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The Clause

A Quarterly Publication of the Boards of Contract Appeals Bar Association

The President's Column **J. Michael Littlejohn**

Dear BCABA Members:

In this issue of *The Clause*, the Board of Governors is proud to include an announcement from the Pro Bono Program of the Veterans Consortium. As you will see, the Pro Bono program provides our military veterans with counsel to pursue their disability claims before the Court of Appeals for Veterans Claims. When Pete McDonald brought this to the Board of Governors' attention in our June meeting, none of us could think a more deserving pro bono cause to "advertise" in *The Clause*. While the BCABA is not officially sponsoring this program, I would encourage all of our members to take a look at the program's website (www.vetsprobono.org) and consider getting involved. Training for the program is scheduled for November 7, 2008 in Washington, D.C.

Our fiscal year for the BCABA is coming to an end and a new year will start as of October 1st. This means it is time again to renew your membership in the BCABA. This past year the BCABA provided the following benefits to our members:

- Quarterly issues of *The Clause*, our scholarly journal on board practice and government contracting.

(continued on page 3)

Table of Contents

BCABA Board of Governors/Officers	2
Pro Bono for Disabled Vets <i>by Jeffrey Stonerock</i>	5
Annual Meeting Application Form	6
Practice Pointers: A Short Primer on the Effective Preparation and Use of Rule 4 Files <i>by Administrative Judges Peter D. Ting and Reba Ann Page</i>	8
A Clause in Search of Meaning: A Critical Dissection of the Price Reduction Clause (Plus Suggestions for Reform) <i>by John Howell</i>	17
The Proper Exercise of FAR's 52.217-8 Clause <i>by Ernesto Corrales</i>	52
Your Checklist for Outside Counsel Legal Services Agreements <i>by John "Johnny" E. Miller</i>	57
Change Order Accounting: Why Contracting Officers Should Require It; Why Contractors Should Do It Anyway <i>by Jeffrey P. Hildebrant and Peter A. McDonald</i>	63
Fair Value Accounting—And Why Government Contractors Should Care <i>by Peter A. McDonald</i>	70

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President's Column (cont'd):

- Access to the members-only portion of the BCABA website (www.bcaba.org), which includes BCABA membership lists, copies of handouts from BCABA events, forms and other helpful hints about board practice.
- The annual Trial Practice Seminar held this past spring brought together judges and attorneys to discuss the "dos and don'ts" of trial tactics for board cases.
- The BCABA annual Educational Seminar for 2007 provided a full day of CLE credit geared to government contracts and board practice. (The 2008 Seminar is scheduled for October 16, 2008. See details inside.)
- The BCABA Executive Policy Forum (to be held on September 18, 2008) – a discussion of hot topics in board practice available to Gold Medal Member firms and government employee members
- We co-sponsored the annual BCA Judges reception honoring the board judges.
- We submitted comments on the newly proposed CBCA rules.
- We established a Young Attorney Writing Award.

Our ability to continue providing these types of services depends on the active participation of members, for certain, but also on your continued financial support. The cost of membership is a bargain. This year, becoming a member of the BCABA is even cheaper than a full tank of gas! Membership for private practice attorneys is only \$45 and government employees can join for only \$30. A membership renewal form is included in this edition of *The Clause*. Also, I would encourage all firms to sign up their government contracts attorneys for membership so that you can be listed as a GOLD MEDAL MEMBER FIRM.

Finally, please do not forget that the BCABA Annual Educational Seminar is coming up on **October 16th**. This will be a great time to obtain that last-minute CLE, and to learn a little more about issues relating to board practice and government contracts. A preliminary registration form is included in *The Clause* and on our website at www.bcaba.org.

See you all at the annual Educational Seminar!

Best Regards,

J. Michael Littlejohn
President

Notice of Upcoming Events

- All members wishing to obtain the new user name and password for the member portion of the BCABA website can contact Mike Littlejohn at Michael.Littlejohn@akerman.com.
- The BCABA Annual Meeting will be held on **October 16, 2008** at the M Street Hotel in Washington, D.C. Details are on page 6 of this issue. Members needing more information should contact Dave Nadler at 202-420-2281.

Bored of Contract Appeals (a.k.a. The Editor's Column)

by

Peter A. McDonald

C.P.A., Esq.

(A nice guy . . . basically.)

By special permission of the Board of Governors, leading this issue is a highly informative article on a program about pro bono work for disabled veterans. The next article, by Judges Peter Ting and Reba Ann Page (ASBCA), provides insightful practice tips on Rule 4 files, a worthwhile topic to all practitioners. John Howell then provides an in-depth and well-reasoned analysis of the Price Reduction clause, a subject more complex than many realize. Ernesto Corrales reminds us about the requirements associated with the proper exercise of options. In the following article, law firm attorneys can learn a good deal from Johnny Miller's discussion of legal services agreements. Finally, there is a really boring article on fair value accounting that few would even understand (it was only included as filler material anyway).

The Clause is not copyrighted and will reprint, with permission, previously published and copyrighted articles that warrant further exposure. We are receptive to original articles that may be of interest to government contracts practitioners. Remember people: Don't take all this government contract stuff too seriously — have a life. We again received some articles that were just not suitable for publication, such as: "Paparazzi Hound Pete & Demi!"; "Critical Shortage of Government Contract Attorneys Continues!!"; and "DOJ Adds The Ten Commandments to Ethics Reporting Requirements!!!"

Pro Bono for Disabled Vets

by

Jeffrey Stonerock, Esq.*

Baker Botts LLP

[Note: This article, which lies outside the scope of what is normally published in *The Clause*, appears with the unanimous approval of the BCABA Board of Governors.]

Disabled veterans who appeal their disability determinations have their cases initially heard before the Board of Veterans Appeals, whose administrative decisions may then be appealed to the U.S. Court of Appeals for Veterans Claims (CAVC).

While the Government is represented by counsel in CAVC appeals, over 60% of the veterans are pro se. To address this problem, the government awarded a grant to the Veterans Consortium, which was formed by the American Legion, Disabled American Veterans, Paralyzed Veterans of America, and National Veterans Legal Services Program.

The Pro Bono Program has had participating attorneys from every state, as well as a large number of volunteers from Washington, D.C. In recent years, case loads have been rising for both the Board of Veterans Appeals and the CAVC, and indications are that the number of pro se appellants at the CAVC will continue to climb.

The Pro Bono Program of the Veterans Consortium seeks to address this growing need by recruiting attorneys who volunteer to assist disabled veterans with their appeals. The Pro Bono Program screens each pro se appeal, before placement with a volunteer attorney.

Volunteers who accept a referral from the Pro Bono Program receive educational materials and training. Specifically, volunteer lawyers receive the current Veterans Benefit Manual (paperback or CD), which includes a compendium on veterans law issues. They also receive subscriptions to two veterans law journals. In addition, each volunteer is assigned an experienced mentor. These measures enable the pro bono lawyer to acquire sufficient expertise in veterans law to effectively represent a disabled veteran before the CAVC.

More detailed information about the Pro Bono Program is available at the program's website, www.vetsprobono.org. If you are a member of the private bar and can perform some pro bono work in this worthy area, we would like to hear from you.

* - Jeffrey Stonerock is a partner in the law firm of Baker Botts LLP in Washington, D.C. Mr. Stonerock, a disabled veteran himself, took his first Pro Bono Program case in 2000 and has chaired the Veteran's Consortium Executive Board since June 2005.



Boards of Contract Appeals Bar Association Annual Program

*The New Procurement Landscape:
Compliance, Claims, and GSA/IDIQ Contracting*
October 16, 2008

M Street Hotel
1143 New Hampshire Avenue, NW
Washington, DC 20037

8:30-9:00 a.m. Registration

9:00 – 10:15 Contracting in the New Compliance Environment

Moderator: Christopher A. Myers, Partner, Holland & Knight LLP

10:30-11:45 Effective Claims Resolution at the Boards

Moderator: Stuart B. Nibley, Partner, Dickstein Shapiro LLP

11:45-1:00 Lunch (provided)

Keynote Luncheon Speaker: Mr. Shay Assad

Director, Defense Procurement, Acquisition Policy & Strategic Sourcing

1:15-2:00 GSA Schedule and ID/IQ Contracting

Moderator: John Howell, Partner, McKenna Long & Aldridge LLP

2:15-2:45 Legal Ethics and Litigation at the Boards

Moderator: Frederick W. Claybrook, Jr., Partner, Crowell & Moring LLP

3:00-4:00 BCA Judges Panel

Moderator: Lynda Troutman O'Sullivan, Assistant General Counsel (Dispute Resolution), Department of the Air Force

4:00-4:30 BCABA Business Meeting



Boards of Contract Appeals Bar Association Annual Program

*The New Procurement Landscape:
Compliance, Claims, and GSA/IDIQ Contracting*

October 16, 2008

M Street Hotel
1143 New Hampshire Avenue, NW
Washington, DC 20037

Credit Card Information Form

If you wish to pay for the Boards of Contract Appeals 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:

Name(s) of Registrant(s): _____
[Please attach a separate list, if necessary.]

Name on the Credit Card: _____

Type of Credit Card (VISA/Master Card): _____

Name of your Firm or Agency: _____

Total Dollar Amount to be charged – breakdown:

For Annual Program Registration Fee(s) \$ _____

For Membership Dues* \$ _____

Credit Card Number: _____

Credit Card Expiration Date: _____

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

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

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

Practice Pointers:
A Short Primer on the Effective Preparation and Use of Rule 4 Files

by
Administrative Judges Peter D. Ting and Reba Ann Page*

[Note: Published in *The Procurement Lawyer*, Volume 43, No. 4, Summer 2008 . Copyright © 2008 by the American Bar Association. Reprinted with permission.]

In government contract litigation before the Armed Services Board of Contract Appeals (ASBCA, or Board), no rule is better known or more important than ASBCA Rule 4.¹ The rule has five sections that variously describe the duties of the parties for submission of the file (Rule 4(a) and Rule 4(b)); give guidance for its preparation (Rule 4(c)); describe how to furnish voluminous, bulky, or outsized documents (Rule 4(d)); prescribe the removal and readmission of documents (Rule 4(e)); and describe situations in which the filing of Rules 4(a) and (b) files may be dispensed with (Rule 4(f)).

Rule 4 is elegantly simple, but is also the heart and soul of practice before the Board. No rule that has the virtue of such simplicity, however, can anticipate every scenario of actual practice, and Rule 4 is no exception. Although the rule provides flexibility, it also provides opportunities for missteps. The purpose of this article is to provide some practical insights and recommendations that may be useful to practitioners who appear before the Board, and thus to make the litigation process more efficient for all.²

Preparation: Rules 4(a) and (b)

Regardless of which party initiates a claim, litigation before the Board starts with an appeal by the contractor, which generally is referred to as the appellant. As between the government and the appellant, Rule 4(a) requires the government contracting officer to put together the initial Rule 4 file. Once assembled, the rule requires the contracting officer to transmit one copy of the file to the Board and one to the appellant. Rule 4 also requires the appellant to complete the Rule 4 process by transmitting its supplemental Rule 4 file—the Rule 4(b) file—to the Board with two copies to the government trial attorney.

The following statement may sound trivial, but it addresses a real problem and it needs to be said: Rule 4 files should be functional and easy to use. Each Rule 4 volume should not be so thick that it is not portable, or is difficult to open and close. For multivolume Rule 4 files, it is important that the case name, docket number(s), volume numbers, and tab ranges are boldly and legibly shown on both the front and spine of each volume so that it can be easily identified and retrieved in an office or courtroom setting. Each volume should have a complete index that lists the contents of each volume and describes each document by tab number, author, and date of preparation. *See* Appendix A.

