility for clearly substandard workmanship is likely best redressed under any included Inspection¹⁰⁸ and Warranty¹⁰⁹ clauses.

3.2.3 Project-Specific Risks and Delays

Generally, a delay will be excused entitling a contractor to a time extension if an unforeseeable triggering condition for which the contractor is not responsible is implicated under any included excusable delay provision of a Default Termination clause¹¹⁰ and, under certain circumstances, the increased costs associated with a given delay caused by the government are available under other remedy granting provisions (i.e., any included Changes Clause)¹¹¹ entitling the contractor to financial compensation. A delay will not be excused and the government may be entitled to liquidated or default termination damages where a delay is due to the fault or negligence of the contractor, its suppliers, or any performance risks that are naturally¹¹² assumed under a fixed-price construction contract.

In high-risk overseas construction, the dividing line between excusable and inexcusable delays is often grey, especially, given the likelihood of supervening events that could further skew the scope of responsibility for a given delay. At least one author has noted:

[T]he contractor in a fixed-price construction contract with the government takes responsibility for many types of risks, such as the availability *and quality of labor*; *the availability, delivery and quality of materials*; submission of adequate shop drawings and submittals; the performance of subcontractors and suppliers; site conditions and work restrictions identified in the contract; and safety. *To the extent that delays arise out of any of these risks that have been assumed by the contractor, those delays will be considered unexcused.* In fact, one can go as far as to say that delays that cannot be brought within the definition of excusable delays ... are by definition unexcused.¹¹³

That author goes further to discuss at least one case that underscores the fact that the application of the triggering standards (i.e., foreseeability and contractor fault) and conditions for excusable delay provisions were not tailored to overseas conditions and, therefore, there is a high likelihood that many overseas federal construction contractors naturally assume the risk of what would likely be deemed excusable delays.¹¹⁴

In order to further this point, we should assume a hypothetical contract for federal construction in Iraq that includes an excusable delay provision¹¹⁵ for fixed price construction

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and a provision requiring compliance with local laws. Under such a contract, a contractor whose ability to operate in Iraq has been suspended by the relevant Iraqi ministry for failing to obtain a building license attributable to bureaucratic delays within the ministry (*e.g.*, an unpublished change in law) may choose to seek a schedule extension from its contracting officer. Even though the “acts of the Government” provision would not apply because 48 C.F.R. §52.249-10 (“Default (Fixed-Price Construction)”) was not intended to apply to sovereign acts by foreign governments on the face of the regulation; the list in 48 C.F.R. §52.249-10(b)(1) is not exclusive. In order to have any attendant delays excused, the contractor may have to prove to the contracting officer that cases like *JTL, Inc.*,¹¹⁶ are inapposite — *i.e.*, the contractor did not assume the risk of the specific bureaucratic delay because the delay was neither foreseeable nor within the contractor’s control.

In order to do so, the contractor would have to prove that even though bureaucratic delays are, generally, foreseeable in overseas construction, the particular delay was neither foreseeable nor attributable to the contractor’s negligent disregard for the local laws and, therefore, could not have been accounted for in the contractor’s original schedule. Similar negotiations regarding foreseeability and contractor responsibility in high risk and uncertain conditions would be required in the event of unavailability of materials or skilled labor due to changes in operational conditions and turnover. Further, a government direction to proceed in the face of an otherwise excusable delay could form the basis for a constructive acceleration claim so even if a contractor does not succeed on the merits of the delay argument, that contractor may be able to argue constructive acceleration with the contracting officer in the alternative.

Other common delays in high-risk overseas construction projects involving the assumption of the risk inquiry include constructive change claims of commercial impracticability due to defective designs. For example, a contracting officer may not accept that an act of the public enemy or opposition forces in Afghanistan which substantially damages a building prior to the conclusion of construction is an excusable delay. Under these circumstances, a contractor may alternatively claim that the designs were defective due to the occurrence of a supervening event that neither party could have contemplate at the time of contract formation that has made performance under the original specifications cost prohibitive.¹¹⁷ However, the contracting officer may argue that the contractor has assumed the risk of the supervening event because it is entirely foreseeable that a contractor performing a wartime contract could be subject to attack. Certainly, the issue of foreseeability of the specific location, nature and effect of a given attack is debatable depending on the circumstances.

In high-risk overseas construction, the contractor will also expressly assume the pre-acceptance risk of loss and/or damage arising from supervening events under 48 C.F.R. §52.236-7 (“Permits and Responsibilities”). Often insurance cannot be obtained or is prohibitively expensive on overseas construction projects and, therefore, if the government includes 48 C.F.R. §52.236-7 in a given contract and if acceptance (including beneficial occupancy by the Government) has not occurred, then many contractors will seek to enforce

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flow-down provisions in affected subcontracts as a means of mitigating the associated risks. Further, contractors may seek to negotiate a settlement with the contracting officer where the excusable delays caused by the government occurred and were the sole reason that construction was not completed prior to the occurrence of a natural disaster.

3.3 Post-Construction Cost Considerations

Prior to and after acceptance of the work¹¹⁸ — whether by beneficial occupancy upon substantial completion, passage of a reasonable time or final payment — an overseas construction contractor will be subject to several cost recovery considerations that will not apply to domestic contractors. There are two reasons for this fact. First, firm-fixed price construction contracts are subject to the cost principles where cost analysis is required (e.g., when certified cost and pricing data is required because there was not adequate price competition for a given requirement because a sole or single source award was issued to address an emergency requirement in high-risk overseas federal construction).¹¹⁹ Second, it is not uncommon for temporary and permanent construction to be required under a cost-reimbursable contract, whether or not such construction is only to be performed incidental to logistical support operations, in high-risk overseas operations. Accordingly and, given the potential for audit, it is even more important for overseas federal construction contractors to document business judgments (especially given the increased likelihood of a need to submit convenience termination settlement proposals), maintain adequate records, and implement business systems capable of tracking costs.

Ironically, the author has found very few cases interpreting reasonableness of costs incurred under an affected firm-fixed price contract or a cost-reimbursable contract in high-risk federal construction overseas. In the event that performance conditions require a construction contractor to supplement more costly and unanticipated labor or materials, contractors should seek an advance agreement with the contracting officer regarding the allowability of those costs, ensure that the costs are not expressly unallowable (i.e., contingencies or non-Afghan security company costs due to changes in Afghanistan laws) and, otherwise, document related business decisions. However, it should be noted that an advance agreement may not be forthcoming¹²⁰ and may not always insulate the contractor from government auditor inquiries into the allowability of a given cost. Accordingly, a contractor performing construction or incidental construction under a cost reimbursable contract should consult with a company attorney if that contractor is required¹²¹ to fulfill a contractual requirement under a cost-reimbursable contract even though the allowability of those costs could be subject to questioning in the future.

4.0 Managing Subcontractors in Overseas Federal Construction

Generally, prime contractors operating overseas must ensure that any decision to rely upon on foreign sources is guided by determinations of value-added,¹²² risk coverage and

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mitigation; flow-down compliance and monitoring requirements; and adequate enforcement mechanisms. That said, the federal government's emphasis on adequate subcontractor management and oversight has placed risk mitigation at the forefront of all overseas federal construction contractors performing in high-risk conditions. In general, these prime contractors should ensure that any pre-mobilization efforts of subcontractors are performed at risk given the high likelihood of a convenience termination of the prime contract due to changing conditions/requirements. Further, prime contractors should consult with company attorneys in order to adequately shift the risk of delay due to materials and labor shortages, political risk (i.e., changing local governments), and the risk of loss to their subcontractors.

International subcontract management is an arena where developing an internal culture of compliance at the prime level is critical to monitoring and enforcing compliance requirements upon

subcontractors. Indeed, this involves getting the prime contractor's employees, along with the management and employees of overseas subcontractors, to abide by the anti-kickback regulations; observe the extraterritorial criminal laws that are applicable to U.S. companies and contractor employees overseas; fairly recruit, compensate and maintain standards of quality regarding living conditions of third country laborers; observe host-country civil and criminal law requirements; and report any indiscretions as required.¹²⁴

4.1 Purchasing System and Quality Control Considerations

Construction prime contractors can enforce subcontract requirements and defend themselves against responsibility for subcontractor indiscretions via ongoing monitoring, compliance certifications, contingent payment provisions, and enforceable dispute resolution provisions. In addition to requiring subcontractors to certify compliance with applicable laws and other contract requirements; prime contractors should have a purchasing system that involves active monitoring of subcontractor compliance whether through a specified individual or department. If this compliance function of a purchasing system is conducted under the direction of a company attorney, there is some likelihood that attorney-client privilege would attach to the related efforts of the specified individual or department.

The responsible department should document its efforts to regularly inspect the subcontractor's implementation of any quality controls; require periodic compliance certifications and reporting; investigate any perceived noncompliance; require corrective actions where necessary; ensure that corrective actions are completed; provide robust rights to audit; and/or otherwise inspect a subcontractor's books and records when necessary. In addition to ensuring any noncompliance is detected and addressed, these controls will also provide a defense in administrative and legal proceedings in the event that a subcontractor's indiscretions are imputed upon the prime contractor.

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4.2 Enforcement via Contingent Payment Provisions

Contingent payment provisions (i.e., pay-when-paid and pay-if-paid clauses), when enforced in conjunction with retention and set-off rights under a subcontract can be a critical means of enforcing compliance with contract requirements by overseas subcontractors who may have otherwise attempted to evade personal jurisdiction in U.S. courts¹²⁵ and can also shift the risk of nonpayment by the government back to the contractor when related to subcontractor activities. That is, if a subcontractor is subject to the risk of nonpayment under a subcontract term, that subcontractor may be more likely to comply with subcontract requirements and may submit to personal jurisdiction in the U.S. to recover sums allegedly owed. Although contingent payment provisions are heavily scrutinized in some states, many international subcontractors are loathe to incur the expenses associated with resolving disputes in a foreign location and, therefore, may likely accept withholdings and setoffs under any contingent payment provisions so as not to disrupt the business relationship pending a contracting officer's or another fact-finder's final decision regarding the prime's (and, therefore the subcontractor's) entitlement to payment under a contract.

4.3 International Alternative Dispute Resolution

In the event that a dispute occurs, it is critical to account for the risk that an arbitral award and/or decision may not be enforced by a court or administrative entity in the jurisdiction in which the overseas construction is performed. Given what in the author's experience is a generally accepted perception that local court decisions in many jurisdictions within the Middle East and North Africa lack consistency, arbitration in internationally reputable seat is preferable, however, it cannot overcome the risk presented by the fact that many local courts, that are not subject to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention")¹²⁶ often disregard foreign arbitration decisions and may even adjudicate a case brought by a local contractor under the local laws (including, Sharia law, where applicable) while wholly disregarding the choice of law, seat and dispute resolution provisions specified by the parties in a contract. Given that a local court may attach a U.S. contractor's property and may enter an order revoking the foreign contractors license to operate in the jurisdiction, contractors operating in high-risk overseas environments should be prepared to coordinate with the relevant U.S. embassy in the jurisdiction, along with local counsel and a local government relations¹²⁷ representative in order to prevent a court from taking jurisdiction and enforcing a judgment in violation of the parties' agreement.

5.0 Local Law Considerations

Federal construction contractors performing overseas are required to adapt to and comply with the legal regimes within the local area of operation. In high-risk overseas construction, the ability to adapt is often complicated by the absence of the rule of law and an

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opaque bureaucracy. In addition to becoming familiar with the local legal regime and engaging local counsel, any contractor operating overseas must also have a well-vetted government relations officer who can draw upon her bureaucratic connections to prevent project delays in a manner that does not come within the definition of improperly influencing a foreign government official under the Foreign Corrupt Practices Act. Although federal construction occurs world-wide, our focus is upon local operational compliance required throughout the Middle East and North Africa (“MENA”) in the aggregate because that region is currently the location of the substantial majority of overseas federal construction.

5.1. Entity Formation and Registration

Many federal construction contractors, operating outside of a U.S. territory overseas, will establish a registered foreign office¹²⁸ in the locale in order to refrain from incurring taxation costs and mandatory local joint venture requirements in many areas within MENA. However, depending on the level of business activity the contractor intends to conduct in the region; incorporation could either be required or advisable, in which case, the contractor will often be required to establish a joint venture, with a local managing member after meeting minimum capitalization requirements. Although a local managing member requirement serves the government’s interest in ensuring that a party within the region can be made responsible in the event of “flight”¹²⁹ by a foreign joint venture partner; many countries within MENA will further require the parties to operate under the license to do business of the joint venture partner or a local sponsor, with property that is attachable in the country, to ensure that a local partner can always be made to account for the business activities of the non-host country partner. Regardless of whether a registered branch office or incorporated company is formed, each entity will generally be required to file annual financial statements that have been audited by a local accounting firm.