It goes without saying that the documents in the Rule 4 file need to be legible. Although a document may be included in the Rule 4 file, if it is unreadable, then it serves no useful purpose. Ideally, each tab should have a unique but simple numerical tab number: begin with Rule 4, tab 1, followed by Rule 4, tab 2, etc. Unless there is a good reason for it, avoid using a

(continued on next page)

Effective Preparation and Use of Rule 4 Files (cont'd):

complicated alphanumeric system that might identify a document as “tabG7a.”

All individual pages of an unnumbered document under a tab should be sequentially numbered. Litigants in large and complex cases often “Bates” stamp each page of all documents as a means of document management. Bates stamping is an excellent way of numbering all pages of a document and all documents in a Rule 4 file. Unless each page is numbered, unnecessary time will be spent at the hearing trying to locate the right page. This will result in a confusing record, and that confusion will follow counsel and the Board long after the hearing is over.

When an appeal is assigned to the judge at an early stage, some judges have prescribed the format for Rule 4 submissions. *See Appendix C*. Unsatisfactory Rule 4 files have been returned to be redone before the hearing. Unfortunately, Rule 4 does not address how many copies of a Rule 4 file may be needed in the event of a hearing. Even though it may not be apparent at the time the Rule 4 file is assembled whether there will eventually be a hearing, it is prudent for the contracting officer and the appellant to assemble at least five copies of their respective Rule 4(a) and Rule 4(b) files. If a hearing does take place, the presiding judge, the witness, and counsel for each party will each need his or her copy at the least.

The Board often accommodates the parties by scheduling out-of-town hearings. Since ASBCA judges do not travel with an entourage, transporting a large set of Rule 4 file volumes to and from an out-of-town hearing location can be daunting. The logistics of where to send it, where to store it, and how to physically move it to a courtroom can be problematic. The task of sending the Rule 4 file—the Board’s only record—back to the Board can be equally challenging. For this reason, judges have frequently asked that each party make available a set of Rule 4 volumes at the out-of-town site. When you receive such a request, having already prepared an extra set avoids the need for last-minute copying and assembling at a time when you can least afford to be without your set of the Rule 4 file and are pressed by other trial preparation efforts.

Content of the Rule 4 File

Once an appeal has been filed, Rule 4(a) charges the contracting officer to assemble and transmit to the Board and the appellant a Rule 4 file “consisting of all documents *pertinent* to the appeal” (emphasis added). Rules 4(a)(1) through (5) specify what documents are considered “pertinent” and must, at a minimum, be included in the Rule 4 file. Appellant’s claim and the contracting officer’s decision are considered pertinent (Rules 4(a)(1) and (3)), as are the contract, including applicable specifications, amendments, plans and drawings (Rule 4(a)(2)). The trinity of the claim, final decision, and entire contract should be made part of every Rule 4 file. Further, all correspondence “relevant to the appeal” between the parties is considered pertinent (Rule 4(a)(3)), and any additional information “relevant to the appeal” is considered pertinent as well (Rule 4(a)(5)).

Note that not all documents generated over the course of a contract belong in the Rule 4 file;
(*continued on next page*)

Effective Preparation and Use of Rule 4 Files (cont'd):

include only those that are “pertinent” and “relevant” to the appeal. Occasionally, one party or the other does not include documents in the Rule 4 file that it considers unfavorable to its position. Presumably, this practice is thought to be justified on the basis that proceedings before the Board are adversarial in nature, and it is up to each party to include that evidence favorable to its case. This is not, however, what Rule 4 requires. Rule 4 requires the inclusion of *all* documents that are “*relevant*” and “*pertinent*” to the appeal (emphasis added). A document does not become irrelevant or not pertinent because it is not favorable to a party’s position.³

One way to determine what should or should not be included in the Rule 4 file is to remember that the Contract Disputes Act, 41U.S.C. §§601-613 (CDA, or Act), not only establishes the Board’s jurisdiction, but also sets forth measures to ensure that fundamental due process is afforded to each party. Importantly for purposes of litigation and preparation of the Rule 4 file, the CDA circumscribes the scope of an appeal by the bounds of a contractor’s claim.⁴ The Act envisions a logical progression for documenting and handling disputes between the government and contractors. Following the filing of a claim by the contractor that sets forth the basis for its demand and the remedy sought, the government is given the opportunity to evaluate the claim and render a final decision by the contracting officer within a prescribed period, after which a contractor may institute an appeal. *See* 41U.S.C. §§605(a) and (b). Just as a prudent contractor should submit its claim with attached supporting documentation for the contracting officer’s evaluation, the contracting officer should assemble and reference pertinent documents during the process of issuing the final decision.

Even though Rule 4 gives the contracting officer just 30 days after receipt of an appeal to submit the Rule 4 file, as a practical matter, contracting officers are well advised to begin assembling Rule 4 documents promptly after a claim is received as part of the decision-making process. By the time the final decision is issued, the task of collecting the relevant and pertinent documents for the Rule 4 file should have been largely if not totally completed. *See* 41 U.S.C. §605(c)(2)-(3).

An appeal can also be taken when the contracting officer fails to issue a decision. 41U.S.C. § 605(c)(5). Where a contracting officer, for whatever reason, fails to issue a decision, and thus has not addressed a contractor’s claim, the task of assembling and transmitting a Rule 4 file consisting of “relevant” and “pertinent” documents could be more challenging. Nonetheless, Rule 4 does not excuse the contracting officer who has failed to issue a final decision from assembling and transmitting the Rule 4 file containing documents relevant and pertinent to the appeal.

Where the contracting officer does not put together an adequate Rule 4 file, the burden essentially falls upon the appellant to submit a Rule 4(b) file containing documents “relevant” and “pertinent” to its appeal. In some instances, the contracting officer simply would not have the documents that support the contractor’s claim. For example, in order for a contractor to prove entitlement where a contract provision contains a latent ambiguity, the contractor has the burden to show that it relied upon the ambiguous provision.⁵ In that case, the contracting
(continued on next page)

Effective Preparation and Use of Rule 4 Files (cont'd):

officer most likely would not have the contractor's bid papers that might show reliance on the part of the contractor. And even if the government subsequently obtains the contractor's bid papers through discovery, there would not be an incentive for the government to supplement the Rule 4 file to help the contractor to prove its case. Similarly, the contracting officer would not have the contractor's accounting records showing what costs were incurred. The contractor should therefore be vigilant in putting together its Rule 4(b) file and supplement that record where necessary.⁶ Because additional relevant and pertinent documents might surface as a result of discovery, the Board generally allows the parties to supplement their respective Rule 4 submission prior to hearing.

Rule 4(b) requires the appellant to transmit any documents "not contained" in the government's Rule 4 file. This suggests that the appellant should first determine which are already included in the government's Rule 4 file and not include the same documents in its Rule 4(b) file. Having duplicative documents can cause confusion in citing to the record and should be avoided.

Organization: Rule 4(c)

Rule 4(c) instructs that "[d]ocuments in the appeal file . . . shall be arranged in chronological order where practicable." Although arranging documents chronologically works well for less complex cases involving one or two issues, that approach makes little sense for complex cases involving multiple issues. It is not unusual for a construction case, for example, to include a multitude of constructive change claims as a basis for an overall delay and disruption claim. In that situation, the facts of each constructive change will most likely have to be separately addressed by the parties and determined by the Board; arranging the Rule 4 documents purely on a chronological basis may prove unworkable. To get to the right documents at hearing, counsel, the witnesses, and the judge will have to locate, open, and close multiple Rule 4 volumes. This has caused Rule 4 volumes to pile up on counsels' table, the witness stand, and the bench. When this happens, the hearing has to come to a halt so that the Rule 4 volumes can be returned to their rightful places before the proceeding can resume.

For complex cases involving multiple issues, the better approach is to devote the first few volumes of the Rule 4 file to documents common to all of the issues and to arrange documents pertinent to discrete issues or subjects separately in their own sections of the Rule 4 file. The documents within each section should then be arranged in a chronological order. This approach makes for a more efficient and less stressful hearing since all of the documents on a subject or issue are found in one place, and less time is spent on the unproductive effort of locating documents scattered throughout the Rule 4 volumes. This approach also makes for a more concise and focused transcript, which, in turn, eases your burden in writing your post hearing briefs, and eases the Board's burden in reviewing the record for decision.

A Rule 4 file is best put together with some thought given as to how the case is going to be presented. Since a contracting officer may be unfamiliar with what happens in a hearing, it is *(continued on next page)*

Effective Preparation and Use of Rule 4 Files (cont'd):

strongly recommended that the assigned trial attorney be involved in preparing the Rule 4 file, especially for a large, complex case. It has been suggested that a large, complex case is simply a collection of smaller, less complicated cases, and if the smaller, less complicated cases are properly managed, the large, complex case will eventually fall into place. This concept applies as well in putting together a Rule 4 file.

Before sending off your Rule 4 file to the ASBCA and your opponent, it is prudent to double-check to ensure that all copies are complete and correct. Having different sets of the same Rule 4 file containing different documents under the same tabs occurs from time to time. When this happens, confusion and delay inevitably result, not only at the hearing but during subsequent phases of Board proceedings. It is necessary that all Rule 4 copies conform to the Board's version, which in the end, is the record upon which the decision will be based.

Status of Documents in the File: Rule 4(e)

Rule 4(e) provides that “[d]ocuments contained in the appeal file are considered, without further action by the parties, as part of the record upon which the Board will render its decision.” If neither you nor your opponent objects to any documents in the Rule 4(a) and Rule 4(b) files, and if only some but not all of the Rule 4 documents are referred to or testified about at the hearing, when the hearing is concluded all documents in the Rule 4 files, including the ones no one testified about, would automatically become a part of the record upon which the Board would render its decision.

Rule 4(e) does permit a party to object to the inclusion of a document as a part of the Rule 4 file “for reasons stated,” if the objection was made “reasonably in advance of hearing,” and before “settling the record” if there is no hearing in the case of a Rule 11 submission or dispositive motion. One of the most common objections to Rule 4 documents is authenticity. Once a timely objection is made, Rule 4(e) instructs that the Board “shall remove the document or documents from the appeal file and permit the party offering the document to move its admission as evidence in accordance with Rules 13 and 20.” If a Rule 4 document is otherwise “relevant” and “pertinent,” an authenticity objection to a document can usually be cured by witness testimony under Rule 20.

Rule 4(e) can be read to require the physical removal of those documents to which an objection has been made. More often than not, however, the Board would simply insert a sheet at the appropriate Rule 4 tabs, or otherwise make a notation to indicate there is a pending objection without actually physically removing the objectionable documents. In such instances, the affected documents are considered “constructively” removed. This practice is instituted to avoid having to physically remove the objectionable documents, putting them someplace outside the Rule 4 file, and reinserting them later if and when the documents are readmitted.

Documents removed pursuant to Rule 4(e) may prove crucial to your case. Obviously, your opponent is not going to take the trouble to move into evidence a document that is helpful to
(continued on next page)

Effective Preparation and Use of Rule 4 Files (cont'd):

your case. Under Rule 20, both parties can again offer into evidence those documents removed earlier pursuant to a Rule 4(e) objection. Thus, depending upon the judge's ruling, a document or documents removed earlier may be readmitted. With a host of other matters competing for your attention at the hearing, it is possible that you may unintentionally fail to move into evidence a removed document or documents important to your case. For this reason, you should have a plan for ensuring that all removed documents are addressed or ruled upon by the judge at the hearing. One way is to prepare a log beforehand and check off each removed document as it is readmitted. *See Appendix C.* It is also a good idea to arrange to compare your log with your opponent's, and ask the presiding judge to confirm on the record before the close of hearing the Rule 4 tabs and documents that have been readmitted over the course of the hearing.

With respect to consideration of documents that are the subject of Rule 4(e) objections, ASBCA Rule 13(c) gives the Board the prerogative of requesting "additional evidence on any matter relevant to the appeal" in settling the record. Rule 20(a) gives the Board the prerogative of requiring evidence "in addition to that offered by the parties" at the hearing. Thus, technically, with notice to the parties, the Board may on its own readmit documents removed from the Rule 4 files pursuant to Rule 4(e) objections.⁷ Notwithstanding the Board's prerogatives, however, since it is your responsibility to prove your case, you should not depend on the Board to evaluate the need for documents removed under Rule 4(e).

Final Thoughts

There is no magic in putting together a well-organized and useful Rule 4 file. To be well organized and useful, everything in the Rule 4 file needs to be relevant, coherent, easy to use, legible, and conforming.⁸

*_*_*_*_*_*_*_*_*_*

Appendix A Sample Rule 4 File Index

<u>Volume Number</u>	<u>Tab Number</u>	<u>Author & Brief Description of Document</u>	<u>Date of Document</u>	<u>OPTIONAL Bates Stamp Numbers</u>
I	1	Contract No. XYZ1234	6 Feb 1997	B1-B245
I	2	Appellant's Certified Claim and Request for Final Decision	23 Jun 2003	B246-B312
I	3	Final Decision by Contracting Officer Doe denying appellant's claim	14 Aug 2003	B313-B358
I	4	Letter from Contractor VP Smith to Government PM Jones re interpretation of spec. ¶ 5.3.14	March 1997	B359-B362

(additional relevant and pertinent documents)

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Effective Preparation and Use of Rule 4 Files (cont'd):

Appendix B Excerpts from Sample Pre-Hearing Order on Preparation of Rule 4 File

Preparation of Rule 4 File. Board Rule 4 Preparation, Content, Organization, and Status of Appeal File directs the parties with respect to submission of documentary evidence; review this rule carefully. In addition, the parties shall follow these instructions:

1. All documentary evidence, with the exception of that offered for impeachment, should be submitted as part of the Rule 4 file. Appellant's impeachment evidence offered at trial should be marked A-1, A-2, etc. Similarly, the Government's impeachment evidence shall be marked G-1, G-2, etc.
2. Documents should be ordered chronologically or in other logical order.
3. Ensure that each and every document is legible. If documents are printed on both sides, make sure the printing is in the same direction. Review each Rule 4 file to make sure it is correctly assembled.
4. All Rule 4 documents shall be tabbed sequentially, e.g., tab 1, tab 2, etc. Identify each document with a label, e.g., R4, tab 1, etc. The parties should confer in assembling supplements to the Rule 4 file to ensure that numbers are not duplicated.
5. Ensure that each page of any document is sequentially numbered or Bates stamped, if appropriate.
6. Documents should be placed in 3-ring binders not larger than 2 inches wide. Label both the front and the spine of each binder with the case name, docket number, tab numbers contained in that binder (e.g., tabs 1-10), and the volume number (e.g., "1 of 3"). Outsized drawings may be submitted separately.
7. Prepare an index for the entire Rule 4 file, and place a copy in each volume. The index should state whether it was prepared by the Appellant or the Government, and should contain columns indicating the tab number, a brief description of the document, and the date of that document.
8. Unless the record is voluminous and prior permission from the judge is obtained, provide one copy of the Rule 4 file to the Board, and bring an additional copy for the use of the judge to the hearing if it is held out of town.
9. Contact the Board to obtain permission from the judge before submitting information on compact disks.
10. Expert witness reports shall be exchanged, and a copy provided to the Board, in accordance with the established schedule.
11. The Board may return any improperly prepared Rule 4 files to the appropriate party for correction.

Objections to Rule 4 File Documents. The parties shall exchange and file with the Board any objections not previously filed to documents set forth in the Rule 4 file or supplements thereto. Any objections filed shall state with specificity the basis upon which they rest. The Board will address any objections to the Rule 4 file documents at the beginning of the hearing and, unless

Effective Preparation and Use of Rule 4 Files (cont'd):

good cause is shown for later objections, will consider only the written objections previously lodged. Pursuant to Rule 4(e), any Rule 4 file documents not excluded will be considered as part of the record by the Board.

*_*_*_*_*_*_*_*

Appendix C
Indicating Status of Rule 4(e) Documents

ASBCA No(s). _____

Appeals(s) of _____

R4 Tabs Removed Per R4(e) Objection	Check or Initial if Readmitted	Date Readmitted
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

*_*_*_*_*_*_*_*

Endnotes

¹ - This article does not address practices under a similar rule before the United States Civilian Board of Contract Appeals.

² - Since Rules 4(d) and 4(f) are seldom invoked, this article focuses on Rules 4(a), (b), (c) and (e).

³ - See, e.g., *Johnson & Son Erector Co.*, ASBCA No. 23689, 86-2 BCA ¶18,931 at 95,595 (CCH) (“[n]ormally, the contracting officer collects the pertinent documents and submits them to the Board,” with objections, if any, filed later); *Southeastern Services, Inc.*, ASBCA No. 21278, 78-2 BCA ¶13,239 at 64,743 (CCH) (some documents in Rule 4 file “did not qualify” as authentic); *American Electronic Laboratories, Inc.*, ASBCA Nos. 17779, 18278, 78-1 BCA ¶12,907 at 62,864-65 (CCH), *aff’d*, 222 Ct. Cl. 153 (1980) (rule “gives the contracting officer wide latitude in assembling R4 documents in that he must determine what correspondence or data is ‘pertinent to the appeal’ and what additional information is ‘considered material.’”).

⁴ - See, e.g., *J.S. Alberici Constr. Co. Inc. and Martin K. Eby Constr. Co. Inc., a joint venture*, ENGBCA No. 6178, 98-2 BCA ¶29,875 at 147,917 (CCH), *aff’d*, 53 F.3d 1381 (Fed. Cir. 1998):

The emphasis upon the claim and its supporting documentation comports with the balanced approach taken by the CDA, which was carefully structured to ensure fundamental fairness to both parties. The Government is entitled to learn the basis of the claim asserted by the contractor, ensuring both a lack of prejudice to the Government and judicial economy by establishing a process where claims are resolved at the lowest possible level.

41U.S.C. § 605(a). See also *Skip Kirchdorfer, Inc.*, ASBCA No. 40515, 93-3 BCA ¶25,899 at 128,834 (CCH); *Standard Technology, Inc.*, ASBCA No. 41831, 91-2 BCA ¶23,936 (CCH); *Stencel Aero Engineering Corp.*, ASBCA No. 28654, 84-1 BCA ¶16,951 at 84,315 (CCH).

⁵ - See, e.g., *Fruin-Colnon Corp. v. United States*, 912 F.2d 1426, 1430, 1432 (Fed. Cir. 1990); *Lear Siegler Management Services Corp. v. United States*, 867 F.2d 600, 603-04 (Fed. Cir. 1989).

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Effective Preparation and Use of Rule 4 Files (cont'd):**Endnotes (cont'd)**

⁶ - The determination of evidence relied upon by a party to support its position cannot be overstated. For a cautionary tale regarding preservation of records offered and eventually relied upon, see *Grumman Aerospace Corp.*, ASBCA No. 48006, 06-1 BCA ¶33,216 (CCH), *aff'd*, *Grumman Aerospace Corp. v. Wynne*, 497 F.3d 1350 (Fed. Cir. 2007).

⁷ - The ultimate determination of whether evidence will be admitted or considered remains the exclusive province of the Board. See, e.g., *Southern Defense Systems, Inc.*, ASBCA Nos. 54045, 54528, 07-1 BCA ¶33,536 at 166,134 (CCH) (“Rule 4(e) was never contemplated to permit either party unilateral means to foreclose evidence as part of the record.”).

⁸ - For another interesting discussion of this worthwhile topic, see Carol N. Park-Conroy, *Documentary Record Can Help or Hinder Appeal*, 32-3 *The Procurement Law.*, Spring 1997.

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**A CLAUSE IN SEARCH OF MEANING:
A CRITICAL DISSECTION OF THE PRICE
REDUCTIONS CLAUSE (PLUS SUGGESTIONS
FOR REFORM)**

by
John A. Howell*

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- I. Introduction
- II. Evolution of the Price Reductions Clause
 - A. Present Clause
 - B. Early Origins of Clause
 - C. Notion of “Equivalent Price Reduction” Under Pre-3M Clauses
 - D. Notion of “Equivalent Price Reduction” Under Post-3M Clause
 - 1. Purpose
 - 2. Price Reductions to Customers Other Than Federal Agencies
 - 3. Price Reductions to Federal Agencies
 - E. 1982 GSA Multiple-Award Schedule Policy Statement:
The Basis-of-Award Clause
 - 1. New Policy
 - 2. Philosophy
 - 3. The 1982 Clause
 - F. Regulatory Activity from 1982 to 1994
 - G. 1994 Price Reductions Clause
 - H. 2004 Price Reductions Clause
- III. Transactions Covered by the Clause
 - A. Sales
 - B. Rentals and Leases
 - C. Services
- IV. Price Reductions to Federal Agencies
 - A. Price Reductions to Schedule Customers
 - B. Price Reductions to Nonschedule Customers
 - C. Price Reductions to Congress
- V. Price Reductions to State and Local Governments
- VI. Price Reductions to Commercial Customers
 - A. Basis of Award
 - B. The “Triggering Events”

(continued on next page)

A Clause in Search of Meaning (cont'd):

VII. Effect of Maximum Order Limitation or Maximum Order Threshold

VIII. Calculation of Price Reductions

IX. Effective Date of Price Reductions

A. Price Reductions to Federal Agencies

B. Price Reductions to Other Customers

X. Reporting Requirements

A. Notification to Contracting Officer of Price Reductions

B. Former Requirement for Contractor's End-of-Contract

Statement of Price Reductions

XI. Sanctions for Noncompliance with the Clause

A. Price Adjustment

B. Termination for Default or Convenience or Nonrenewal of Contract

C. Debarment/Suspension

D. Monetary Recovery Under the Civil False Claims Act

E. Monetary Recovery Under the Program Fraud Civil Remedies Act

F. Criminal Prosecution

XII. Reforming the Price Reductions Clause

XIII. Conclusion

I. INTRODUCTION

A Price Reductions clause is a standard feature of all General Services Administration (GSA) and Department of Veterans Affairs (DVA)¹ multiple award schedule (MAS) contracts.² Briefly stated, the clause is intended to maintain the relationship that was established at the time of contract award between the Government and the offeror's customer or category of customer upon which the award was predicated. This customer or category of customer is referred to as the "basis-of-award customer," the "target customer," or the "customer of comparability." The clause is designed to ensure that, during the term of the contract, any changes in pricing practices by the contractor, which would result in a less advantageous relationship between the Government and this customer or category of customer, will result in a proportionate price reduction to the Government. The clause is extremely complicated to administer³ and frequently results in extensive monetary exposure for MAS contractors. This article dissects the clause, explores its evolution and operation, and examines the major liability-related issues surrounding it.⁴ Finally, the article offers various proposals for "reforming" the clause.