5.2. Compliance

If an exception is not provided under a SOFA or other international agreement, construction contractors will also be required to obtain the necessary professional (i.e., engineering) licenses and work permits in order to be able to perform in a foreign jurisdiction and, often regardless of whether the contractor is operating or performing on U.S. territory (i.e., a military installation) in the region. In addition to incurring local fines and penalties along with performance delays due to performance stays issued by local administrative agencies for the failure to obtain, update and otherwise maintain these local business licenses; the contractor could be subject to disallowances under its U.S. government contract for failure to comply with all applicable laws.

Host-country employment regulations applicable to foreign, domestic and third-country labor also impose requirements and costs with which U.S. government contractors operating in MENA are not familiar. In order to mobilize in MENA, U.S. government contractors that are not operating under any applicable SOFA exception will often have to secure temporary visas,

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while awaiting permanent visas, to import third-country nationals into the region in order to support the work, especially, given that local employees may not be authorized to enter U.S. or host-country military facilities in certain countries. Often the contractor is not able to secure a visa either because a rapidly issued notice to proceed under an award of a U.S. government contract did not provide the U.S. government contractor the time required to register and receive approval of permanent visa applications, or because of a substantial noncompliance with a precondition to receiving a visa. In either case, the contractor could be required to incur costs associated with facilitating the exit and re-entry of workers operating under temporary visas prior to its expiration.

Local labor requirements also entitle foreign and, sometimes direct-hire U.S. citizen and third-country employees,¹³⁰ to benefits that are drastically different from U.S. labor laws and, therefore, impose additional compliance costs on the construction contractor. For example, local employees may be entitled to shorter work weeks and substantially compensated overtime; extended leave; holiday pay; limitations on hours worked; year-end bonuses; guaranteed severance pay with substantial notice of termination; and much more stringent termination rights.¹³¹ The human resources department of any international contractor should work in consultation with a company attorney and local counsel to ensure that policies are in place that specifically integrate the local and U.S. labor policies that apply within area of operations in addition to providing employees clear notice of the corporate procedures for effecting their project related employment rights. This transparency will assist the company in partnering with employees in realizing their labor rights and will reduce the likelihood of costly, project halting disputes.

Local import and export restrictions can also impact supply chain expediency and create project delays,¹³² especially, if a contractor has not accounted for the potential bureaucratic delays in its project management strategy. In order to circumvent the associated “red tape” and delays, many construction contractors attempt to avail themselves of Free Trade Zones¹³³ in the region that are not subject to the same export restrictions and import duties, among other local laws, as other areas in the Middle East. However, if goods that are properly licensed to travel from a Free Trade Zone to another do not exit the country or arrive at their required destination then any applicable license (or license requirement) will be violated and the contractor will incur administrative sanctions, including fines and penalties, regardless of whether an intervening event (i.e., military attack on or robbery of a convoy) is to blame for the violation of the license.

6.0 Conclusion

Federal overseas construction is a critical part of our nation’s security, diplomatic and humanitarian efforts. In recent conflicts, international construction and other contractors’ embedded support for our servicemen and servicewomen is admirable. This reality underscores

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the fact that the risks associated with overseas federal construction matter¹³⁴ in a manner that is as important as and is also intertwined with the protection of corporate best interests. We hope that our efforts will help ensure that responsible companies that are best suited to manage these associated risks in partnership with their government customers, continue forward in this noble and patriotic commitment. The risks associated with overseas federal construction are high but can be managed via a collaborative effort and we are thankful to the government representatives, contractors, and servicepersons dedicated to working together in support of our nation's best interest.

Endnotes

1. Attorney, Shulman, Rogers, Gandal, Pordy & Ecker, P.A., Potomac, MD, and former counsel for Kellogg, Brown & Root (KBR). B.A., University of Virginia (2004); J.D., William & Mary Law School (2007). The author would like to thank Ira E. Hoffman, Chair of the Government Contracts and International Practice Groups at Shulman Rogers, for his invaluable comments, suggestions, and support, and Lauren E. Forgie, a summer law clerk at Shulman Rogers, for her significant contributions toward finalizing this white paper. Further, the guidance and support of Donald R. Rogers and Lawrence A. Shulman is much appreciated.
2. John S. Vento, *Funding and Related Issues Regarding Federal Government Construction Outside the United States*, in *Federal Government Construction Contracts* 759, 759 (Michael A. Branca, Aaron P. Silberman, & John S. Vento eds., 2010).
3. Although the substantial majority of this white paper is dedicated to overseas construction, many of the considerations presented could equally apply to high-risk construction, whether in an emergency or otherwise, performed in the United States. Despite this apparent overlap and the mitigation considerations presented, construction contractors should not rely upon this white paper and should always seek the advice of company attorneys when constructing under high risk and emergency conditions whether operating domestically or abroad.
4. *See id.* at 767-769 (providing insight into how the division of responsibility among agencies for overseas federal construction and construction-related services is complicated by allocations of federal appropriations).
5. U.S. Gov't Accountability Office, GAO-10-819, *Army Corps of Engineers: Organizational Realignment Could Enhance Effectiveness, but Several Challenges Would Have to be Overcome* 4 (2010).
6. *Id.* (emphasis added).
7. *Id.* at 3-4.
8. Federal Acquisition Regulation, 48 C.F.R. parts 1-53 (2010).
9. 48 C.F.R. §§5108-5152.
10. 48 C.F.R. §§ parts 201-253 (2010).
11. The EFARS are not published in the Code of Federal Regulations, but the regulations are available at <http://www.usace.army.mil/CECT/Pages/EFARS.aspx>.
12. Pub. L. No. 107-217, 116 Stat. 1129 (1996) (codified at 40 U.S.C. § 1103(d)).
13. *See* U.S. Dep't of State, <http://www.state.gov/m/a/c13743.htm> (last visited June 20, 2011) (containing link to NISPOM).
14. 48 C.F.R. §§601-653.
15. U.S. Dep't of State, OBO, <http://www.state.gov/oboarchive/c29962.htm> (last visited June 20, 2011) (noting that The Energy Independence and Security Act of 2007 has reclassified energy and water as issues of national security).
16. Adam E. Namm, U.S. Dep't of State, OBO, *Constructive Diplomacy: The U.S. Department of State's Overseas Building Program* (2011) available at <http://www.state.gov/obo/news/163300.htm> (last visited June 20,

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2011); Adam E. Namm. U.S. Dep't of State, OBO, <http://www.state.gov/obo/about/dirmessage/index.htm> (last visited June 20, 2011) (asserting that OBO has published the “first Long Range Overseas Maintenance Plan, mandating all new embassies be built to the specifications of LEED Certification from the U.S. Green Buildings Council[.]”).

17. U.S. Gov't Accountability Office, GAO-06-641, Embassy Construction: State Has Made Progress Constructing New Embassies, but Better Planning Is Needed for Operations and Maintenance Requirements 1 (2006).

18. Foreign Assistance Act of 1961, Pub. L. No. 87-195, 75 Stat. 424 (1961) (codified at 22 U.S.C. §2151).

19. Mark Hanson & Edmund Amorosi, *Overseas Construction Under USAID Regulations: Not Business as Usual*, 43 Procurement Law. 7, 7 (Fall 2007).

20. *Id.*

21. 22 C.F.R. §228.

22. See Hanson & Amorosi, *supra*, note 13, at 8. (noting that the criteria includes, among other things, having performed similarly complex services to those in the solicitation within three to five years prior to the issuance date of the solicitation, having achieved a total business volume equal to or greater than the value of the project being bid in three to five years of the issuance date of the solicitation, and possessing the technical and financial resources to perform the project).

23. Compare 22 C.F.R. §228.31 with 48 C.F.R. §9.104-1.

24. 22 C.F.R. §228.31.

25. *Id.*, §228.35.

26. See, e.g., David S. Hatem, Kenneth B. Walton, & David H. Corkum, *Architect-Engineer Contracting*, in Federal Government Construction Contracts 79, 83, *supra*, note 2, at 538 (explaining that a traditional construction company may be unfamiliar with the increased level of design liability exposure associated with a design-build contract as compared to a design-bid-build or construction management contract, and articulating that an Architect-Engineer firm may not be accustomed to the statutory cap on billable design fees that are calculated as a percentage of estimated construction costs).

27. See, e.g., 48 C.F.R. §§18.101 and 218.170 (generally, setting for the proposition that the FAR and DFARS provide flexibility, specifically, in regard to the full and open competition requirement, in the event of unusual and compelling urgency).

28. See FAR 48 C.F.R. §16.603.

29. The FAR stipulates that letter contracts shall contain a definitization period within the earlier of 180 days or of 40 percent of work completion, however, construction contractors will likely want definitization to occur as soon as the tacit realism of cost estimates can be verified via actual costs incurred during performance. See FAR 48 C.F.R. §16.603-2(c). That said, contractors assume the risk of an agency's waiver of durational and other limitations on undefinitized contract actions. 48 C.F.R. §218.201(7).

30. 48 C.F.R. §6.302-2(c)(1).

31. See, e.g., 48 C.F.R. §§52.243-1 (Aug. 1987); 52.243-2 (Aug. 1987).

32. 48 C.F.R. §§32.1103(e), 18.123 and 218.170(j)(1).

33. 48 C.F.R. §§32.402(c)(1)(ii)a), 32.404(d) and (f), and 18.121.

34. 48 C.F.R. §§18.120 and 28.101(a).

35. A contracting officer can waive the Miller Act bonding requirements for work performed in a foreign country upon determining that it is impracticable for the contractor to furnish performance and payment bonds. 48 C.F.R. §28.102-1(a)(1).

36. The Miller Act applies to government contracts exceeding \$150,000.00 and requires contractors to obtain payment and performance bonds. 40 U.S.C. §3131(b).

37. A contracting officer can waive the Miller Act for work performed in a foreign country upon determining that it is impracticable from the contractor to furnish performance and payment bonds. 48 C.F.R. §28.102-1(a)(1).

38. 48 C.F.R. §§18.000, 218.170.

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39. The Davis-Bacon Act specifies prevailing or minimum wage requirements that apply to Federal construction contractors domestically. *See* 40 U.S.C. §3142(a)-(c); 48 C.F.R. §22.403-1. The Davis-Bacon Act has been waived for overseas construction projects. 40 U.S.C. §3142(a).
40. The Buy America Act requires contractors to use articles, materials and supplies that have been mined, produced or manufactured in federal construction projects. 41 U.S.C. §10a; 48 C.F.R. §§25.1 and 25.2 (2010). In addition to the fact that the Trade Agreements Act creates an exception to the Buy America Act in overseas federal construction projects, the Buy America Act also includes an express exception applicable where products are acquired for use outside of the United States. 41 U.S.C. §10a; 48 C.F.R. §25.004.
41. The Berry Amendment places several contentious restrictions on the use of certain specialty metals from non-U.S. suppliers in United States government procurements. 10 U.S.C. §2533a. The Berry Amendment does not apply to acquisitions outside the United States in support of combat operations, acquisitions in support of contingency operations where there is an unusual or compelling need, or emergency acquisitions by activities located outside the United States for personnel of those activities. 48 C.F.R. §218-201(9).
42. Nat'l Indus. Sec. Program Operating Manual (NISPOM), Dep't of Def. Directive 5220.22-M at 1 (Feb. 2006) (citing Exec. Order No. 12829, 58 Fed. Reg. 3479 (Jan. 1993)).
43. *Id.* at §5-800.
44. *Id.* at §1-100.
45. *Id.* at §§2-100, 2-102(d), 2-200, 2-209, 7-101. In addition, it is worth noting that the NISPOM places restrictions on foreign-owned companies' ability to qualify for facilities and personnel security clearances along with the circumstances in which a cleared prime contractor can enter into subcontracts with foreign companies requiring access to classified information. *See* NISPOM, §§2-300 to 2-310.
46. *Id.* at §2-100.
47. *Id.* at §2-200.
48. *Id.* at §§2-102(d), 2-209, 7-101.
49. *Id.* at §2-300(c). (A U.S. company that is determined to be under Foreign Ownership, Control or Influence is not eligible for a facility clearance "unless and until security measures have been put in place to negate or mitigate FOCL").
50. Valerie Bailey Grasso, Baird Webel & Scott Szymendera, Cong. Research. Serv., RL 34670, The Defense Base Act (DBA): The Federally Mandated Workers' Compensation System for Overseas Government Contractors, at 15 (Apr. 2010).
51. Another example includes the Overseas Private Investment Corporation ("OPIC"), a quasi-governmental agency that offers political risk insurance for U.S. contractor assets while conducting business with foreign governments overseas. *See* Overseas Private Investment Corporation Insurance, <http://www.opic.gov/insurance>. (last visited June 26, 2011).
52. 42 U.S.C. §§1651-1654. *See*, also, 48 C.F.R. §§28.305, 52.228-3.
53. The War Hazards Compensation Act, 42 U.S.C. §§ 1701 *et seq.*, is another form of federally backed insurance whereby self-insured contractors and insurance providers are reimbursed by the government for employee injuries sustained as a result of identified war hazards on overseas projects.
54. Grasso *et al.*, *supra*, note 48, at 11. (stating that different agencies have different programs. For example, DoD has allowed contractors to select and negotiate rates with DBA insurers of choice. While other agencies have adopted "single-source" models whereby one single offeror provides DBA insurance to all of that agency's affected contractors).
55. 48 C.F.R. §28.305(d).
56. *Id.* at Summary (stating that contractors are reimbursed for DBA program premiums).
57. *Id.* at 3. (stating: "[D]BA insurance is an exclusive remedy for injured workers." [Therefore,] "Injured workers and the survivors of workers killed on the job are entitled to benefits for employment-related injuries, illnesses, and deaths regardless of fault and are not permitted to sue their employers or the federal government for any types of damages caused by employment-related incidents.")
58. 48 C.F.R. §228.370.