II. EVOLUTION OF THE PRICE REDUCTIONS CLAUSE

A. Present Clause

The Price Reductions clause has changed since its inception. The current version of the clause dates from May 2004.⁵

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A Clause in Search of Meaning (cont'd):

B. Early Origins of Clause

The current Price Reductions clause has evolved significantly from prior versions, and an understanding of the complex administrative history of the clause is essential to a full appreciation of its nuances, intricacies, and arguable eccentricities. The clause—or at least a vestigial version of it—dates at least as far back to 1957, and was initially interpreted in an unpublished 1961 General Services Administration Board of Contract Appeals (GSBCA)⁶ case entitled *Appeal of Roxbury Carpet Co. (Roxbury)*.⁷ The Price Reductions clause in Roxbury—which appeared as article 13 of the General Provisions of the 1958 nonschedule requirements contract in question⁸—read as follows:

13. PRICE REDUCTIONS.—If at any time after the date of the bid, the Contractor reduces the comparable price of any article or service covered by the contract to customers other than the Federal Government, the price to the Government for such article or service shall be reduced proportionately. Such reduction shall be effective at the same time and in the same manner as the reduction in the price to customers other than the Government. The Contractor shall invoice the ordering offices at such reduced prices, indicating on the invoice that the reduction is pursuant to the “Price Reductions” article of the General Provisions. The Contract [sic] shall furnish promptly to the General Services Administration issuing Office complete information as to such reductions.⁹

In *Roxbury*, the contractor had agreed to furnish Axminster carpet to government users.¹⁰ About eight months into contract performance, the GSA advised the contractor that “recent issues of various trade journals had carried stories that the Appellant had reduced the price of certain current lines of its carpeting.”¹¹ The GSA asked the contractor to advise the GSA whether the contractor had reduced the comparable price of any contract item to its commercial customers.¹² The contractor responded negatively, claiming that its commercial contract prices were “not comparable factually or equitably to the prices under its [government] contract.”¹³ The GSBCA rejected the contractor’s argument, holding that nothing in the language of article 13 compelled “a comparison of the various elements that go into the Establishment of the contract price with the elements that are used in establishing the price for commercial sales.”¹⁴ The GSBCA concluded that “Article 13, fairly interpreted, means that if the contractor, during the contract term, makes a general reduction in his commercial price for the contract item, without pertinent quality differentials, below his corresponding commercial price therefore which was in effect at the time of his bid, the FSS [Federal Supply Service] is entitled to expect its price to be reduced proportionately.”¹⁵

Sometime after the spring of 1958, the GSA adopted a revised form of article 13 for use in GSA requirements contracts.¹⁶ The GSA seemingly adopted the revised clause primarily to clarify the types of commercial price reductions that would result in a proportionate price reduction for federal buyers.¹⁷ By September 1964, the same clause (with minor variations) appeared as article 34 of the GSA’s Contract Supplemental Provisions (Form 1424).¹⁸ It is
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A Clause in Search of Meaning (cont'd):

noteworthy that the revised clause added the concept of a “horizontal price reduction” and the notion of a price schedule used as the basis for “bidding” the contract.

In 1967, the Price Reductions clause first appeared in the General Services Administration Procurement Regulations (GSPR), the precursor to the GSAR.¹⁹ For possibly the first time, the GSPR clause required the schedule contractor to submit an end-of-contract Statement of Price Reductions to the GSA contracting officer certifying either (1) that the contractor had not granted any price reductions or (2) if it had, that it had reported each price reduction to the contracting officer within ten days of the effective date of the price reduction.²⁰

The GSBCA interpreted the 1964 clause in two 1972 decisions. The first of these decisions, *Pennwalt Corp.*, involved an indefinite-quantity-type supply contract for the delivery of refrigerant gases to the Government.²¹ In part, the contractor argued that the Price Reductions clause should not apply to certain line items that involved sales of gases placed in government-owned cylinders, given that the contractor did not sell or offer to sell these gases to commercial customers in customer-owned cylinders.²² Noting that the contractor’s filling of government-owned cylinders involved increased costs to the contractor due to its need to shut down its production line to accomplish the changeover, the GSBCA found that the government items were not the same products as offered to the commercial customers; therefore, the Price Reductions clause should not have been applied to these line items.²³ With respect to other line items, however, the contractor had argued that the GSA should not have applied the Price Reductions clause because the contractor had reduced its commercial pricing to its wholesalers—in the contractor’s view, a “vertical” price reduction rather than a “horizontal” price reduction under the clause.²⁴ The GSBCA rejected this contention, holding that the word “horizontal” in the clause did not restrict its application to relationships between competitors on the same distributional level.²⁵ The GSBCA then determined that the wholesale prices were “comparable” to the government prices in that the commercial and government quantities were similar.²⁶ Finally, the GSBCA concluded that the clause did not require it “to go behind the prices to determine profit margins or to ascertain other subjective determinations which [the contractor] entertained when formulating those prices in order to determine their comparability.”²⁷

The second GSBCA case, *Racon Incorporated*, also involved a contract for the delivery of refrigerant gases.²⁸ As in *Pennwalt*, the contractor argued that its revisions to certain of its wholesale price schedules had not effected a general price reduction because the reductions had not been offered to its customers generally, but only to wholesalers.²⁹ After predictably rejecting this contention, the GSBCA turned its attention to whether the general price reduction was on comparable prices.³⁰ While noting that some of the commercial products were not comparable to the products sold to the Government, the GSBCA focused on the items that were truly identical.³¹ The GSBCA rejected the contractor’s argument that the Price Reductions clause should not be applied because the government contract prices were already so much lower than the contractor’s commercial prices “that the two [could not] be considered comparable, especially since applying the general price reductions to the Government contract price would force [the contractor] to sell its product below cost.”³² Noting that the GSBCA is “not a court of equity,” the GSBCA was unwilling to conclude that the Government may only invoke the clause when the contractor would not suffer a loss.³³ Significantly, the GSBCA
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A Clause in Search of Meaning (cont'd):

approved a mode of calculation for the price reduction based on a percentage reduction rather than a dollar-for-dollar reduction.³⁴

C. Notion of “Equivalent Price Reduction” Under Pre-3M Clauses

In 1970, the GSA promulgated a new Price Reductions clause.³⁵ The new clause eliminated the GSA’s “horizontal reduction” language and added the concept of a maximum order limitation (MOL).

In 1972, the GSA revised the 1970 Price Reductions clause.³⁶ As revealed in the GSBCA’s 1978 decision in *3M Business Products Sales, Inc.*,³⁷ the new clause stated that

If, after the date of the offer, the Contractor (i) changes any of the pricing documents or related discounts which were offered to and used by the Government to establish the prices in this contract or (ii) sells any supplies, equipment, or services covered by this contract at a price below that listed in any of the above referenced pricing documents so as to reduce any price within the applicable maximum order limitation to any customer, an equivalent price reduction shall apply to this contract for the duration of the contract period or until the price is further reduced, except for temporary price reductions. For the purposes of this paragraph, any method by which the price is effectively reduced shall constitute a price reduction . . .³⁸

In *3M*, the GSBCA held that the Government was entitled to a price adjustment under the Price Reductions clause of a Federal Supply Service (FSS)³⁹ MAS contract for microphotographic equipment because the contractor had failed to furnish the required discount and pricing information and had offered undisclosed higher discounts to commercial customers.⁴⁰ Although factually the *3M* case involved both defective-pricing data and price reductions, the GSBCA analyzed the case as if only price reductions were present. While finding that the Government was entitled to a price reduction, the GSBCA limited the amount of the reduction to the actual monetary reduction that the contractor had granted to its commercial customers.⁴¹

In analyzing the clause, the GSBCA noted that the General Accounting Office (GAO)⁴² and the GSA contracting officer (acting on the basis of a GSA audit report) had interpreted the term “equivalent price reduction” in the clause differently.⁴³ The GAO had interpreted the phrase to mean that the Government should receive the same price reduction as a commercial customer so that the Government would pay no more than that customer; by contrast, the GSA contracting officer (CO) had interpreted the term to mean that the Government should receive an additional percentage discount equal to the percentage discount granted to the contractor’s commercial customer.⁴⁴ According to the GSBCA, under the GSA’s formula, the GSA price would always be less than the price paid by the commercial customer receiving the discount.⁴⁵ The GSBCA held that the GAO’s interpretation of “equivalent price reduction” was the equitable interpretation, concluding that—in the absence of any evidence showing that the clause was intended to be punitive in nature—the price reduction should be limited to the actual
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A Clause in Search of Meaning (cont'd):

monetary reduction granted to the commercial customers.⁴⁶ Therefore, according to the GSBCA, the price reduction should not be calculated on the basis of an additional percentage discount as the GSA audit report had done but instead should be calculated so as to allow the Government the same low price that was granted to the commercial customers.⁴⁷

Curiously, the GSBCA in the *3M* case cited but neither followed, distinguished, nor overruled *Racon*, in which the GSBCA had calculated a price reduction on the basis of percentage reductions.⁴⁸ Interestingly, the GSBCA in *Racon* also had rejected the contractor's argument that the Price Reductions clause may not be invoked if the contractor's contract price is already below cost and the percentage reduction would require it to absorb a further loss.⁴⁹

D. Notion of "Equivalent Price Reduction" Under Post-3M Clause

The GSBCA's opinion in *3M* resulted in the GSA's near-immediate promulgation of a new Price Reductions clause⁵⁰ designed to mitigate the effects of the case. The 1978 post-*3M* clause—which is two clauses removed from the current 2004 Price Reductions clause—had several important features.

1. Purpose

The primary purpose of the new clause was to retain throughout the contract period the same *pricing relationship* that existed at the time of contract award between the contractor's discounts to the Government and the contractor's discounts to its commercial customers.⁵¹

2. Price Reductions to Customers Other Than Federal Agencies

The new clause stated that if, after the date of the offer, the contractor (1) changed any of its pricing documents, including pricelists and information in the Discount Schedule and Marketing Data (DSMD) sheets, or related discounts, which were furnished to and used by the Government as the basis for negotiating the prices in the contract, or (2) sold any item covered by the contract at a price below that in any of these pricing documents so as to reduce any price to any customer, other than the Government, for sales within the contract MOL,⁵² an equivalent price reduction would apply to the contract for the balance of the contract period or until the price was further reduced or, in the case of temporary price reductions, for the duration of any temporary price reduction period.⁵³ The clause defined the term "[e]quivalent price reductions" to mean that the contract price would be reduced so as to maintain the *same price or discount relationship* between the Government and the other customers as existed at the time the contract negotiations were concluded.⁵⁴ Significantly, the clause prescribed the mode of calculating a price reduction: it was to be computed by determining the percent by which the price to any customer was reduced and then reducing the contract price by the same percentage.⁵⁵ Under the clause, any method by which the price was effectively reduced was deemed to constitute a price reduction.⁵⁶

The new clause, however, did not apply to any contractor price reductions to states, the District of Columbia, or other political subdivisions.⁵⁷ The clause also permitted the contracting officer to exempt a sale at below-contract pricing from the application of the clause

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A Clause in Search of Meaning (cont'd):

if the sale was caused by an error in quotation or billing, provided that the contractor furnished adequate documentation to the contracting officer.⁵⁸

3. Price Reductions to Federal Agencies

Except for temporary “government-only” price reductions, the new clause required that if—after the effective date of the contract—the contractor reduced the price of any contract item to any federal agency and the sale (whether “on” or “off” schedule) was within the contract MOL, an equivalent price reduction would apply to all subsequent sales of the contract item to federal agencies for the duration of the contract period or until the price was further reduced.⁵⁹ The contractor, however, was permitted to offer the contracting officer a temporary “government-only” price reduction having a duration of thirty calendar days or more (with the proviso that during the last month of the contract period, any such offer had to be for the remainder of the contract period).⁶⁰

E. 1982 GSA Multiple-Award Schedule Policy Statement: The Basis-of-Award Clause

In October 1982, the GSA promulgated a policy statement with respect to MAS contracting⁶¹ that included a new Price Reductions clause.⁶² In promulgating the 1982 clause—one clause removed from the current clause—the GSA announced a new policy and philosophy relating to the clause.

1. New Policy

Unlike the post-3M clause, the 1982 clause was not activated any time that an MAS contractor reduced its prices to any customer; instead, the clause was activated only when prices were changed so as to change the relationship between the Government and the customer or category of customer upon which the contract award was predicated.⁶³ Along with narrowing the application of the Price Reductions clause, the GSA also deleted the exclusion of sales to state and local governments from the purview of the clause on the theory that state and local procurement programs would not be adversely affected by the change.⁶⁴

2. Philosophy

The 1982 policy statement noted that:

The price reductions clause is intended to maintain the relationship that was established at the time of contract award between the Government and the offeror’s customer or category of customer upon which the [award] was predicated. [Accordingly, under the clause,] any changes in pricing practices by the contractor resulting in a less advantageous relationship between the Government and the customer or category of customer upon which the [contract award] was predicated [] result[ed] in a price reduction to the Government to the extent necessary to retain the original relationship.⁶⁵

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A Clause in Search of Meaning (cont'd):

3. The 1982 Clause

The 1982 clause reads as follows:

a. *General.* The price reductions clause [is] intended to ensure that . . . the Government [should] maintain its relative price/discount (and/or [with respect to automated data processing equipment (ADPE)⁶⁶ and telecommunications schedule contracts] term and condition) advantage [throughout the term of the contract] in relation to the Contractor's commercial customer(s) price/discount upon which the contract award was predicated. The customer or category of customers upon which the contract award [was] predicated [were to] be identified at the conclusion of negotiations.

b. *Price Reductions to Customers Other than the Federal Agencies.*

(1) Prior to the award of [the schedule] contract, the contracting officer and the offeror [had to] reach an agreement as to the price relationship between the Government and the offeror's identified customer or category of customers upon which the contract award [would be] predicated. This relationship had to be maintained throughout the contract period. Any change in the contractor's commercial pricing arrangements for the identified customer or category of customers which disturb[ed] this Relationship constituted a price reduction.

(2) The contractor [had to] report all price reductions made during the Contract period to the contracting officer along with an explanation of the Conditions under which the reductions were made. Those reductions which did not disturb the Government's price position relative to the contractor's identified customer or category of customers were not subject to the provisions of the clause. However, the information [would] be used in conjunction with the negotiations for the following contract period.

(3) If, after the date of the conclusion of negotiations, the contractor (i) reduce[d] the prices contained in its commercial catalog, pricelist, schedule, or other documents (or grant[ed] any more favorable terms and conditions) [which were] offered by the contractor and used by the Government to establish the prices with the contract; or (ii) reduce[d] the prices through special discounts to the identified customer or category of customers upon which the award was predicated so as to disturb the relationship of the Government to that identified customer or category of customers, a price reduction would apply to the contract for the remainder of the contract period or until [the price was] further reduced, or, in the case of temporary price reductions, for the duration of any temporary price reduction period.

(4) This clause [did] not apply to Contractor's firm fixed price Definite Quantity contracts with specified delivery in excess of the Maximum Order Limitation specified in the [schedule] contract.

(5) The contracting officer [could] exempt from the application of this clause

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A Clause in Search of Meaning (cont'd):

any sale at a price below the contract price if [the sale was] caused by an error in quotation or billing, provided adequate documentation [was] furnished by the contractor immediately following the discovery of the error.

(c) *Price reductions to federal agencies.* . . . Except for temporary “Government-only” price reductions . . . [the 1982 clause—like the post-3M clause—required that] if, after the effective date of th[e] contract, the contractor reduced the price of any contract item to any Federal agency and the sale [fell] within the contract maximum order limitation, an equivalent price reduction [] appl[ied] to all subsequent sales of the contract item to Federal agencies for the duration of the contract period or until the price was further reduced. The contractor [could] offer . . . a temporary “Government-only” price reduction [with] [] a duration of 30 calendar days or more, except during the last month of the contract period when any such offer [had to] be for the remainder of the period).⁶⁷

Unlike the post-3M clause, the 1982 clause exempted nonschedule sales of telecommunications, ADPE, and teleprocessing services to federal agencies from the purview of the clause; thus, in these instances, federal agencies did not receive an equivalent price reduction on subsequent schedule sales of these items.⁶⁸

F. Regulatory Activity from 1982 to 1994

In 1985, the GSA proposed revisions to its 1982 MAS policy statement.⁶⁹ Under these proposed revisions and certain 1986 proposed revisions to the GSAR,⁷⁰ the Price Reductions clause would have been revised to (1) require that contractors only report price reductions affecting the customer(s) or category of customers that were identified as the basis of negotiations rather than all price reductions; (2) preclude federal agencies from being identified as the basis of award for an MAS contract; and (3) exempt sealed-bid, single award contracts with state or local governments or the District of Columbia from the purview of the clause. Due in part to paperwork-reduction concerns expressed by the Office of Management and Budget, these provisions were never promulgated.

In October 1992, and in apparent response to then-Senator John Glenn’s introduction of Senate Bill 2619, the Multiple Award Schedule Program Reform Act of 1992,⁷¹ the GSA announced that it was considering issuing an MAS Price Adjustment clause to replace the Price Reductions clause. Under the proposed clause, sales of schedule items to federal agencies (whether pursuant to a schedule contract or “off schedule”) would apparently not have triggered a price reduction, and contractors would not have had to report any price reductions not involving a basis-of-award customer. In addition, the proposed clause would have provided for price *increases* under certain circumstances.

Notwithstanding the GSA’s 1992 announcement, however, the GSA issued a proposed rule in June 1993⁷² that would have prescribed a new Price Reductions clause differing only
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A Clause in Search of Meaning (cont'd):

slightly from the then-current 1982 clause. In pertinent part, the new clause would have revised the 1982 clause to (1) delete the requirement to report price reductions to commercial customers that did not serve as the basis of award and (2) extend the period—from ten to fifteen days after the effective date of a price reduction—during which a schedule contractor must notify the contracting officer in writing of the reduction.⁷³ In addition, the period during which a schedule contractor must submit a Contractor's End-of-Contract Statement of Price Reductions⁷⁴ would have been extended from ten to fifteen calendar days after the end of the contract period.⁷⁵

G. 1994 Price Reductions Clause

In February 1994, the GSA proposed another Price Reductions clause to clarify the clause's applicability, reduce contractor reporting requirements, and eliminate price reductions based on a low price to a federal agency.⁷⁶ The clause—which, after a twelve-year hiatus, returned to the GSAR—became effective on October 19, 1994.⁷⁷ The October 1994 clause (1) eliminated any reporting requirement with respect to price reductions that do not involve a basis-of-award customer, (2) eliminated paragraph (c) (“Price Reductions to Federal Agencies”) of the 1982 clause,⁷⁸ (3) required the contractor to extend price reductions to the Government under the same terms and with the same effective dates as the contractor extended to its commercial customers, and (4) required that price reductions under the clause be reflected in contract modifications.⁷⁹ In addition, the clause extended the period—from ten to fifteen days after the effective date of a price reduction—during which a schedule contractor must notify the contracting officer of the reduction. The clause also eliminated the requirement for submitting a Contractor's End-of-Contract Statement of Price Reductions.⁸⁰ Finally, the clause revised the language describing the triggering events for a price reduction by essentially splitting the two triggering events described in subparagraph (b)(3)(i) of the 1982 clause into two subparagraphs: (c)(1)(i) and (c)(1)(ii). Specifically, under the October 1994 clause—and, indeed, under the current May 2004 clause—“[a] price reduction applies to purchases under the contract if, after the date negotiations conclude, the Contractor—(i) [r]evises the commercial catalog, pricelist, schedule, or other document upon which contract award was predicated to reduce prices; (ii) [g]rants more favorable discounts or terms and conditions than those contained in the commercial catalog, pricelist, schedule, or other documents upon which contract award was predicated; or (3) grants special discounts to the customer (or category of customers) that was the basis of award, and the change disturbs the price/discount relationship of the Government to the customer (or category of customers) that was the basis of award.”⁸¹

In February 1999, the GSA revised the 1994 clause to substitute the phrase “maximum order threshold” for the phrase “maximum order limit” in paragraph (d)(1) of the clause—the portion of the clause that currently excepts sales to commercial customers under firm, fixed-price definite-quantity contracts with specified delivery in excess of the maximum order threshold from the purview of the clause.⁸² Later in 1999, and as part of its GSAR “rewrite,” the GSA moved the Price Reductions clause from GSAR 552.238-76 to its current location at GSAR 552.238-75.⁸³

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A Clause in Search of Meaning (cont'd):

H. 2004 Price Reductions Clause

The current May 2004 Price Reductions clause,⁸⁴ which the GSA issued as part of its final rule implementing cooperative purchasing,⁸⁵ differs only slightly from the October 1994 clause. In particular, the current clause emphasizes that a sale to a state or local governmental entity under the GSA's cooperative purchasing program will not trigger a price reduction under the clause.⁸⁶ In addition, as noted, the current clause substitutes the phrase "maximum order threshold" for the phrase "maximum order limitation" in paragraph (d)(1) of the clause: the portion of the clause that excepts sales to commercial customers under firm, fixed-price definite-quantity contracts with specified delivery in excess of the maximum order threshold from the purview of the clause.⁸⁷

III. TRANSACTIONS COVERED BY THE CLAUSE

A. Sales

The current Price Reductions clause uses the verb "grants" in two locations (subparagraphs (c)(1)(ii) and (iii)) and the noun "sales" in one location (subparagraph (d)(1)), thus suggesting that a contractor's mere offer to sell a contract item commercially, or its quotation of a price with respect to the item, cannot implicate the clause, at least where the quotation or offer is not accompanied by a revision to the commercial pricelist that was used as the predicate for contract award.⁸⁸

B. Rentals and Leases

Although the Price Reductions clause does not use the terms "rental" or "lease," the GSA takes the position that the clause covers rentals and leases of contract items as well as sales of such items. The application of the Price Reductions clause to rentals or leases (particularly in the context of the Information Technology schedule) can present complex issues with respect to, inter alia, (1) whether price reductions that affect one but not all of a contractor's rental- or lease-pricing plans activate the clause and (2) whether current government rentals or leases of contract items (i.e., a contractor's "installed base") must be adjusted prior to their expiration to reflect a price reduction. A carefully drafted basis of award⁸⁹ can address the first issue; an offeror's insistence that any contract modification only apply a price reduction to new rentals or leases can (if agreed to by the GSA) obviate the second issue.