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Endnotes (cont'd)

59. Pub. L. No. 85-804, as amended by Pub. L. No. 93-155 (codified as amended at 50 U.S.C. §§1431-1435). Given the complexity associated with agency approval of the use of the Public Law Indemnity 85-804, its utility is highly questionable. 48 C.F.R. §50.104-3.

60. For example, the Foreign Sovereign Immunities Act provides for jurisdiction over foreign government agencies and instrumentalities (*e.g.*, state-owned enterprises) in U.S. federal district courts under certain circumstances. 28 U.S.C. §§1330(a), 1660(a)(1)-(6). *See, e.g., Wye Oak Tech., Inc. v. Republic of Iraq*, 2010 WL 2613323 at 11 (E.D. VA 2010) (holding that a defense materials and equipment provider could sue the Iraqi government on a breach of contract claim given that the contractor had performed substantial portions of the contract in the U.S.).

61. See 48 C.F.R. §252.225-7040, Contractor Personnel Authorized to Accompany U.S. Armed Forces Deployed Outside the United States (JUL 2009), (which makes civilians operating in high-risk conditions overseas subject to the law of war, other laws regarding the use of force, and orders of the combatant command. While construction contractors performing construction and construction-related services are subject to the law of nature and, therefore, may resort to acts covered by the law of war; the real risk presented by 48 C.F.R. §252.225-7040 is the potential conflict between orders of the combatant command and the requirements of the contracting officer. Any strategic plan for high-risk construction should involve a company attorney's input regarding the contractor's best action if presented with a situation where circumstances may require rapid interpretation of the contractor's obligations in the event of such conflicting orders or an order that may result in an immediate contract change even though the contracting officer, often located CONUS, may not be able to provide immediate authorization for the action).

62. For a list of applicable SOFAs, *See* Cong. Research. Serv., RL34531, Status of Forces Agreement (SOFA): What Is It, and How Has It Been Utilized?, 17-29 (2011).

63. *Id.* at 1.

64. For example, civilian contractor employees accompanying the armed forces may be subject to the Military Extraterritorial Jurisdiction Act ("MEJA") and even military courts martial under the Uniform Code of Military Justice ("UCMJ"). 18 U.S.C. §3261; 48 C.F.R. § 252.225-7997. The Civilian Extraterritorial Jurisdiction Act ("CEJA") has not been enacted and, therefore, does not yet apply criminal penalties to civilian contractors performing construction on federal projects overseas. S. 2979, 111th Cong. §2 (2010).

65. 15 U.S.C. §§78dd-1 *et seq.*

66. 22 U.S.C. §1704.

67. 15 U.S.C. §§78dd-1(a) and 78dd-2. For a summary of the FCPA's antibribery elements see Jacob S. Frenkel & Ira E. Hoffman, *International Compliance: Mitigating Risk in FCPA and Other Cross-Border Transactions*, 43 Md.B.J No. 4, at 32, 35 (July/Aug. 2010).

68. 15 U.S.C. §§78dd-1(f)(2) and §78dd-2(h)(3). *See* Frenkel & Hoffman, *supra* note 57, at 35 (asserting that knowledge includes actual and conscious disregard of circumstances that suggest high probability of an offense).

69. 15 U.S.C. §78dd-2(h)(2) It is worth noting that the definition of foreign official may include persons acting in an official capacity for or on behalf of a government agency.

70. The author is aware of only a few cases that have been litigated under the FCPA which is likely explained by the fact that the tendency is for contractors to negotiate and settle rather than litigate given the risks at stake. Accordingly, one might assume that the definition what constitutes a "knowing" violation is more likely than not within the discretion of the Department of Justice as-applied simply by raising allegations and during the course of an investigation.

71. Payments that are typically subject to scrutiny include proper cash or any other questionable payments made incidental to a proper payment to agencies for licenses, visas, registrations and customs duties. While any cash payments to agencies could implicate a red flag, there is often real concern that a company's government relations representative or subcontractor could utilize a bribe in order to overcome bureaucratic delays and changing, unpublished laws. In the latter situation, a prime contractor could be held equally responsible such incidental, improper payments made on its behalf regardless of whether the prime contractor only authorized the underlying proper payment.

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Conducting Construction Overseas (cont'd):

Endnotes (cont'd)

72. 15 U.S.C. §78m(b).
73. 15 U.S.C. §78dd-1(b).
74. 15 U.S.C. §78dd-1(f)(3)(A).
75. David M. Howard & Elisa T. Wiygul, “FCPA Compliance: The Vanishing ‘Facilitating Payments’ Exception?”, Dechert LLP (Apr 2010), http://www.dechert.com/library/4-7-10-WCSL-Howard_and_Wiygul-FCPA_Compliance-The_Vanishing_Facilitating_Payments_Exception.pdf.
76. 15 U.S.C. §78dd-1(c)(1).
77. Frenkel & Hoffman, *supra*, note 57, at 35 (stating: “Implementing a compliance program in consultation with counsel is a best practice, because management and the directors can discuss the issues under the protection of the attorney-client privilege.”).
78. Any agreement with local government relations representatives should be subject to review by local counsel for compliance with and likelihood of enforcement under local laws. Further, any due diligence review of local consultants should be conducted in consultation with a company attorney and should include reference checks, bank account and records reviews, and inquiry into any government relations officer’s familial and other ties in the government.
79. In order to adequately record transactions with foreign government agencies for licenses and related services, company representatives should insist upon receipts. Given that rules throughout MENA are subject to change without public notice and comment, company representatives may want to receive an advance opinion from local counsel confirming the exact cost of licenses along with the legality of the proposed transaction under local law.
80. For Foreign Corrupt Practices Act “red flags,” *See* <http://www.justice.gov/criminal/fraud/fcpa/docs/lay-persons-guide.pdf>.
81. For example, contractors can reimburse foreign officials bona fide expenses incurred during sales trips whereby the company facilities and product demonstrations occur. 15 U.S.C. §78dd-2(c)(2). However, if the covered activities arise above the level of mere reimbursement and the trip becomes too extravagant, then sales efforts could constitute an illegal bribe.
82. 22 U.S.C. §7104 (2007).
83. *See* 48 C.F.R. §22.1704(a)(4) and (b).
84. 48 C.F.R. §22.1704.
85. 48 C.F.R. §22.1703.
86. For Export Administration Regulations “red flags,” *see* <http://www.bis.doc.gov/enforcement/redflags.htm>.
87. 48 C.F.R. §252.204-7008.
88. Andrew D. Irwin & Michael J. Navarre, *Selected Compliance and Contract Administration Issues in Contingency Contracting*, 09-13 Briefing Papers, at 4-5 (Dec. 2009).
89. 15 C.F.R. §§730-774.
90. 22 C.F.R. §§120-130.
91. *See* Irwin & Navarre, *supra*, note 88, at 3 (discussing executive orders and other laws establishing sanctions against specific countries).
92. *See, e.g.*, 48 C.F.R. §§52.243-1 (AUG 1987); 52.243-2 (AUG 1987).
93. Tony Capaccio, *Dyncorp is Two Years Late Finishing Afghan Barracks Construction*, Bloomberg (Mar. 8, 2011), available at <http://www.bloomberg.com/news/2011-03-08/dyncorp-is-two-years-late-finishing-afghan-barracks-construction.html>.
94. Even though a large majority of contingency and emergency construction overseas may be temporary and, therefore, not as susceptible to subsurface conditions as permanent structures; that which is defined as “temporary” construction overseas seems to be more about mobility than durational use. That is, a building may be deemed temporary if it is movable regardless of whether it has a durational life in excess of a century. Therefore, the duty to build sustainable and safe, temporary structures overseas cannot be underscored enough.
95. 48 C.F.R. §36.503.
96. 48 C.F.R. §52.236-3(a).
97. *Id.*

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Conducting Construction Overseas (cont'd):

Endnotes (cont'd)

98. 48 C.F.R. §52.236-3(b).
99. 48 C.F.R. §52.236-2(a) (requiring contractors to provide prompt notice to the contracting officer of subsurface or latent physical site conditions that differ material from those indicated in the contract documents furnished by the government).
100. 48 C.F.R. §52.236-2(a) (requiring contractors to provide prompt notice to the contracting officer of previously unknown and unusual physical site conditions that are materially different from those ordinarily encountered or which may inhere in the character of work performed).
101. Arundel Corp. v. United States, 103 Ct. Cl. 688, 711, 1945 WL 4054 (1945).
102. 48 C.F.R. §36.502 (establishing an exception to the requirement that the Differing Site Conditions clause be included in an other than fixed price contract or in the event that the simplified acquisition threshold is not exceeded).
103. *Id.* at §36.503.
104. United States v. Spearin, 248 U.S. 132, 136, 39 S. Ct. 59, 61(1918); PCL Constr. Services, Inc. v. United States, 47 Fed. Cl. 745, 795, 2000 WL 1474486 (2000).
105. *See, e.g.*, Geoffrey T. Keating, *Changes*, in Federal Government Construction Contracts, *supra*, note 2, at 23, and Robert K. Cox, *Defective Specifications—Impracticability/Impossibility of Performance*, in Federal Government Construction Contracts, *supra*, note 2, at 492 (both articles discussing cases where the government was responsible for defective designs that it provided and from which the contractor could not deviate).
106. J.L. Simmons Co., v. United States, 188 Ct. Cl. 684, 689, 412 F.2d 1362, 1362 (1969).
107. Appeals of Columbia Engineering Corp., ASBCA No. 32679, 89-2 B.C.A. (CCH) ¶21689 (Feb. 13, 1989).
108. *See, e.g.*, 48 C.F.R. §§46.312 (2010) and 52.246-12 (AUG 1996).
109. *See, e.g.*, 48 C.F.R. §§46.710(e)(1) and 52.246-21 (APR 1994).
110. *See, e.g.*, 48 C.F.R. §52.249-10(b)(1) (APR 1984).
111. *See, e.g.*, 48 C.F.R. §52.243-4(d) (AUG 1987).
112. Andrew D. Ness, *Delay, Suspension of Work, Acceleration and Disruption*, in Federal Government Construction Contracts, *supra* note 2, at 538 (discussing risks naturally assumed by contractors under fixed price construction contracts).
113. *Id.* (emphasis added).
114. JTL, Inc., ENGBCA No. 6323, 98-2 B.C.A. (CCH) ¶29873 (May 22, 1998).
115. *See, supra*, note 111.
116. *Id.* (In JTL, Inc., a contractor was found to have assumed the risk of failing to timely obtain certain state permits and certifications that were normal and expected).
117. L.W. Matteson, Inc. v. United States, 61 Fed. Cl. 296, 320, 2004 WL 1662264 (Fed. Cl. July 20, 2004).
118. In the event that a contractor is reliant upon progress or other contract financing payments in high-risk emergency conditions, it is important for contractors to not only submit timely invoices but to consider whether submitting a certified request for payment is in the company's best interest given that the Prompt Payment Act has been waived for delinquent invoices in certain contingency and emergency operations. Defense Federal Acquisition Regulations, 76 Fed. Reg. 11371 (Mar 2, 2011).
119. 48 C.F.R. §§31.102, 15.403-1, 15.403-4.
120. 48 C.F.R. §31.109 (suggesting that contracting officers should, but are not required to, consider an advance agreement where costs are "special" or "unusual.").
121. *See, e.g.*, 48 C.F.R. §52.243-2(d) (Aug. 1987).
122. 48 C.F.R. §31.203(i).
123. 18 U.S.C. §3261; 48 C.F.R. §252.225-7997.
124. 48 C.F.R. §52.203-13.
125. *c.f.*, Baragona v. Kuwait Gulf Link Transp. Co., 594 F.3d 852, 854-855 (11th Cir. 2010). The Baragona case neither involved a subcontractor nor contingent payment provision. However, it is worth noting that the court found that it did not have personal jurisdiction over a foreign contractor under a Georgia long-arm statute even

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though, among other things, a substantial majority of contract administration occurred in the state of Georgia.

126. United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 9 U.S.C.A. 201, 330 U.N.T.S. 38.

127. Government relations representatives will often have close relationships with government officials, but will not be legally affiliated with the ruling families and government representatives in various Middle Eastern countries. In the event of bureaucratic delays at a local government agency, government relations representatives are critical to opening and streamlining communication channels with local government officials in order to accomplish business objectives.

128. Given the fact that title to land is often not properly recorded and is otherwise not clear throughout many regions in MENA, many contractors will rent office space within the vicinity of the area of operation. That said, it is important to note that any contract with local businesses should be vetted to ensure that the company is reputable, will not pass bribes to government officials, and is not owned by local government officials.

129. A common "exit strategy" for some financially distressed contractors has been to simply leave a country without formally dissolving an entity or otherwise "winding down" a companies' efforts in a country under the corresponding legal requirements in the host country.

130. Local employment laws generally do not provide employees the same entitlements as local laborers and, therefore, construction contractors can often reduce projects costs by hiring third-country nationals and employing them under the extraterritorial U.S. laws that apply to expat employees.

131. Local labor laws may require construction contractors to provide employees with substantial notice prior to terminating a given employee. Further, foreign employers may be required to provide an end-of-service gratuity which is a pre-calculated payment to the terminated employee that is contingent upon the time with which the employee was working for the contractor within the country.

132. Augusto Lopez-Claros and Simon C. Bell, *Doing Business in the Arab World 2011: Comparing Business Regulation in 20 Economies.*, World Bank Group (2011), available at <http://www.doingbusiness.org/reports/regional-reports/arab-world> (stating "In the Arab world, the average time for export has fallen from 28 days to 22 days in 2011 and the time for imports has been reduced from 34 to 26 days.")

133. See John H. Donboli & Farnaz Kashefi, *Doing Business in the Middle East: A Primer for U.S. Companies*, 28 Cornell Int'l L.J. 414 (2005) (discussing Free Trade Zones throughout the Middle East, generally, and in specific countries within the Middle East).

134. Steven L. Schooner, *Why Contractor Fatalities Matter*, Parameters, Volume 38, No. 3, at 79 (Autumn 2008), available at <http://www.carlisle.army.mil/usawc/parameters/Articles/08autumn/schooner.pdf>. See, also, Valerie Bailey Grasso, Baird Webel & Scott Szymendera, Cong. Research. Serv., RL 34670, *The Defense Base Act (DBA): The Federally Mandated Workers' Compensation System for Overseas Government Contractors* at 4 (Apr. 2010) (stating with regard to DBA claims alone: "Between September 2001 and the end of December 2009, there were 1,987 deaths covered by the DBA").



Contractor Cybersecurity Investigations: “Once More Unto the [Digital] Breach”¹

by
*Caitlin K. Cloonan*²

I. Introduction

The world around us seems to have “gone digital.” This is true not only for personal entertainment, communications and online shopping, but also for federal contracting and defense systems. All of this data exists in the common ether of cyberspace, and becomes an ever-growing target for intruders looking to breach, exploit, destroy, disrupt, deny, or degrade digital networks and the data they hold. Today many federal contractors find themselves responsible for protecting national secrets, intellectual property and personal data from cyber attacks. Whether the attacks are launched by advanced computer specialists trolling the net for closely-held government secrets, or by anonymous “hacktivists” targeting companies for sport - no electronic data is 100% secure. As these cyber threats to national security become more common and gain increasing attention from a variety of government agencies, contractors must prepare for the inevitable cyber intrusion, and the investigation that follows.

A. Cyber Intrusions - A Clear and Present Digital Danger

In recent years, cyber intrusions have become pervasive throughout commercial and government networks. Indeed, the first six months of 2011 proved to be one of the worst years for cybersecurity breaches in over a decade.³ Global companies like Sony, Google and Lockheed were all targeted - along with hundreds of other corporations, and government contractors. In July 2011, hackers accessed and posted restricted NATO documents on Twitter, bragging, “Hi NATO. Yes, we haz [*sic*] more of your delicious data.”⁴ While the tone of such incidents may appear to be little more than an obnoxious college prank, security experts believe that digital intruders will soon be able to use their skills to cause physical damage to critical data, networks, and thus to the actual infrastructure they control. In recent years, many U.S. defense agencies have shifted their focus away from physical threats, such as bombings or chemical warfare, and increasingly consider the implications of cyber attacks. Within these circles, some believe that these cyber threats could present apocalyptic level risks. For instance, the Central Intelligence Agency recently indicated that cyber attacks have the second-greatest potential for national destruction behind a nuclear attack.⁵

Given these high stakes, the government has a vested interest in maximizing data security. However, even the most advanced digital networks have fallen victim to cyber intrusions. In early August 2011, McAfee, Inc., one of the world’s leading virus protection and internet security firms, reported a massive five-year hacking operation which compromised the data of dozens of government agencies, defense contractors and other organizations across the globe. In response to this cyber crisis, McAfee’s vice president of threat research offered a sobering prediction, stating that “every company in every industry with valuable intellectual

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property and trade secrets had been compromised, or will be shortly, and that the bulk of victims rarely discover such breaches or their impact.”⁶ He further cautioned that “the only organizations that are exempt from this threat are those that don’t have anything valuable or interesting worth stealing.”⁷

B. Cybersecurity - A “Perfect Storm” of Contractor Risks

The increasing number of advanced cyber threats comes at the same time as the government increases contractor regulation, oversight and enforcement actions. Together, these circumstances create a “perfect storm” of contractor performance and compliance risks. Contractors responsible for federal data may be hard-pressed to keep up with the flood of legislation, regulations and policies proliferated by the federal government. For instance, in the last session of Congress alone, Congressional leaders introduced approximately 50 cyber-related bills.⁸ In May 2011, the Obama administration introduced its own legislative proposal focused on “improving cybersecurity for the American people, U.S. critical infrastructure, and the Federal Government’s own network and computers.”⁹

The Department of Defense (“DoD”) has also proposed extensive new cybersecurity regulations which are sure to have a significant effect on the federal contracting community. In June 2011, DoD issued a Proposed Rule addressing the protection of unclassified DoD information and contractor obligations for reporting cyber incidents.¹⁰ The Proposed Rule, which would become part of the Defense Federal Acquisition Regulation Supplement (“DFARS”), applies broadly to contractors (or subcontractors) having non-public DoD information resident on or transmitting through its unclassified information systems. The Proposed Rule establishes detailed security requirements, depending upon the nature of the information involved. Specifically, it includes detailed requirements for reporting a cyber security breach. For instance, within 72 hours of discovering a “cyber incident” that affects DoD information on, or transiting through, a contractor’s unclassified information systems, a contractor would be required to report the incident to DoD.¹¹ Examples of reportable cyber incidents include data exfiltration or manipulation or other loss or compromise of DoD information or unauthorized access to an unclassified system on which the DoD data resides.

Under the Proposed Rule, reporting of a cyber incident itself would not automatically be assumed to be evidence that a contractor had inadequate information safeguards for DoD unclassified information or otherwise failed to provide adequate safeguards. However, DoD reserves the right to consider such incidents in the context of an overall assessment of the contractor’s compliance. Such extensive cyber breach reporting requirements are not unique to DoD contracts. Forty-six states, the District of Columbia, Puerto Rico and the Virgin Islands have enacted legislation requiring companies provide similar notice of security breaches involving the release of personally identifiable information (“PII”) data.¹² Thus, contractors (and subcontractors) responsible for accessing or storing individual personal data in a government contract must also ensure full compliance with relevant state IT security laws and regulations.

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When developing these cyber security regulations, the government recognizes that by outsourcing federal IT requirements, federal contractors are often on the “front lines” of this cyber war. As such, many agencies have sought to collaborate and team with contractors responsible for managing and protecting vast amounts of federal data. However, when a federal contractor falls victim to a cybersecurity incident, this “collaboration” may quickly end. Contractors may suddenly find themselves across the table from their federal agency “partner” and on the receiving end of an audit, investigation, and possible civil or criminal prosecution. Faced with this near-inevitable situation, contractors may ask themselves, “now what?” Below are some basic guidelines and tips for contractors investigating and resolving cyber intrusions so as to not become a victim of this cyber war.

II. Contractor Cyber Intrusions - Basic Guidelines

A. Prepare, Prepare, Prepare

Companies must have cybersecurity policies in place as part of their compliance programs. Such procedures should set forth specific requirements, protocols, instructions and penalties for non-compliance and should be reviewed at least annually. Employees, directors, and key consultants should be thoroughly trained in these IT security procedures. Preparation and response to the inevitable intrusion of a company’s secure data system begins with policies, preparation, training, and extends to prompt and sure-footed responses, some of which are outlined below.

B. First, Stop the Bleeding

Companies may respond differently to cyber intrusions. However, as stated above, firms handling any type of government data should have standard protocols in place to quickly respond to any data security breach and limit the window of vulnerability of the government’s data. Such protocols are often proscribed within the contract requirements or through applicable regulations. If not, contractors should prepare and circulate detailed incident response procedures internal information technology security teams, and ensure that company personnel are properly trained to take action to act immediately upon first notice of an intrusion.

C. Next, Sound the Alarm

In the commercial world, the stigma associated with cyber intrusions can be so damaging, that businesses may try to minimize, or even hide such incidents from public scrutiny. Many businesses fear that such publicity would affect their stock price, damage their reputation or brand, generate litigation, and also send a signal that its cybersecurity is ineffective. However, hiding security breaches is not an option for government contractors. Again, certain state and federal regulations expressly require formal notice when a firm learns of any type of breach into its network. Once a contractor provides the required notice to its

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agency customer, the agency may share this information with other federal entities which may lead to additional scrutiny of the contractor's security system and its contract compliance. Depending on the nature of the contract, and the data at risk, this may include various organizations, including, but not limited to the FBI, Defense Criminal Investigation Service ("DCIS"), Office of Inspector General ("OIG"), U.S. Secret Service, Special Investigations offices and the various military agencies.

D. Third, Cooperate & Investigate

While Federal investigations present various liability concerns, contractors often find it is in their best interest to cooperate in good-faith with the Government auditors and investigators to resolve these issues in a swift and effective manner, in strict accordance with their contractual obligations, and reduce the risk of prosecution. However, not all Government agencies view cyber intrusions in exactly the same way, or coordinate their investigations. This fact was highlighted in a recent Department of Justice ("DOJ") audit of the FBI-led, multi-agency task force known as the National Cyber Investigative Joint Task Force ("NCIJTF"). Published in April 2011, the DOJ Office of the Inspector General noted that sharing intelligence information between agencies was challenging, and the basis for withholding information was not always made clear to agency partner participants.¹³ This lack of coordination presents a challenge for contractors, since each agency has its own strategy, agenda and jurisdiction.

For instance, certain government agencies consider a data breach to be a criminal or contractual violation, exposing contractors to a menu of potential civil and criminal penalties and fines. To mitigate these enforcement risks, contractors may take drastic measures to remedy any cyber intrusions, including shutting down parts of their corporate network or adding additional IT security measures, possibly at the company's expense. As contractors work to remedy these issues government agencies may also deny the contractor access to federal networks until the breach has been resolved. In addition to the costs associated with investigation and remedial action, suspension of network access could endanger contract performance and subject contractors to future costly contract delay claims or negative performance ratings.

On the other hand, some government agencies approach data breaches as a national security issue, and may treat such intrusions as opportunities to gain valuable counter-intelligence about the latest cyber threats. Where the value of this cyber intelligence outweighs the risks of continued intrusion, government investigators could potentially direct a contractor to proceed with their activities and permit the continued intrusion, so that government intelligence officers can monitor it, or develop new security measures to defend against it. This situation may be especially relevant where contractors are working with classified data or using secure networks.