C. Services

Until the late 1990s, the GSA MAS schedules were product-centric schedules containing very few services, and, accordingly, the Price Reductions clause evolved in and was drafted to reflect a product-centric environment. Nonetheless, it is well-settled today that—at least where the schedule contractor has not succeeded in "negotiating out" the clause—the

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A Clause in Search of Meaning (cont'd):

clause applies to services just as it applies to products. The application of the clause to services frequently presents difficult issues of “mapping” commercial price reductions on labor categories to schedule labor categories to determine whether the contractor has, in fact, triggered the clause.

IV. PRICE REDUCTIONS TO FEDERAL AGENCIES

A. Price Reductions to Schedule Customers

Under the 1982 clause, a contractor’s price reduction to a schedule customer (i.e., a federal agency buying a schedule item under the schedule) always activated the Price Reductions clause. Under the current clause, however (and since the 1994 clause), such price reductions never activate the clause. Instead, the schedule price is simply a “rack rate” that the schedule contractor cannot exceed, and the contractor is entirely free to “spot discount” to federal customers without that spot discount serving to lower the schedule “rack rate” on further sales to federal customers.⁹⁰

B. Price Reductions to Nonschedule Customers

As noted in Part II.D of this article, price reductions to a nonschedule federal customer (i.e., a federal agency buying a schedule item on the “open market”) always activated the 1982 Price Reductions clause unless the schedule contract related to ADPE, telecommunications, or teleprocessing services.⁹¹ Under the 2004 version of the clause, however—and since the 1994 version—price reductions on a schedule item to nonschedule federal customers never activate the clause. In an interesting case at the GSBCA, however, a schedule contractor argued that it was only obligated to give schedule discounts to ordering offices that identified themselves as “GSA qualified” to receive the discounts.⁹² The GSBCA dismissed this contention, noting that the contract assumed that ordering offices are either required to or are entitled to use the schedule contract and that the schedule contractor shoulders the burden to identify those nonmandatory users whose orders the contractor chooses not to fulfill.⁹³

C. Price Reductions to Congress

By special statutory authority, sales or leases to the Congress never activate the Price Reductions clause.⁹⁴

V. PRICE REDUCTIONS TO STATE AND LOCAL GOVERNMENTS

As noted in Part II.D of this article, the 1982 MAS policy statement abolished the former policy excepting sales to state and local governments from the purview of the Price Reductions clause, and such customers may serve as the basis-of-award customer.⁹⁵ Where a state or local government participates in the GSA’s cooperative purchasing or

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A Clause in Search of Meaning (cont'd):

disaster-recovery-purchasing programs, however, the schedule contractor may extend a price reduction to the state or local government without triggering the clause even where the state or local government is a basis-of-award customer.⁹⁶

VI. PRICE REDUCTIONS TO COMMERCIAL CUSTOMERS

From the schedule contractor's viewpoint, the major issues with respect to the Price Reductions clause arise in the context of commercial price reductions. In order to analyze this area, it is important to, first, discuss the concept of basis of award and, second, discuss the various "triggering events."

A. Basis of Award

As noted in Part II.D to II.G of this article, the distinctive feature of the post-1982 Price Reductions clause is the concept of a basis-of-award customer: a specially designated customer or category of customer upon which schedule negotiations were based. In practice, and following the conclusion of negotiations for an MAS contract, the GSA or DVA prepares a "proposed" basis of award summarizing the discounts that the Government has achieved relative to the discounts that the offeror disclosed in its Commercial Sales Practices Format. The GSA or DVA ordinarily proffers this formulation in its request for final proposal revisions with requests that the offeror acquiesce in the formulation. The offeror must carefully scrutinize the formulation and actively negotiate the basis of award because of its critical importance in determining when a MAS contractor⁹⁷ has to offer a price reduction to the Government due to the activation of the Price Reductions clause.⁹⁸ The GSAR requires that the award document "state clearly" the price/discount relationship between the Government and the basis-of-award customer.⁹⁹

The basis of award may be a class of commercial customers (e.g., dealers), a specially named commercial customer (e.g., Ajax Company), or even a collection of named commercial customers (e.g., Ajax Company, Baker Company, and/or Charlie Company).¹⁰⁰ With respect to service schedules (or, indeed, even product schedules, although much less likely in practice), the basis-of award customer also can be a government customer or customers and/or a government contract or contracts.¹⁰¹ In any event, however, the basis-of-award customer need not be the schedule contractor's most-favored commercial customer. Under informal GSA policy, GSA contracting officers are not supposed to predicate a basis of award upon vague customer identifications such as "all commercial customers" or "the general public."¹⁰² Finally, as a practical matter, the GSA and DVA usually will not insist on designating an educational institution as an offeror's basis-of-award customer so long as the institution uses the schedule items for educational purposes and the schedule contractor extends the same pricing arrangement to government educational institutions.¹⁰³

Because of corporate mergers, acquisitions, dissolutions, or other events, a basis-of-award customer can sometimes become "lost" during contract performance.¹⁰⁴ When this occurs, the schedule contractor is well advised to negotiate a replacement basis-of-award customer with the GSA or DVA in order to avoid the possible repricing of the contract on the basis of the contractor's costs.

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A Clause in Search of Meaning (cont'd):

B. The “Triggering Events”

The 2004 Price Reductions clause has three triggering events, known as category (i), (ii), and (iii) price reductions. Category (i) and (iii) price reductions are easy to understand, but category (ii) is all but inscrutable. It is noteworthy that an offeror for a schedule contract can trigger the clause under any of these categories—and incur liability once it becomes a contractor—by reducing its commercial pricing after the date negotiations conclude.¹⁰⁵

A category (i) price reduction applies if the contractor reissues or revises the commercial pricelist that was used as the basis of negotiations and, in so doing, reduces its prices.¹⁰⁶ This species of price reduction is relatively straightforward and is intended to apply to any document that could be characterized as a commercial pricelist from which discounts are offered.¹⁰⁷ Interestingly, however, the clause does not refer to contractors that do not have written discounting policies but that negotiate their schedule contract on the basis of their standard commercial sales practices. Notwithstanding this omission, there seems little question that the GSA would assert the right to a price reduction if the contractor alters its standard commercial sales practices so as to reduce its prices.

Leaving category (ii) price reductions aside for the moment, a category (iii) price reduction describes “garden-variety” commercial price reductions to a basis-of-award customer. As has been noted, a schedule contractor has been required under every Price Reductions clause since the October 1982 version to determine whether the commercial customer to which it has reduced its prices fits within the “identified customer or category of customers that served as the basis of award.”¹⁰⁸ Simply put, if the commercial customer is a member of the identified class, the contractor has activated the Price Reductions clause.¹⁰⁹ This species of price reduction will trigger the clause irrespective of whether the reduction is published or unpublished or is even referable to a pricelist or other document provided to the GSA or DVA.¹¹⁰ Further, although the language in subparagraph (c)(1)(iii) of the clause suggests a contrary conclusion,¹¹¹ different commercial terms and conditions (commercial versus schedule) appear to be irrelevant.¹¹²

Category (ii) price reductions present a real conundrum. Clearly, a category (ii) price reduction is intended to encompass at least some types of “unpublished” (or even “published”)¹¹³ general price reductions not involving a reissuance or revision to a pricelist. Equally clearly, a category (ii) price reduction is not intended to merely describe a “garden-variety” price reduction to a basis-of-award customer; otherwise, there would be no need to define a category (iii) price reduction.¹¹⁴ What is unclear, however, is how “general” a price reduction must be to fall within the purview of a category (ii) price reduction but outside the confines of a category (iii) price reduction.¹¹⁵ Based upon the early history of the clause, which emphasizes that it was initially intended to apply to “horizontal” price reductions to the class of customer identified in the pricelist used for negotiating the schedule contract (e.g., wholesaler pricelist), a strong argument could be made that a category (ii) price reduction only encompasses general unpublished (or even published) discounts or concessions relating to that class of customer.¹¹⁶ This conclusion is supported by the notion that subparagraphs of clauses *in pari material*—in this case, the descriptions of category (ii) and (iii) price reductions in subparagraphs (c)(1)(ii) and (c)(1)(iii) of the clause—should be construed together to give meaning to each.¹¹⁷

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A Clause in Search of Meaning (cont'd):

VII. EFFECT OF MAXIMUM ORDER LIMITATION OR MAXIMUM ORDER THRESHOLD

For many years, most MAS schedules included an MOL for the purpose of forcing ordering offices to attempt to obtain greater discounts for purchases in above-normal quantities. Ordering offices could not submit, and contractors could not accept, orders in excess of an MOL. Thus, the MOL was the dollar amount or unit quantity above which no schedule sales could be made.¹¹⁸ For the last several years, however, the MOL has been replaced by a so-called maximum order threshold (MOT)¹¹⁹ that permits agencies to issue delivery or task orders exceeding that amount.¹²⁰

Firm fixed-price definite-quantity sales with specified delivery in excess of the applicable MOT (or, previously, MOL) do not activate the Price Reductions clause. Each element of this exclusion, however, must be met. For example, some schedule contractors enter into national account agreements or master agreements with commercial customers that provide for extremely low pricing based upon an expectation that above-MOT sales will result. These agreements may state that such pricing is being extended to a commercial customer based upon its high volume of previous purchases from the contractor. Although the schedule contractor may assume that such an agreement does not trigger the Price Reductions clause, GSA or DVA auditors will likely disagree with the contractor in the context of a postaward audit. From an auditor's standpoint, the agreement will be viewed as failing to satisfy the "definite-quantity" requirement. To carry the argument further, some national account agreements or master agreements purport to guarantee the requisite above-MOT volume but do not provide for any penalty in the form of a billback (or "truebill") provision if the commercial customer does not actually achieve such volume. In a postaward audit, GSA or DVA auditors will generally likewise conclude that these agreements also fail to satisfy the "definite-quantity" requirement. Finally, even if the national account agreement or master agreement contains a billback feature, it will be disregarded if the commercial customer has not actually enforced it.¹²¹

VIII. CALCULATION OF PRICE REDUCTIONS

As repeatedly noted in this article, the 2004 Price Reductions clause, and every version of the clause since October 1982, is designed to ensure that the Government maintains its *relative* price/discount advantage throughout the term of the contract in relation to the price/discount of the contractor's commercial customer or customers upon which the contract award was predicated. Thus, any change in the contractor's commercial pricing practices that results in a less advantageous relationship between the Government and the customer or category of customer upon which the schedule contract was predicated will result in a price reduction to the Government to the extent necessary to retain the original relationship. How does the contractor compute the reduction? Surprisingly for an issue of such importance, the current GSAR provides no answer. History, however, provides a guide.

In 1979, when the GSA prescribed its post-3M Price Reductions clause, the GSA published sample calculations in the GSAR showing how to compute an "equivalent price reduction" under the clause.¹²² Unfortunately, however, this guidance was deleted from the
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A Clause in Search of Meaning (cont'd):

GSAR when the GSA issued its 1982 MAS policy statement and has never returned to the regulation. Notwithstanding this omission, however, the post-3M calculations are arguably still relevant to the 2004 Price Reductions clause because neither the policy statement nor any subsequent GSA pronouncement has evidenced any intent to change this “best practice” method of calculating a price reduction.

The sample calculations provide the following examples of how an “equivalent price reduction” should be computed in specific circumstances:

Example No. 1. The [schedule] contract is with a regular dealer, and the Government discount is 28 percent from the Manufacturer’s Suggested Retail Pricelist. The discount schedule and marketing data sheet furnished by the offeror referenced the same price list and indicated that the dealer gives a 20 percent discount to other customers. A specific product is listed on the commercial pricelist furnished to the Government as the basis for negotiation at \$100 per unit. This product is sold by the contractor to a customer other than the Government for \$75 during the 3rd month of the contract. What “equivalent price reduction” is due to the Government for sales of this product for Government orders [that are] placed after the \$75 sale?

(1) Discounts and net prices:

	Price List	Discount Offered	Net Price
To the Government	\$100	28%	\$72
To other customers	\$100	20%	\$80

(2) Price reduction granted other customers in 3rd month of contract = \$5
(\$80 – \$75)

(3) Additional price reduction to other customers = 6.25% ($5 \div 80$)

(4) Comparable price reduction per unit applicable to Government purchases of the product after the \$75 sale to other customers = \$4.50 ($\$72 \times 6.25\%$)

(5) New reduced Government unit price = \$67.50 ($\$72 - \4.50)

(6) New government discount = 32.5%

$$\frac{(\$100 - \$67.50)}{\$100} = \frac{\$37.50}{\$100} = 32.5\%$$

Example No. 2. The [schedule] contract is with a manufacturer, and the Government’s discount is 30 percent from the Manufacturer’s Suggested Retail Pricelist. The discount schedule and marketing data sheet indicate discounts to regular dealers of 40 percent from the same pricelist. The contractor increases its discount to dealers from 40 to 50 percent in the 4th

A Clause in Search of Meaning (cont'd):

month of the contract period. What “equivalent price reduction” should the Government receive?

(1) Discounts and net prices:

	Price List	Discount Offered	Net Price
To the Government	\$100	30%	\$70
To other customers	\$100	40%	\$60

(2) Additional price reduction granted to regular dealers = \$10 (\$60 – \$50)

(3) Price reduction percentage = 16.67% (10 ÷ 60)

(4) Comparable price reduction per unit applicable to government purchases after the reduction in price to regular dealers = \$11.67 (\$70 × 16.67%)

(5) New reduced government unit price = \$58.33 (\$70 – \$11.67)

(6) New government discount = 41.67%

$$\frac{(\$100 - \$58.33)}{\$100} = \frac{\$41.67}{\$100} = .4167 \text{ or } 41.67\%^{123}$$

Under this calculation method, the discount ratio does not remain constant (e.g., 30%/40% is not the same ratio as 41.67%/50%); rather, the price ratio remains constant (e.g., \$60/\$70 is the same ratio as \$50/\$58.33). It is possible, of course, to base the calculation methodology on the discount ratio remaining constant.¹²⁴

Although the post-3M sample calculations¹²⁵ are not official GSA regulatory guidance, they are useful as negotiating tools and generally reflect the GSA’s analysis as to how to compute price reductions under the current Price Reductions clause.¹²⁶

IX. EFFECTIVE DATE OF PRICE REDUCTIONS

A. Price Reductions to Federal Agencies

With the exception of temporary “government-only” price reductions, a price reduction to a federal agency under the 1982 Price Reductions clause was effective at the time of the initial purchase by the agency at the reduced price. Temporary “government-only” price reductions were effective at the time of acceptance by the contracting officer. In either case, the contractor was required—pending the modification of the schedule contract—to invoice federal customers at the reduced price and to indicate that the price reduction was pursuant to the Price Reductions clause. Under the 1994 and subsequent clauses, price reductions to a federal agency do not activate the clause, and the “effective date” of a price reduction for federal agencies is immaterial.

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A Clause in Search of Meaning (cont'd):

B. Price Reductions to Other Customers

Under the 2004 Price Reductions clause, a price reduction to a nonfederal customer (e.g., a basis-of-award customer) is effective for the Government¹²⁷ at the same time and for the same period as extended to the commercial customer (or category of customers).¹²⁸ While the clause does not mention the possibility of temporary commercial price reductions, many schedule contractors routinely offer such reductions (also available to the Government) as an integral part of their commercial and federal sales and marketing activities.¹²⁹

X. REPORTING REQUIREMENTS

A. Notification to Contracting Officer of Price Reductions

Under subparagraph (f) of the 2004 Price Reductions clause, a schedule contractor must notify the contracting officer in writing of any price reduction subject to the clause as soon as possible but not later than fifteen calendar days after the effective date of the reduction. Under the 1982 clause but not the current clause, if the contractor failed to provide timely notice, any price reduction that triggered the clause (including any temporary price reduction) would apply to the contract for the duration of the contract period or until the price was further reduced. Although the 2004 clause is silent on this point, a schedule contractor that fails to notify the contracting officer of a temporary price reduction to a basis-of-award customer will presumably suffer the same fate in an audit scenario; i.e., the GSA or DVA will assert that the price Reduction applies to the contract for the duration of the contract period or until the contractor further reduces its commercial price. As a practical matter, therefore, a schedule contractor's failure to notify the contracting officer of a commercial price reduction will presumably vitiate any claim by the contractor that it only intended for the reduction to be temporary. In addition, any such failure also may constitute a basis for termination of the contract for default. Because the Price Reductions clause does not apply to above-MOT commercial sales that fit within the parameters of paragraph (d)(1) of the clause, however, the schedule contractor does not have to report such sales to the contracting officer.¹³⁰

As noted in Part II.E of this article, the GSA proposed in 1985 and 1986 to modify the 1982 Price Reductions clause to delete the then-existing requirement that schedule contractors report all price reductions made during the contract period. Instead, the proposed clause would have merely required a contractor to report all price reductions to those customers or category of customers upon which the contract award was predicated; the reporting requirement would not have applied to other price reductions. The contractor would further have been required to notify the contracting officer and federal agencies in writing of any price reduction at the same time as the contractor provided notice of the price reduction to its commercial customer.

Although these proposed changes were not enacted at the time, the GSA's 1994 Price Reductions clause and all subsequent clauses eliminate the requirement to report price reductions to commercial customers that did not serve as the basis of award. In addition, the 1994 clause and subsequent clauses have extended the period—from ten to fifteen days after the effective date of a price reduction—during which a schedule contractor must notify the

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A Clause in Search of Meaning (cont'd):

contracting officer in writing of the reduction. Finally, the 1994 clause and subsequent clauses provide that the schedule contract must be modified to reflect any price reduction that becomes applicable in accordance with the clause.¹³¹

B. Former Requirement for Contractor's End-of-Contract Statement of Price Reductions

Under the 1982 Price Reductions clause, a schedule contractor was required to furnish a statement to the contracting officer within ten calendar days after the end of the contract period certifying that either (1) there had been no applicable price reduction during the period or (2) the contractor had reported any price reduction to the contracting officer. For each reported price reduction, the contractor had to list the date when it notified the contracting officer of the price reduction. This provision had the practical effect of “flushing out” unreported price reductions and was a major compliance concern for schedule contractors. Although the GSA's June 1993 proposed rule on the Price Reductions clause would have preserved this provision (and extended the ten-day reporting period to fifteen days), the GSA's 1994 Price Reductions clause and subsequent clauses do not contain a Contractor's End-of-Contract Statement of Price Reductions.

XI. SANCTIONS FOR NONCOMPLIANCE WITH THE CLAUSE

Price-reduction problems in the MAS context often also involve a contractor's submission of defective pricing data, and the Government will ordinarily pursue whatever theory offers the largest potential recovery.¹³² As with defective pricing,¹³³ the Government may impose various sanctions for violations of the Price Reductions clause.

A. Price Adjustment

Although the 2004 Price Reductions clause is silent on this point, a schedule contractor's failure to notify the GSA or DVA of a price reduction to a basis-of-award customer—including a temporary price reduction—presumably entitles the Government to an appropriate price adjustment for the remainder of the contract period (computed from the time of the reduction) or until the contractor further reduces its price.¹³⁴

B. Termination for Default or Convenience or Nonrenewal of Contract

Under the Price Reductions clause, a schedule contractor's failure to notify the GSA or DVA of a price reduction constitutes a breach of contract entitling the Government to terminate the contract for default. In such an instance (in addition to its price reductions exposure), the contractor is liable to the GSA or DVA for any excess costs of procurement. As in the case of other government contracts, MAS contracts also contain a Termination for Convenience clause that could be theoretically exercised in this context; more likely, however, the GSA or DVA would simply cancel the contract under the Cancellation clause.¹³⁵

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A Clause in Search of Meaning (cont'd):

C. Debarment/Suspension

A schedule contractor that fails to notify the GSA or DVA of a price reduction may face debarment or suspension. Typically, however, this sanction is not employed absent aggravated circumstances—such as where the schedule contractor also has submitted defective pricing data to the GSA or DVA.

D. Monetary Recovery Under the Civil False Claims Act

Undisclosed price reductions may result in claims under the civil False Claims Act (FCA)¹³⁶ on the theory that the schedule contractor has submitted inflated invoices to the Government. As adjusted in 1999 for inflation, the FCA provides for a civil penalty of not less than \$5,500 and not more than \$11,000 plus between two and three times the amount of damages that the Government sustains because of the false claims.¹³⁷ Violators are also liable to the Government for the costs of any civil action brought to recover any such penalties or damages.¹³⁸

E. Monetary Recovery Under the Program Fraud Civil Remedies Act

The Program Fraud Civil Remedies Act¹³⁹ applies to false claims of \$150,000 or less.¹⁴⁰ As such, the Act is arguably much more useful in the price reductions context than in the defective-pricing context, where a schedule contractor's typical exposure under the FCA is much higher than the \$150,000 ceiling under the Program Fraud Civil Remedies Act. The Act provides for a civil penalty of not more than \$5,500 for each such claim¹⁴¹ and generally provides for an assessment of not more than twice the amount of such claim or the portion of such claim that is determined to violate the Act.¹⁴²

F. Criminal Prosecution

While such a prosecution would be rare, a schedule contractor's failure to disclose a price reduction to the GSA or DVA could subject the contractor to criminal sanctions under the False Statements Act,¹⁴³ which proscribes the knowing and willful making of a false statement to or the concealment of a material fact from the Government. Such an act also could implicate the criminal False Claims Act,¹⁴⁴ which proscribes the knowing submission of any false, fictitious, or fraudulent claim to the Government.

XII. REFORMING THE PRICE REDUCTIONS CLAUSE

Schedule contractors have consistently complained about the burdens of complying with the Price Reductions clause.¹⁴⁵ In addition, schedule contractors have argued that the clause is inconsistent with customary commercial practice¹⁴⁶ and should be removed from the GSAR.¹⁴⁷ Third, at least one commentator has suggested that the clause is particularly unsuited for the current services-centric schedules environment.¹⁴⁸ Finally, schedule contractors have
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A Clause in Search of Meaning (cont'd):

complained about the clause's vagueness and imprecision.¹⁴⁹ Herewith, I offer some suggestions for "reforming" the clause:¹⁵⁰

(1) Emphasize that the basis-of-award customer need not be the schedule contractor's most-favored commercial customer. Acknowledge that the offeror may justify a differential between its offered schedule price and its lowest commercial price.

(2) Clarify the category (ii) "triggering event" by emphasizing that a category (ii) price reduction only applies to general unpublished discounts or concessions relating to the contractor's "pricelist" customer. Address the situation where a contractor's pricelist covers multiple categories of commercial customers.

(3) Clarify the category (iii) "triggering event" by emphasizing that a change in terms and conditions to a basis-of-award customer that is favorable to the customer will trigger the clause.