Based on these various, sometimes competing government agendas, contractors may find themselves in a Catch-22 as they consider how to report and remedy these data breach

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issues without exposing the firm to contract liability, criminal/civil investigations or enforcement actions. In such cases, contractors should maintain written communication with all government investigators and document any government technical direction and or legal action. Contractors should alert all government investigators regarding competing direction and request each government agency representative provide formal written guidance for how the contractor must proceed.

E. Manage Disclosure and Publicity

The threat of cyber intrusions looms large for any business, and this risk is compounded for government contractors. Negative publicity about cyber attacks can damage even an exceptional contractor's reputation across the government. However, contractors may legally be required to issue breach notifications both to the government, and to individuals whose data may have been compromised. By law, government personnel are prohibited from sharing proprietary and confidential contractor data outside the government. However, in some instances, the government may not treat a reported data breach as "confidential" contractor information. As part of its investigation and remedial action, investigators may share this fact with other federal agencies, or contractors. Such publicity can affect a firm's ability to compete for future government procurements or generate costly audits and inquiries on current contracts. To mitigate this risk, contractors should have a prepared press relations and media strategy to respond to public inquiries and questions from both commercial and government customers. Any public disclosure of a cyber incident should be closely reviewed by legal counsel.

III. Tips For Investigating Cyber Intrusions

A. No two cybersecurity incidents are alike, and thus, every contractor must develop its own, tailored investigation strategy and remedial actions. However, below are some basic guidelines that contractors may consider when faced with a cybersecurity breach.

1. Identify the Type of Breach: The type of response and investigation will largely be driven by the nature of the cyber breach. These incidents often fall into two broad categories: (1) attacks on network confidentiality, integrity and/or availability; and (2) data theft, fraud, and forgery. Contractors should ask themselves, did the incident/breach result from sub-standard corporate (internal) security, and/or contractual non-compliance; or was this an entirely new form of attack that the firm could never prepare-for, expect or prevent?

2. Identify What Data Was Compromised: After identifying the nature of the breach, contractors should work with their internal IT staff to identify what data was stolen, infected, accessed or altered due to the cyber intrusion. This is particularly critical for contractors responsible for classified data, since the loss of such data could trigger national security concerns.

3. Notify the Government: In business, timing is everything. In cybersecurity, notice is everything. This may be the hardest first step in handling a cybersecurity breach. Once a contractor has identified the type of breach, and the data at issue contractors must know who,

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what, when, where and how to notify their federal agency contacts. For this reason, contractors should examine their contracts for specific notice requirements, and also ensure compliance with the latest federal regulations on cybersecurity breach notification. The best policy is to discuss this issue with contracting officers prior to the occurrence of an intrusion to ascertain the government's expectation and concerns.

4. Preserve Evidence (Hardcopy and Electronic): As with many investigations, contractors should issue a "hold notice" to ensure that documents and digital data are preserved pending the investigation. This "hold" notice should go to the widest number of employees related to or involved with intruded data bases or systems. Preserving electronic data, and metadata is different from preserving tangible evidence and documents. Contractors without skilled IT personnel should enlist professional assistance to ensure that any malware or data involved in a breach is properly preserved for review. This preservation becomes especially challenging where contractors work from remote locations using personal IT hardware and software. Contractors must also be careful to ensure that post-breach remedial actions performed by IT personnel do not destroy, corrupt or alter electronic evidence.

5. Use Advanced Fact Gathering Techniques: Information technology often involves advanced computing systems, software and equipment. Therefore, contractors should ensure that trained, skilled personnel are used to properly gather and investigate the facts. This is also necessary to prevent the potential loss of data evidence.

6. Review the Government Contract(s) Affected: Depending on how data is stored and shared within the contractor's network, a single breach could affect data, software and hardware affecting multiple government contracts. Contractors should immediately identify the data security requirements in each of its federal contracts, and work to identify any areas of non-compliance.

7. Assess Potential Government Responses: In addition to triggering any number of agency investigations, government agencies may consider a cyber incidents as a basis for any number of government actions, including, but not limited to terminating the contract for default, requiring the contractor to implement system security upgrades at no cost to the government, filing claims against the contractor, and assigning the contractor a negative past performance rating.

8. Work With Subcontractors: Many prime contractors rely on subcontractors to perform critical contract requirements including IT-related tasks. Nevertheless, the prime remains responsible for contract performance. Thus, when entering a subcontract, prime contractors should carefully consider flowing-down key IT security clauses to ensure that the subcontractor complies with the latest federal IT security regulations and is fully cooperative if and when a prime contractor investigates a potential cyber incident. Prime contractors should also confer with their subcontractors prior to disclosing information from a potential security incident, to ensure the prime does not engage in unauthorized disclosure of the subcontractor's data. Such disclosures could potentially trigger a suit against the prime by its subcontractor.

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9. Review Prior Investigations (if any): Whenever possible, contractors should review past similar cybersecurity breaches and subsequent investigations as they may offer helpful “lessons learned” or provide strategic considerations. Such lessons are not exclusive to an individual company. Contractors may also consider reaching out to others within the industry who have experienced similar cyber incidents in order to draw upon other firms’ experiences.

10. Establish an Investigative Scope: A contractor’s IT network is only as strong as its weakest link, and IT networks can be compromised from a host of different sources. When investigating, contractors should work with their IT department to examine and investigate various sources of IT security risks cyber risks (e.g., remote employee access, connections to government or other contractor networks, shared servers, wireless communications, etc...).

11. Brief Company Officers/Managers on the Contract(s) Requirements and Risks: Communication is critical when conducting any internal investigation. Company managers must understand the respective contract(s) security requirements and understand the risks associated with a data breach. Assessing the requirements and risks may be best completed through a coordinated effort among IT specialists, contract experts and legal counsel.

12. Identify and Understand Goals/Agenda of Government Investigators: Cyber intrusions often trigger involvement by a variety of government agencies, each having its own role and agenda. The agency itself may be interested solely in the legal effect of contract non-compliance. At the same time other government investigators may consider such non-compliance as a potential false claim. Still other Government investigators may examine the breach to determine criminal liability. Finally, some Government investigators may become involved only to gather information regarding the cyber intrusion to develop protocols to prevent similar breaches. The scope of the Government’s involvement and inquiry may be detailed in a federal subpoena or audit letter. Conversely, government investigators may also take a far less disciplined approach. In such cases, a contractor should carefully document communications with the investigator(s) to ensure there is a record demonstrating the company’s efforts and continued cooperation with each Government investigator.

13. Establish an Investigation Plan and Set a Deadline: Following a cyber intrusion, the government may issue a subpoena or audit letter detailing issues subject to government review. This often serves as a roadmap for the investigation, and the timeline. However, even if the government has not launched an immediate formal inquiry, it can do so at a later date - either on its own, or following a potential whistleblower suit. Therefore, contractors should act swiftly and develop an internal investigation plan and set a date to review findings. These findings can then become the basis for any contractor remedial actions.

14. Coordinate and Manage Investigation Teams: Investigating cyber breaches can involve personnel at all levels, both inside and outside the company. This includes, IT support and technical staff, contracts personnel, attorneys and managers. To limit confusion and

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Contractor Cybersecurity Investigations (cont'd):

miscommunication, it is critical to coordinate these team efforts, possibly through the use of regularly scheduled team meetings.

15. Preserve the Privilege: Even when contractors work in good faith to investigate and remediate potential data security issues, they could potentially create a road map of emails and other documents, which in the hands of a government auditor or investigator, could potentially be damaging. Contractors should seek legal guidance for how to design its investigation and implement reasonable steps to preserve the privilege wherever possible.

16. Document the Investigation: As in any investigation, contractors are often advised not to generate many new “discoverable” documents that could serve as a roadmap to federal investigators. However, contractors should coordinate with their legal counsel to document the investigation and capture its results, under the protection of the legal privilege. This documentation should explain the reason for the investigation, identify personnel involved, show the chain of evidence, detail specific findings and conclusions and remedial actions. The report should contain only factual information and not speculate about anything or suggest motives.

17. Perform a Post-mortem and Train Personnel: Contractors should draw upon lessons learned from investigating and remedying security breach incidents and roll these lessons learned into future IT security planning, and corporate training.

IV. Conclusion

At a time when cyber intrusions have become as certain as death and taxes, government contractors should recognize the responsibilities and risks associated with securing government data. Faced with the inevitability of information security breaches, and the potential for increased scrutiny from a host of government agencies, a contractor’s best defense against these risks lies in having plans in place to react, respond and remediate these issues.

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Endnotes

1. 'Once more unto the breach!' - Taken from the 'Cry God for Harry, England, and Saint George!' speech of Shakespeare's Henry V, Act III, 1598.
2. Caitlin K. Cloonan is counsel in Arnold & Porter LLP's Government Contracts group.
3. See Matt Liebowitz, *2011 Set to Be Worst Year Ever for Security Breaches*, Security News Daily (June 9, 2011) <http://www.securitynewsdaily.com/2011-worst-year-ever-security-breaches-0857/>.
4. See Elizabeth Montalbano, *Anonymous Claims Hack On NATO Servers*, Information Week Government (July 21, 2011) <http://www.informationweek.com/news/government/security/231002316>.
5. See David Goldman, *Countries brace for The Code War*, CNN Money (August 4, 2011) http://money.cnn.com/2011/08/03/technology/cyber_attack/index.htm.
6. See Martin Bricketto, *McAfee Sounds Alarm Over Hacking Threats To Data*, Law 360 (August 3, 2011) http://www.law360.com/governmentcontracts/articles/262365utm_source=newsletter&utm_medium=email&utm_campaign=governmentcontracts.

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Contractor Cybersecurity Investigations (cont'd):

Endnotes (cont'd)

7. See n.6.
8. See "Fact Sheet: Cybersecurity Legislative Proposal." The White House (May 12, 2011) <http://www.whitehouse.gov/the-press-office/2011/05/12/fact-sheet-cybersecurity-legislative-proposal>.
9. See n.8.
10. DFARS Case 2011-D039, Proposed Rule, *Safeguarding Unclassified DOD Information*, 76 *Fed. Reg.* 36,089-95, (29 June 2011) (to be codified at 48 C.F.R. pts. 204, 252).
11. See n.10.
12. See Summary of State Security Breach Notification Laws, National Conference of State Legislatures (October 12, 2010) <http://www.ncsl.org/default.aspx?tabid=13489>.
13. See Matthew J. Schwartz, *FBI Defends Cyber Investigation Capabilities*, *InformationWeek* (May 3, 2011) <http://www.informationweek.com/news/security/government/229402636>.



Alleging Bias When Your Opponent Gets the Benefit of the Doubt: A Winning Protest Strategy Requires Access to All the Facts

by
*Oliya S. Zamaray**

I. Introduction

The Federal Acquisition Regulation ("FAR") requires that the Government's business be conducted "in a manner above reproach" and

except as authorized by statute or regulation, ***with complete impartiality and with preferential treatment for none***. Transactions relating to the expenditure of public funds require the highest degree of public trust and an impeccable standard of conduct.¹

But government officials, like everyone else, are not immune from the shortcomings of human nature. Bias, favoritism, and partiality sometimes play a role in a government official's decision-making. As a result, from time to time, bias is raised as a protest ground to challenge a contract award. But, when compared to the number of times biased is raised, protests alleging bias are rarely successful.² Why? And what can a contractor do to successfully protest a procurement action on grounds of bias?

To prevail on an allegation of bias, a contractor must prove that the Government acted in bad faith and without a reasonable basis.³ This is often difficult because a government contracts forum reviewing a protester's allegation of bias will be guided by the "well-established principle" that Government officials are presumed to act in good faith when executing their procurement functions.⁴ The difficulty of this burden is evidenced by the simple fact that one of the only recent cases in which the Government Accountability Office ("GAO") sustained a protest on grounds of bias was related to the 2005 Darleen Druyun scandal.⁵ In that case, a senior procurement official actually acknowledged her bias in favor of the Boeing Company.⁶ Additionally, she had been previously indicted for her improper conduct.⁷ Showing bias in that case was made relatively straight-forward once it was shown that Darleen Druyun had a material financial interest in "steering" contracts.⁸ GAO has long "recognized that an actual or apparent conflict of interest may arise when an agency employee has both an official role in the procurement process and a personal stake in the outcome."⁹ But what about instances where there is no immediately apparent personal financial stake in the outcome of a government action? Must a contractor tolerate blatant favoritism and bias in the procurement process?

To successfully litigate a protest based on bias, a contractor must diligently review all of the facts, make important tactical decisions, and have access through discovery to relevant government documents that either verify or refute the contractor's assertions. This article provides an overview of the state of the law with regard bias as established by GAO, the U.S. Court of Federal Claims ("COFC"), and the U.S. Court of Appeals for the Federal Circuit ("Federal Circuit"). It reviews the challenges a protester faces in alleging bias and the steps it

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Alleging Bias (cont'd):

must take to overcome the legal hurdles which often favor the Government. This article highlights the particular importance of discovery and the benefits of a full administrative record afforded by the COFC. In the same vein, this article recognizes the shortcomings of GAO's document production rules and practices in facilitating GAO's oversight function in relation to bias. The article concludes that it is good policy to allow contractors to challenge the presumption of good faith afforded to government officials, lest it become an Orwellian premise that slowly, but surely, undermines the integrity of the procurement system.

II. Overcoming the "Presumption of Good Faith" Afforded to the Government

A. High Evidentiary Burden

Because a strong presumption of good faith is afforded to the Government, government contracts fora are often reluctant to find the absence of good faith. In fact, for nearly six decades, the Federal Circuit and its predecessor have repeatedly held that the court is "loath to find to the contrary of good faith" on the part of government officials.¹⁰ Therefore, "it takes, and should take, well-nigh irrefragable proof" to induce the court to do so.¹¹ Thus, clear and convincing evidence is required to rebut the presumption of governmental regularity¹² and induce a court to find the absence of good faith on behalf of the Government.¹³ The high evidentiary burden imposed upon contractors appearing before GAO not only requires credible evidence of bias based on hard facts, contractors must also prove that the government official in question had specific intent to harm the protester and took prejudicial action which caused the protester to suffer competitive harm.¹⁴

1. "Hard Facts," Not Inferences, Suspicion, Supposition or Innuendo

Allegations of bad faith must be based on hard facts.¹⁵ Because Government officials are presumed to act in good faith, a reviewing forum - whether GAO or a court - will not attribute unfair or prejudicial motives to procurement officials on the basis of inference or supposition.¹⁶ The Federal Circuit has long held that suspicion and innuendo, and the possibility and appearance of impropriety, without "hard facts" inferring actual misconduct, provide an inadequate basis for withholding award.¹⁷ Such allegations must be supported by convincing proof.¹⁸ As demonstrated by GAO's reasoning, the contractor in JWK International Corporation failed to meet its burden:

We have reviewed the record and find no credible evidence of bias or bad faith on the part of the contracting specialist or any other agency officials. In this regard, we note that *the agency report includes detailed explanations and declarations in response to the protester's claims of bias*. In contrast, *JWK*, while claiming in its pleadings that certain agency actions evidence bias, *has failed to provide any statement, declaration, or any other evidence in support of this aspect of its protest*.¹⁹

As discussed in greater detail below, to support an allegation of bias, a protester before GAO must also present virtually irrefutable evidence that the contracting agency directed its actions with the specific and malicious intent to injure the protester.²⁰

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2. Show Government Official Had "Specific Intent" to Injure Plaintiff

As part of the heavy evidentiary burden, a contractor must offer evidence which shows that the allegedly biased government official had specific intent to injure the contractor.²¹ GAO has made clear that:

In order for a protester to succeed in a claim of bias on the part of a contracting official, the record must ***establish that the official intended to harm the protester***, since government officials are presumed to act in good faith; our Office will not attribute unfair or prejudicial motives to procurement officials on the basis of inference or supposition.²²

The types of government conduct which have been deemed to rise to the level of specific intent to injure the plaintiff vary based on the facts of each case. Actions "motivated alone by malice"²³ or "actuated by animus toward the plaintiff"²⁴ have been held to rise to the level of specific intent to injure the plaintiff. Bias, as evidenced by hostility²⁵ and by specific intent to injure, have also been found where Government conduct was "designedly oppressive."²⁶ Similarly, bias has been found where a Government official conducted himself in a manner that "initiated a conspiracy" to "get rid" of a contractor.²⁷ A reviewing forum will also find bias where the Government enters a contract "with no intention of fulfilling its promises"²⁸ or where the "subjective bad faith" of a procurement officer deprives "a bidder of the fair and honest consideration" of its proposal.²⁹

B. Bias Translates Into Action Which Unfairly Affects Protester's Competitive Position

Competitive prejudice is a fundamental element of a protest action, whether before GAO or a court. The Federal Circuit has held that to prevail in a protest, "the protester must show not only a significant error in the procurement process, but also that the error prejudiced it."³⁰ To establish prejudice, the Federal Circuit requires a protester to show that, but for the alleged error in the procurement process, "there was a reasonable likelihood that the protestor would have been awarded the contract."³¹ Similarly, GAO has held that:

Competitive prejudice is an essential element of a viable protest; where the protester fails to demonstrate that, but for the agency actions, it would have had a substantial chance of receiving the award, there is no basis for finding prejudice, and our Office will not sustain the protest.³²

Even where a protester produces credible evidence of bias, a reviewing forum will sustain a protest alleging bias only where the protester also demonstrates that the agency bias translated into action that unfairly affected the protester's competitive position.³³ Therefore, a protester must not only show that a government official specifically intended to harm the protester,³⁴ it must also demonstrate that the allegedly biased official exerted improper influence in the procurement on behalf of the awardee or against the protester.³⁵ Where a protester fails to

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allege, let alone provide evidence of, any specific acts that were intended to harm the protester, much less resulted in competitive harm, GAO will find no basis to support the contractor's protest in this regard.³⁶

C. Once Bias is Established, Government Can Argue Protester was Not Prejudiced

Once the existence of bias is established, the Government may present evidence to show that the protester was not prejudiced by the Government's actions.³⁷ In the now infamous 2005 Lockheed Martin protest involving Darleen Druyun, GAO stated:

where, as here, the record establishes that a procurement official was biased in favor of one offeror, and was a significant participant in agency activities that culminated in the decisions forming the basis for protest, ***we believe that the need to maintain the integrity of the procurement process requires that we sustain the protest unless there is compelling evidence that the protester was not prejudiced.***³⁸

Even where evidence of bias is present, GAO may deny the protest if the Government is able to show that the protester suffered no competitive prejudice as a result of the official's bias.

III. Demonstrating Bias Requires Access to All the Facts

Considering the high evidentiary burden the law imposes on contractors, demonstrating bias requires nothing short of a complete record. Because of material differences in the nature and content of the administrative record developed at GAO and the COFC, a prudent contractor with a protest ground rooted in bias must give serious consideration to forum selection. Depending on the facts and circumstances of a specific protest, the COFC's potentially more robust administrative record may offer advantages to a protester seeking to meet the high evidentiary burden associated with proving agency bias.³⁹

A. GAO: The Agency Report and Document Production

While providing basic record-development mechanisms, GAO regulations do not come close to requiring the type of broad discovery mandated by the rules of the COFC. Depositions, interrogatories, and requests for admission are neither required nor expressly permitted, and hearings are held only infrequently.⁴⁰ GAO regulations require the procuring agency to file a report⁴¹ with GAO within thirty days after the notice of protest from GAO.⁴² The authorizing statute and GAO's bid protest regulations contain a seemingly straight-forward standard as to what is to be included in a GAO bid protest record: "all relevant documents."⁴³ In practice, however, the procuring agency is given notable leeway in determining the scope of document production. In the first place, the agency report "need not contain documents which the agency has previously furnished or otherwise made available to the parties in response to the protest."⁴⁴ If the protester has filed a request for specific documents, the agency will respond to the request in writing at least five days prior to the filing of the report to identify:

- Whether the requested documents *exist*;

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Alleging Bias (cont'd):

- Which of the requested documents or portions thereof the *agency intends to produce*;
 - Which of the requested documents or portions thereof the *agency intends to withhold*;
- and
- The *basis for not producing any of the requested documents* or portions thereof.⁴⁵

Notably, any objections to "the scope of the agency's proposed disclosure or nondisclosure of documents" must be filed with GAO and the other parties within two days of receipt of the agency's list.⁴⁶ After receipt of the agency report, a protester may request that additional documents be produced - but no later than "2 days after their existence or relevance is known or should have been known, whichever is earlier."⁴⁷ Upon receiving the protester's document request, GAO will determine whether the procuring agency must provide any withheld documents.⁴⁸ The agency must then provide the requested documents, *or portions of documents*, within two days *or explain why it is not required to produce the documents*.⁴⁹

In practice, protesters before GAO are often challenged by a comparatively sparse record, consisting of an agency report that is the representation of the agency's decisions with regard to the existence of key documents, their relevance, and even the difficulty of production. In practice, challenges to document production are (and should be) made, but are often hard-fought battles that may or may not result in the production of important information. To be fair, GAO bid protest rules require the inclusion of some extra-record information, such as the contracting officer's statement in response to the protester's contentions.⁵⁰ However, GAO is often hesitant to require an agency to produce internal email and other communications between government personnel involved in a procurement, even though access to such documents would be the critical source of evidence necessary to either confirm or rebut the presumption of "good faith." Instead, GAO sometimes permits agencies to defend allegations of bias with conclusory (and arguably self-serving) declarations from agency personnel involved in a procurement. GAO's protest decisions do not reflect a practice of allowing the protester regular access to the internal contemporaneous agency communications that could confirm or undermine an agency's after-the-fact sweeping denial of impure motives.⁵¹ Such a lack of transparency in GAO's document production practices can leave a protester in a difficult position when facing the high evidentiary burden in a protest alleging bias. Without access to such documents, the presumption of "good faith" can become a self-fulfilling prophesy.⁵²

B. The U.S. Court of Federal Claims (COFC)

The COFC is charged with deciding bid protests in accordance with the "arbitrary and capricious" standard articulated in the Administrative Procedures Act,⁵³ and the court's discovery process reflects this duty. Appendix C of the Court's rules requires the United States to file "the administrative record in a protest"⁵⁴ and provides guidance on the type of "core documents" that may be appropriate for inclusion in the administrative record.⁵⁵ Coupled with the Court's discovery and supplementation of record mechanisms, this forum provides certain advantages to a protester with a bias allegation. Unlike GAO, the COFC has acknowledged the importance of providing a protester with a mechanism to gain access to relevant internal

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Alleging Bias (cont'd):

documents outside the evaluation record that are probative of the protester's assertions of bias. In order to gain access to such documents through discovery, the COFC requires merely that the protester set forth a "strong showing" (rather than the higher standard of "clear and convincing evidence") of bad faith or improper behavior to move the court to supplement the record.

1. Discovery

The rules of the COFC offer a plaintiff-protester the full range of discovery rights:

Parties may obtain discovery regarding any nonprivileged matter that is relevant to any party's claim or defense - including the existence, description, nature, custody, condition, and location of any documents or other tangible things and the identity and location of persons who know of any discoverable matter. For good cause, the court may order discovery of any matter relevant to the subject matter involved in the action. ***Relevant information need not be admissible at the trial if the discovery appears reasonably calculated to lead to the discovery of admissible evidence.***⁵⁶

Furthermore, Rule 37 of the Court's rules provides for the imposition of sanctions for a party's failure to make disclosures or cooperate in discovery.⁵⁷ This rule empowers the presiding judge to exercise a range of sanctions in accordance with the type and severity of the misconduct. Failure to cooperate includes failure to (1) answer interrogatories; (2) respond to deposition questions; (3) respond to proper requests for admissions; (4) produce documents; and (5) participate in the formulation of a discovery plan.⁵⁸

In practice, the Court's procedures leave no room for agency discretion because *any nonprivileged, relevant information is discoverable*. Furthermore, information need only be "reasonably calculated to lead to the discovery of admissible evidence."⁵⁹ In practice, this results in a thorough discovery process and a robust administrative record. Thus, compared to GAO, a contractor seeking to protest a procurement action on grounds of bias (facing the corresponding high evidentiary burden) is better positioned at the COFC, where it has the benefit of the discovery process.

2. Supplementing the Administrative Record in Court

A party seeking to obtain discovery based on allegations of bad faith must "persuade the court that discovery could lead to evidence that would provide the level of proof sufficient to overcome the presumption of regularity and good faith."⁶⁰ However, protesters alleging bias on the part of a Government official need not lose hope if the record appears, at first glance, to be lacking sufficient evidentiary support.

[W]hile a protester must establish clear and convincing evidence of bad faith or bias to prevail on the merits, a lesser showing suffices to warrant supplementation of the administrative record - that the allegations appear to be sufficiently well grounded.⁶¹

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In 2010, the COFC acknowledged the practical importance of access to relevant information outside the administrative record in rebutting the presumption of good faith:

To be sure, *the requisite clear and convincing evidence need not reside within the four corners of the administrative record*; such a requirement would turn the presumption of good faith into a foregone conclusion, save against "officials who are both sinister *and* stupid."⁶²

One of the basic reasons an existing record may be insufficient is that it is missing "relevant information that by its very nature would not be found in an agency record" such as "information relied upon but omitted from the paper record, or the content of conversations."⁶³ In a 2010 post-award bid protest,⁶⁴ the COFC acknowledged that:

Where bias is alleged, the administrative record frequently will not be complete or suffice to prove or disprove the allegation. Consequently, *to address bias, the court will entertain extrarecord evidence and permit discovery when there has been a "strong showing of bad faith or improper behavior" such that without discovery the administrative record cannot be trusted.* The strong showing must have an evidentiary foundation and not rest merely on counsel's argument, suspicion, or conjecture.⁶⁵

Thus, unlike GAO, the COFC appears to have struck a balance that provides increased transparency to protesters in cases that warrant enhanced scrutiny (*i.e.*, where the protester can make at least a "strong showing" of bias, if not supply clear and convincing evidence, in its initial pleadings) while still precluding protesters from engaging in fishing expeditions where their initial allegations of bias lack any factual support. GAO would strengthen its oversight function if it developed a similar mechanism to guarantee protesters access to contemporaneous internal agency communications and other relevant information exchanges in appropriate cases. The COFC's procedure would be an improvement over GAO's current rules and practices in bias cases.

C. COFC Practice Pointers

A protester at the COFC has an established procedural mechanism to obtain discovery relevant to allegations of bias in a procurement and, if such information is produced, to supplement the administrative record. While the COFC has traditionally considered extra-record evidence in assessing alleged bias or bad faith,⁶⁶ a protester must use care to supplement its complaint with documents and witness statements supporting the alleged bias to satisfy the "strong showing" standard required to obtain the requested discovery.⁶⁷ Because the "intrinsic unreliability of innuendo, inference and hearsay is enough ... to sink plaintiff,"⁶⁸ a protester must offer cogent reasons for its assertions, supported by declarations from individuals with personal involvement in critical events.⁶⁹ This becomes particularly important

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where the procuring agency has provided for its decision a reasonable explanation, borne out by an administrative record that otherwise appears complete. In such instance, the proffered extra-record material must indicate some personal animus or bias on the part of agency officials, reveal a latent inconsistency in the existing record, or otherwise give some indication that the agency's explanation is pretextual. Absent this threshold showing, a plaintiff's bare allegations of bad faith are insufficient to place the issue or the proffered extra-record evidence before the court.⁷⁰

To support its request to supplement the administrative record, a contractor may proffer personal observations or knowledge (not hearsay), which is corroborated, balanced (not purely self-serving) and substantive (not based on mere inference). In a 2011 case before the COFC, a protester submitted extra-record material which indicated personal animus or bias on the part of the agency official involved in the procurement process.⁷¹ The evidence consisted of testimony of employees and officers who allegedly witnessed an agency official claiming, while bids were still being evaluated, that the bid protestor was going to lose the bid or that a competing bidder was going to win the bid, and otherwise acting in a manner to vex the protestor or assist the competing bidder.⁷² In consideration of the evidence to be supplied, the Court held that supplementation of administrative record was warranted.⁷³

Allowing for deposition testimony of the contracting officer or other government officials, where appropriate, may also "enable the court to satisfy its statutory duty to give due regard to the need for expeditious resolution of the action."⁷⁴ This is particularly useful in instances where supplementation will make clear the motives of the decision makers and helps the court determine whether a purported rational basis was merely a pretext for agency bias.

IV. Conclusion

At the heart of the American governance apparatus is the notion that government is most responsive and efficient when powers are separated and subjected to checks and balances that include review by other branches. Alexander Hamilton wrote in the Federalist Papers that the separation of powers is a "powerful means, by which the excellencies of republican government may be retained and its imperfections lessened or avoided."⁷⁵ In his 1796 farewell address, George Washington defended a system of checks and balances as an important means of preventing the arbitrary exercise of power. He cautioned those entrusted with the administration of government "to confine themselves within their respective constitutional spheres, avoiding in the exercise of the powers of one department to encroach upon another."⁷⁶ Washington explained:

The spirit of encroachment tends to consolidate the powers of all the departments in one, and thus to create, whatever the form of government, a real despotism. *A just estimate of that love of power, and proneness to abuse it, which predominates in the human heart, is sufficient to satisfy*

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*us of the truth of this position. The necessity of reciprocal checks in the exercise of political power, by dividing and distributing it into different depositaries, and constituting each the guardian of the public weal against invasions by the others, has been evinced by experiments ancient and modern; some of them in our country and under our own eyes. To preserve them must be as necessary as to institute them.*⁷⁷

The notion that government is most responsive and efficient when it is subjected to checks and balances necessarily extends to executive branch agencies exercising their procurement powers. As a result, current federal procurement law imposes a robust network of checks and balances on the procurement authority of the executive agencies. In fact, in February of 2008, Michael R. Golden, GAO Managing Associate General Counsel, described the GAO protest process as an important part of the "checks and balances" of the procurement system.⁷⁸ However, to operate effectively, a system of checks and balances depends on procedures that allow for transparency – mechanisms that place the relevant information in the hands of the decision-maker. The protest processes at GAO and the COFC assign this responsibility to the *protester*. It is the protester's function to identify protest issues and compile and present the information in support of these issues. GAO and COFC do not conduct an independent review of procurements. Thus, unless GAO's and COFC's procedures for bid protest cases provide access to relevant information to the protester, the efficacy of the protest process in detecting violations and other unreasonable conduct is diminished.

The procurement process currently imposes presumptions, burdens, and procedures against protesters who seek to allege bias on the part of federal agencies; these obstacles hinder effective oversight by GAO and the COFC. The legal presumption that federal procurement personnel always act in good faith combined with the protester's burden of rebutting this presumption by meeting a high evidentiary burden means that, unless a protester has a way to gain access to relevant information, the GAO and COFC protest processes will sometimes fail to detect bias when it occurs. Currently, GAO's rules and practices do not include a mechanism by which a protester can reliably gain access to relevant contemporaneous internal agency communication that would either confirm or rebut the presumption of "good faith." Comparatively, the COFC offers a mechanism by which a protester can obtain discovery of this information if it merely makes a "strong showing" of bias (compared to the higher "clear and convincing" evidence standard). In deciding where to protest, a protester asserting that a contract award was improperly influenced by bias must weigh the different ways that GAO and the COFC handle discovery of bias-related information.

Given that GAO's bid protest function serves as an important check on the exercise of procurement power by executive branch agencies, GAO should review its current rules and practices. GAO should consider the practical realities imposed by the current "good faith" presumption and high evidentiary burden and recognize that, without reliable access to relevant

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internal documents, protesters (and GAO) will be unable to detect and correct incidents of bias in federal procurement. Both GAO and the COFC should continue to ensure that their procedures provide a protester with a fair opportunity to rebut the presumption of good faith in appropriate cases. By applying effective procedures to review bias allegations, GAO and the COFC can promote confidence that the good faith of federal procurement personnel in awarding contracts remains worthy of a presumption.

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Endnotes

1. FAR 3.101-1. "While many Federal laws and regulations place restrictions on the actions of Government personnel, their official conduct must, in addition, be such that they would have no reluctance to make a full public disclosure of their actions." Id.
2. Between 2010 and 2011, the Government Accountability Office ("GAO") published numerous bid protest decisions where at least one of the protest grounds was an allegation of bias. Contractors consistently failed to meet their evidentiary burden in proving bias. See, e.g., Sygnetics, Inc., B-405138.3, et al., 2011 WL 3726258 (Comp. Gen. Aug 22, 2011) (finding record does not support allegation that agency was biased against the protester); Ahtna Facility Services, Inc., B-404913.2, et al., 2011 WL 2827476 (Comp. Gen. Jun 30, 2011) (stating GAO will not consider allegations of bias "based on mere inference, supposition, or unsupported speculation"); Ohana Industries, Ltd., B-404941, 2011 WL 2578856 (Comp. Gen. Jun 27, 2011) (finding Ohana failed to provide credible evidence demonstrating bias against the protester or in favor of the awardee and failed to show how this bias translated into competitive prejudice); Celeris Systems, Inc., B-404651, 2011 WL 1099339 (Comp. Gen. Mar 24, 2011) (denying protest where bias allegation was investigated by the agency and no evidence of improper government action was found); East West, Inc., B-400325.8, et al., 2010 WL 3229455 (Comp. Gen. Aug 6, 2010) (failing to see how facts protester alleged in any way establish bias on the part of agency officials in the source selection process).
3. Dr. Robert J. Telepak, B-247681, 1992 WL 156662 (Comp. Gen. June 29, 1992) (finding that while personal animus may have supplied part of agency's motivation to cancel RFP, where agency's action also had a reasonable basis, protest will be denied).
4. Aero Corp. v. United States, 38 Fed. Cl. 408, 413 (1997); see also Caldwell & Santmyer, Inc. v. Glickman, 55 F.3d 1578, 1581 (Fed. Cir. 1995) ("We assume the government acts in good faith when contracting").
5. Lockheed Martin Corp., B-295402, 2005 WL 433641 (Comp. Gen. Feb. 18, 2005).
6. Id.
7. Id.
8. Id.
9. Celadon Laboratories, Inc., B-298533, 2006 WL 3154971 (Comp. Gen. Nov. 1, 2006). See also Chenega Management, LLC v. United States, 96 Fed. Cl. 556, 583-84 (2010) (requiring, for a conflict of interest, that a nexus exist between the government official's interests and the transaction at issue). In Galen Med. Assocs., Inc. v. United States, 369 F.3d 1324, 1338 (Fed. Cir. 2004), the U.S. Court of Appeals for the Federal Circuit ("Federal Circuit") noted that an appearance of bias can exist where plaintiff demonstrates that the government

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Endnotes (cont'd)

official accused of being biased had "some stake in the outcome of the government action influenced by that individual" or where there is the potential for a "symbiotic relationship" between the awardee and the government official. *Id.* at 1336.

10. *Am-Pro Protective Agency, Inc. v. United States*, 281 F.3d 1234, 1239 (Fed. Cir. 2002). *See also* *Torncello v. United States*, 681 F.2d 756, 770 (Ct. Cl. 1982) ("It requires 'well-nigh irrefragable proof' to induce the court to abandon the presumption of good faith dealing" traditionally afforded to the Government).

11. *Cybertech Group, Inc. v. United States*, 48 Fed. Cl. 638, 651 (2001).

12. *See Galen Med. Assocs., Inc.*, 369 F.3d at 1330; *Am-Pro Protective Agency, Inc.*, 281 F.3d at 1239-40.

13. *Madison Servs., Inc. v. United States*, 92 Fed. Cl. 120, 129 (2010) (requiring plaintiff's allegations of bad faith to rest upon "clear and convincing evidence.")

14. *See, e.g., Alanna Orr*, B-310966.2, 2008 WL 2077928, at *3 (Comp. Gen. May 14, 2008); *Crescent Helicopters*, B-283469.2, 1999 WL 1079805, at *4 (Comp. Gen. Nov. 30, 1999)

15. *Saturn Landscape Plus, Inc.*, B-297450.3, 2006 WL 1028419, at *2 (Comp. Gen. April 18, 2006); *Int'l Res. Recovery, Inc. v. United States*, 61 Fed. Cl. 38, 43 (2004).

16. *RONCO Consulting Corp.*, B-280113, 1998 WL 469702, at *4 (Comp. Gen. Aug. 11, 1998). *Crescent Helicopters*, B-283469.2, 1999 WL 1079805, at *4 (Comp. Gen. Nov. 30, 1999) ("because government officials are presumed to act in good faith, we do not attribute unfair or prejudicial motives to them on the basis of inference or supposition.")

17. *CACI, Inc.-Federal v. United States*, 719 F.2d 1567 (Fed. Cir. 1983). In *CACI*, four of the five members of the Technical Evaluation Committee had some prior social or professional relationship with the vice president of the awardee. *Id.* at 1570. The U.S. Court of Federal Claims ("COFC") enjoined the award in part on the ground that those relationships created a sufficient opportunity for and appearance of impropriety. *Id.* at 1581-82. The Federal Circuit reversed, finding that a review of the record revealed that COFC "ascribed evil motives to [the] four members of the Technical Evaluation Committee in their handling of bids" without "hard facts" supportive of any actual or potential wrongdoing. *See id.* at 1582.

18. *Alanna Orr*, B-310966.2, 2008 WL 2077928, at *3 (Comp. Gen. May 14, 2008).

19. *JWK International Corporation*, B-296969.3, 2006 WL 133963, at *2 (Comp. Gen. Jan. 5, 2006). *See also* *Done Right Building Services, Inc.*, B-310568, 2007 WL 4928306 (Comp. Gen. Dec. 17, 2007 (GAO finds no credible evidence of bias or bad faith where a former employee, who left under "troubling circumstances," subsequently served as a member of the technical evaluation panel) (internal citations omitted); *PAI Corporation*, B-298349, 2006 WL 2494736 (Comp. Gen. Aug. 18, 2006) (denying protest alleging that agency was biased against the protester, where record contains no evidence of bias).

20. *GFS Group, LLC*, B-401560.2, 2009 WL 3215302, at *3 (Comp. Gen. Sept. 14, 2009) (claim that contracting officials were motivated by bad faith or bias must be supported by convincing proof). *But see Tech Sys., Inc. v. United States*, 98 Fed. Cl. 228, 266 (2011) (finding that protester's allegation that agency's "deplorable evaluations" could only be explained by bias and animus was not proven by clear and convincing evidence, even after supplementation of the record).

21. *Slattery v. United States*, 46 Fed. Cl. 402, 405 (2000) (finding that presumption of good faith may be reversed only with "irrefragable proof" of animus or specific intent to injure the plaintiff); *Madison Servs., Inc.*, 92 Fed. Cl. at 129 (noting that this is a difficult standard of proof to satisfy, one that the Federal Circuit has equated with evidence of some specific intent to injure the plaintiff). *See also Galen Med. Assocs., Inc.*, 369 F.3d at 1330; *Caldwell & Santmyer, Inc. v. Glickman*, 55 F.3d 1578, 1581 (Fed. Cir. 1995).

22. *AllWorld Language Consultants, Inc.*, B-291409.3, 2003 WL 245597, at *2 (Comp. Gen. Jan. 28, 2003).

23. *Gadsden v. United States*, 78 F. Supp. 126, 127 (1948) (a malicious employment discharge case).

24. *Kalvar Corp. v. United States*, 543 F.2d 1298, 1302 (Ct. Cl. 1976) (finding that Kalvar made an insufficient showing of malicious intent or "animus" toward it in order to avoid the limitations of the termination-for-convenience clause).

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Alleging Bias (cont'd):

Endnotes (cont'd)

25. Hubbard v. United States, 52 Fed. Cl. 192, 196 (2002) (finding bad faith based upon evidence indicating hostility and intent to injure contractor).
26. Struck Const. Co. v. United States, 96 Ct. Cl. 186, 222 (1942).
27. Knotts v. United States, 121 F. Supp. 630, 636 (Ct. Cl. 1954) (finding government bad faith based solely on circumstantial evidence).
28. Krygoski Constr. Co. v. United States, 94 F.3d 1537, 1545 (Fed. Cir. 1996).
29. E.W. Bliss Co. v. United States, 77 F.3d 445, 447 (Fed. Cir. 1996).
30. See Data Gen. Corp. v. Johnson, 78 F.3d 1556, 1562 (Fed. Cir. 1996).
31. Data Gen. Corp., 78 F.3d at 1563; see also Four Points by Sheraton v. United States, 63 Fed. Cl. 341 (2005).
32. Myers Investigative and Sec. Servs., Inc., B-286971.2, et al., 2001 WL 322776, at *3 (Comp. Gen. Apr. 2, 2001).
33. See, e.g., Millar Elevator Servs. Co., B-284870.5, et al., 2001 WL 173921, at *4 (Comp. Gen. Jan 31, 2001) ("we will sustain a protest allegation of bias only where the protester produces credible evidence of bias and demonstrates that the agency bias translated into action that unfairly affected the protester's competitive position"); AllWorld Language Consultants, Inc., B-291409.3, 2003 WL 245597, at *2 (Comp. Gen. Jan. 28, 2003) ("Again, in order to succeed in a claim of agency bias, the protester must show that any agency bias translated into action that unfairly affected the protester's competitive position").
34. R. L. Sockey Real Estate & Constr., Inc., B-286086, 2000 WL 1721654, at *4 (Comp. Gen. Nov. 17, 2000). See also Morris v. United States, 39 Fed. Cl. 7, 15 (1997) (requiring plaintiff to present clear and strong proof of specific acts of bad faith demonstrating that a Government official acted with malice or a specific intent to injure the plaintiff).
35. R. L. Sockey Real Estate & Constr., Inc., B-286086, 2000 WL 1721654, at *4 (Comp. Gen. Nov. 17, 2000).
36. Id.
37. Lockheed Martin Corp., B-295402, 2005 WL 433641, *4 (Comp. Gen. Feb. 18, 2005).
38. Id. at *4.
39. This article is not meant to be a comprehensive comparison of the discovery procedures and record-development mechanisms available to protesters at GAO and COFC. The author seeks principally to encourage contractors to consider the advantages of the potentially more robust record-development process available at COFC as compared to GAO.
40. In The Boeing Co., B-311344, et al., 2008 WL 2514171 (Comp. Gen. June 18, 2008), GAO distinguished between its discovery mechanism, which contemplates the production of "relevant" documents, and the Federal Rules of Civil Procedure, which enable litigants to discover documents reasonably calculated to lead to the discovery of admissible evidence. GAO wrote:

Our document production rules are much narrower than other federal discovery rules, such as the Federal Rules of Civil Procedure (FRCP), which permits litigants to seek the existence of documents that are reasonably calculated to lead to the discovery of admissible evidence. See, e.g., FRCP Rule 26(b)(1). In contrast, our regulations provide for the production of relevant documents. See 4 C.F.R. sect. 21.3(d).
- Id. at *46 n. 38. In The Boeing Co., GAO also denied the agency's "reverse discovery" request, noting that GAO's regulations do not contemplate such document requests.
41. The "agency report" consists of documents that the procuring agency is required to file with GAO in response to a protest. 31 U.S.C. §3553(b)(2); 4 C.F.R. §21.3(d).
42. 4 C.F.R. §21.3(c).
43. 31 U.S.C. §3553(b)(2); 4 C.F.R. §21.3(d).
44. 4 C.F.R. §21.3(c).
45. Id.
46. Id.

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Alleging Bias (cont'd):

Endnotes (cont'd)

47. 4 C.F.R. §21.3(g).
48. 4 C.F.R. §21.3(h).
49. 4 C.F.R. §21.3(g).
50. See 4 C.F.R. §21.3(d).
51. See, e.g., Chicataw Constr., Inc., B-289592.2, et al., 2002 WL 450054 (Comp. Gen. March 20, 2002). In Chicataw Construction, Inc., GAO acknowledged, without criticism, the agency's production of less than the entire evaluation record, writing in relevant part that "several of the protester's allegations that this evaluation was irrational are based on an admittedly incomplete explanation of the agency's actions." Id. at *5. In The Community Partnership LLC, B-286844, 2001 WL 195342 (Comp. Gen. Feb. 13, 2001), a protester challenging the Government's proposal evaluations argued that the individual evaluators' disposal of earlier iterations of individual evaluation materials had a material impact on the substance of the protest record. GAO found that the record, as a whole, supported the agency's evaluation conclusions. GAO also noted that individual evaluator worksheets may or may not have been necessary to determine the reasonableness of the agency's evaluation. In Textron Marine Sys., B-243693, 1991 WL 165241 (Comp. Gen. Aug. 19, 1991), the protester requested that GAO draw a negative inference from the Government's failure to produce documents the protester believed existed based on certain requirements in the source selection plan. GAO declined to draw a negative inference, finding that the agency made a good faith representation that all documents had been produced.
52. See, e.g., Intercon Assocs., Inc.-Costs, 2006 WL 1653384 (Comp. Gen. June 14, 2006). GAO's decision in Intercon Assocs. included a short discussion of discovery in the context of a bias allegation. Id. at *1. The protester initially objected to the scope of the agency's document production. While the protester's request was pending, the agency awarded the contract to a third concern, rendering the protester's bias allegation academic. The agency was able to circumvent entirely any additional document production in connection with the protester's bias allegation. GAO found that because the underlying protest ground had become academic, further production was not necessary.
53. 5 U.S.C. §706(2)(A). See 28 U.S.C. §1491(b)(4).
54. As compared to GAO's "agency report," the Court's "administrative record" consists of materials that the United States is required to file with the Court in response to a protest. Ct. Fed. Cl. R., App. C, provision 21.
55. Ct. Fed. Cl. R., App. C, provision 22. It is also important to note that when a protest is filed at GAO and then a subsequent protest concerning the same procurement is filed at the COFC, the COFC is required to include in its protest record the agency report filed with GAO as well as GAO's recommendation. 31 U.S.C. §3556.
56. Ct. Fed. Cl. R. 26(b)(1).
57. Ct. Fed. Cl. R. 37.
58. Ct. Fed. Cl. R. 37(b)-(f).
59. Ct. Fed. Cl. R. 26(b)(1).
60. Beta Analytics Int'l, Inc. v. United States, 61 Fed. Cl. 223, 226 (2004).
61. L-3 Commc'ns Integrated Sys., L.P. v. United States, 98 Fed. Cl. 45, 50 (2011) (internal quotations omitted). See also Pitney Bowes Gov't Solutions, Inc. v. United States, 93 Fed. Cl. 327, 332 (2010) ("The test for supplementation is whether there are sufficient well-grounded allegations of bias to support an inquiry and supplementation; the protesting plaintiff need not make a showing of clear and convincing evidence of bias on the merits.").
62. Madison Servs., Inc., 92 Fed. Cl. at 129 (quoting Beta Analytics Int'l, Inc., 61 Fed. Cl. at 226) (emphasis in original).
63. Tech Sys., Inc. v. United States, 97 Fed. Cl. 262, 265 (2011) (quoting Orion Int'l Techs. v. United States, 60 Fed. Cl. 338, 343-44 (2004)).
64. Pitney Bowes Gov't Solutions, Inc. v. U.S. and Stanley Assoc., Inc., 94 Fed. Cl. 1 (2010).
65. Id. (internal citations omitted). In Pitney Bowes, the Court found that the incumbent contractor's allegations of bias in favor of awardee (whose subcontractor had personal relationship with the chairperson of the technical evaluation panel) were sufficiently well grounded to warrant limited discovery and supplementation of administrative record with deposition testimony.

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Alleging Bias (cont'd):

Endnotes (cont'd)

66. See Int'l Res. Recovery, Inc., 61 Fed. Cl. at 43 ("allegations of bad faith must be based on hard facts in order to justify discovery and supplementation of the administrative record"); Beta Analytics Int'l, Inc., 61 Fed. Cl. at 226 (stating that a party may "rely on extra-record evidence to support its claim that discovery regarding bad faith conduct is necessary").
67. L-3 Commc'ns Integrated Sys., L.P., 91 Fed. Cl. 347, 356 (2010) (internal quotation omitted).
68. Madison Servs., Inc., v. United States, 94 Fed. Cl. 501, 511 (2010).
69. Id.
70. Madison Servs., Inc., 92 Fed. Cl. at 130; Cf. Beta Analytics Int'l, Inc., 61 Fed. Cl. at 226 (considering plaintiff's request for discovery on the issue of bad faith, and holding that "to put facts relating to bad faith in play a plaintiff must first make a threshold showing of either a motivation ... or conduct that is hard to explain absent bad faith").
71. Tech Sys., Inc., 97 Fed. Cl. 262.
72. Id. at 266.
73. Id. at 267 (finding, after supplementation of the record, that protester's allegation of bias and animus was not proven by clear and convincing evidence).
74. Asia Pac. Airlines v. United States, 68 Fed. Cl. 8, 18-19 (2005) (allowing supplementation where rationale of decision makers was not apparent from the administrative record) (internal quotations omitted); see also Impressa Construzioni Geom. Domenico Garufi v. United States, 238 F.3d 1324, 1339 (2001) (allowing deposition of contracting officer to elucidate grounds for his decisions and determine whether a rational basis was lacking).
75. THE FEDERALIST NO. 9 (Alexander Hamilton).
76. President George Washington, Farewell Address (Sept. 19, 1796), available at <http://www.ourdocuments.gov/doc.php?flash=true&doc=15>.
77. Id.
78. Joseph R. Berger, *The Year in Sustained Bid Protests at the U.S. Government Accountability Office and the U.S. Court of Federal Claims*, 37 PUB. CONT. L.J. 731, 733 n. 9 (2008). Mr. Golden included this comment in his address at the 2008 West Government Contracts Year in Review Conference (Feb. 28, 2008).