(4) Prescribe further definition as to what must be included in a basis of award and identify where it must appear in the award document.

(5) Prescribe a method for calculating price reductions under the clause.

(6) Address the application of the clause to situations where the schedule contractor has previously obtained a price increase or increases under an Economic Price Adjustment clause.¹⁵¹

(7) Provide examples relating to the application of the clause similar to the examples in the FAR relating to organizational conflicts of interest.¹⁵²

(8) Recast the terminology in the clause so that it clearly addresses the provision of services as well as the sale of products.¹⁵³

(9) Provide further clarity as to the meaning of the exception for firm, fixed-price definite-quantity contracts with specified delivery in excess of the MOT. Emphasize that when a nonexcepted commercial sale above the MOT is to a basis-of-award customer, the Price Reductions clause is triggered.¹⁵⁴ Address the inapplicability of the exception to commercial time-and-materials contracts.

(10) Warn the schedule contractor that if it does not timely report price reductions, the Government will assert the right to a price reduction for the remainder of the contract term.

(11) Emphasize that, in the case of service schedules, the basis-of-award customer may be a government customer(s) and/or contract(s).

(12) In subparagraph (c)(2) of the clause, substitute the phrase "eligible ordering activities" for the word "Government" and clarify precisely when a triggering price reduction is effective for such activities.

(13) Delete the requirement that the contractor's report to the contracting officer include "the conditions under which the reductions were made."

XIII. CONCLUSION

Schedule contractors will never love the Price Reductions clause, but if it is "reformed" and updated, the clause at least will be much easier to administer. The MAS program—clearly the Government's premier indefinite-delivery, indefinite-quantity (IDIQ) contracting vehicle for commercial items—will only benefit as a result.

A Clause in Search of Meaning (cont'd):

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Endnotes

1. Although the GSA administers the MAS program, the GSA may authorize other agencies to award schedule contracts and publish schedules. *See* FAR 38.000, 38.101(d). In this regard, the GSA has authorized the DVA to award schedule contracts for certain pharmaceuticals and medical supplies. *See id.* For a discussion of some issues relating to the Price Reductions clause that are unique to DVA schedule contractors, see Donna Lee Yesner & Stephen Ruscus, *Selling Medical Supplies and Services Through the Department of Veterans Affairs Federal Supply Schedule Program*, 37 Pub. Cont. L.J. 489 (2008).
2. Under the Competition in Contracting Act of 1984, the MAS program is deemed a “competitive procedure” as long as the program is open to all responsible sources and orders and contracts under these procedures result in the lowest cost alternative to meet the Government’s needs. 10 U.S.C. §2302 (2000); 41 U.S.C. §259(b)(3) (2000).
3. Even the GSA admits that “[o]f all the clauses in our multiple award solicitations/contracts, the Price Reduction Clause, I-FSS-390, seems to generate the most questions.” Fed. Supply Serv., Gen. Servs. Admin., Procurement Information Bulletin 90-24 (1990) (on file with the *Public Contract Law Journal*).
4. For a scholarly summary of the clause as it existed in 1985, *see* Carl L. Vacketta, Irving Jaffe & James B. Warren, *The “Price Reductions” Clause*, Briefing Papers, Dec. 1985, at 1. For an excellent discussion of the current clause, *see* John W. Chierichella and Jonathan S. Aronie, *Multiple Award Schedule Contracting* 354 –69 (2d ed. 2006).

5. The current version of the Price Reductions clause reads as follows:

Price Reductions (May 2004)

(a) Before award of a contract, the Contracting Officer and the Offeror will agree upon (1) the customer (or category of customers) which will be the basis of award, and (2) the Government’s price or discount relationship to the identified customer (or category of customers). This relationship shall be maintained through out [sic] the contract period. Any change in the Contractor’s commercial pricing or discount arrangement applicable to the identified customer (or category of customers) which disturbs this relationship shall constitute a price reduction.

(b) During the contract period, the Contractor shall report to the Contracting Officer all price reductions to the customer (or category of customers) that was the basis of award. The Contractor’s report shall include an explanation of the conditions under which the reductions were made.

(c)(1) A price reduction shall apply to purchases under this contract if, after the date negotiations conclude, the Contractor—

- (i) Revises the commercial catalog, pricelist, schedule or other document upon which contract award was predicated to reduce prices;
- (ii) Grants more favorable discounts or terms and conditions than those contained in the commercial catalog, pricelist, schedule or other documents upon which contract award was predicated; or
- (iii) Grants special discounts to the customer (or category of customers) that formed the basis of award, and the change disturbs the price/discount relationship of the Government to the customer (or category of customers) that was the basis of award.

(2) The Contractor shall offer the price reduction to the Government with the same effective date, and for the same time period, as extended to the commercial customer (or category of customers).

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A Clause in Search of Meaning (cont'd):

(d) There shall be no price reduction for sales—

(1) To commercial customers under firm, fixed-price definite quantity contracts with specified delivery in excess of the maximum order threshold specified in this contract;

(2) To Federal agencies;

(3) Made to State and local government entities when the order is placed under this contract (and the State and local government entity is the agreed upon customer or category of customer that is the basis of award); or

(4) Caused by an error in quotation or billing, provided adequate documentation is furnished by the Contractor to the Contracting Officer.

(e) The Contractor may offer the Contracting Officer a voluntary Governmentwide price reduction at any time during the contract period.

(f) The Contractor shall notify the Contracting Officer of any price reduction subject to this clause as soon as possible, but not later than 15 calendar days after its effective date.

(g) The contractor [sic] will be modified to reflect any price reduction which becomes applicable in accordance with this clause.

GSAR 552.238-75 (added by 69 Fed. Reg. 28,063 (May 18, 2004)).

The Alternate I version of the clause substitutes the following paragraphs for the same paragraphs in the basic clause:

(c)(2) The Contractor shall offer the price reduction to the eligible ordering activities with the same effective date, and for the same time period, as extended to the commercial customer (or category of customers).

(d)(2) To eligible ordering activities under this contract [].

Id.

6. In January 2007, the GSBCA was merged into the Civilian Board of Contract Appeals. See National Defense Authorization Act for Fiscal Year 2006, Pub. L. No. 109-163, §847, 119 Stat. 3136, 3391–95.

7. *Roxbury Carpet Co.*, GSBCA No. 494, 1961 WL 12222. The *Roxbury* case was cited in *Pennwalt Corp.*, GSBCA No. 3580, 72-2 BCA ¶9647, at 45,046, and *Racon Inc.*, GSBCA No. 3628, 73-1 BCA ¶9789, at 45,470. According to the GSBCA in *Pennwalt*, *Roxbury* stands for the unremarkable proposition that the Price Reductions clause cannot be invoked unless the item that is the subject of the commercial price reduction is the same item that is on the contractor's GSA schedule contract. *Pennwalt Corp.*, 72-2 BCA ¶9647, at 45,045.

8. Article 13 was not brand new even in 1957 when the GSA issued the solicitation that resulted in the 1958 contract. In *Roxbury*, the GSA represented to the GSBCA that “Article 13 had been used in FSS contracts over a long period of time.” *Roxbury Carpet Co.*, 1961 WL 12222. The GSA further observed that article 13 “ha[d] never been interpreted by the Comptroller General or any board or court.” *Id.*

9. *Id.* (included in Statement of Facts).

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.* The GSA had admitted, however, that article 13 would not apply to “an isolated sale by the Appellant at a reduced price, because a similar quantity situation would not be involved.” *Id.*

16. *Id.* (noting that the contract was entered into on March 11, 1958, and the revision was made thereafter).

17. *Id.*

18. See *Pennwalt Corp.*, GSBCA No. 3580, 72-2 BCA ¶ 9647, at 45,044 (reproducing clause). The 1964 clause read as follows:

34. PRICE REDUCTIONS

(This Price Reductions clause is applicable only to requirements contracts and indefinite quantity contracts.) (a) If
(continued on next page)

A Clause in Search of Meaning (cont'd):

at any time after the date of the bid or offer the Contractor makes a general price reduction in the comparable price of any article or service covered by the contract to customers generally, an equivalent price reduction based on similar quantities and/or consideration shall apply to the contract for the duration of the contract period (or until the price is further reduced). Such price reduction shall be effective at the same time and in the same manner as the reduction in the price to customers generally. For purpose of this provision, a “general price reduction” shall mean any horizontal reduction in the price of an article or service offered (1) to Contractor’s customers generally, or (2) in the Contractor’s price schedule for the class of customers; i.e., wholesalers, jobbers, retailers, etc., which was used as the basis for bidding on this contract. (For purposes of determining a “general price reduction” under this clause, sales to States, including the District of Columbia, and other political subdivisions by the Contractor, or reductions in price schedules of the Contractor to such agencies, shall have no application.) An occasional sale at a lower price, or sale of distressed merchandise at a lower price, would not be considered a “general price reduction” under this provision. The Contractor shall invoice the ordering offices at such reduced prices indicating on the invoice that the reduction is pursuant to the “Price Reduction” article of the contract provisions. The contractor, in addition, shall within 10 days of any general price reduction notify the General Services Administration’s Contracting Officer of such reduction by letter. Failure to do so may require termination of the contract, as provided in the “Default” clause of the General Provisions. Upon receipt of any such notice of a general price reduction all ordering offices will be duly notified by the Contracting Officer.

Id. (quotation marks omitted).

19. *See* Price Reduction Provision, 32 Fed. Reg. 9,402, 9,432 (June 30, 1967) (adding 41 C.F.R. §5A-7.101-77); *see also id.* at 9,471 (adding 41 C.F.R. § 5A-73.123-1, which prescribed use of the clause (with exceptions not relevant here) “in each invitation for bids or solicitation for offers and resulting Schedule”). In 1969, the prefatory language of the clause was revised to extend the application of the clause to “solicitations” for indefinite quantities rather than merely “invitations for bid” for indefinite quantities. *See* Price Reduction Provision, 34 Fed. Reg. 8,237, 8,240 (May 28, 1969).

20. Price Reduction Provision, *supra* note 19, 32 Fed. Reg. at 9,432; *see also infra* notes 74–75 and accompanying text.

21. *Pennwalt Corp.*, 72-2 BCA ¶9647.

22. *Id.* at 45,045.

23. *Id.* at 45,045–47. As noted in note 7 *supra*, the GSBCA cited *Roxbury* for the proposition that the Price Reductions clause cannot be invoked unless the item that is the subject of the commercial price reduction is the same item that is on the contractor’s GSA schedule contract. *See supra* note 7.

24. *Pennwalt Corp.*, GSBCA No. 3580, 72-2 BCA ¶9647, at 45,046.

25. The GSBCA noted that this interpretation “would unduly narrow the applicability of the clause and [would be] unreasonable.” *Id.* at 45,046.

26. *Id.*

27. *Id.*

28. *Racon Inc.*, GSBCA No. 3628, 73-1 BCA ¶9789.

29. *Id.* at 45,739.

30. *See id.* at 45,740.

31. *Id.*

32. *Id.* at 45,741.

33. *Id.*

34. *Id.* A dissenting board judge criticized this approach, however, noting that “[t]he phrase ‘equivalent [price] reduction’ [did] not specify whether the reduction should be made by percentages or by actual cent per pound of the general price reduction.” *Id.* at 45,743 (James, J., dissenting).

35. Price Reductions Clause, 35 Fed. Reg. 810 (Jan. 21, 1970) (repositioning the clause from 41 C.F.R. §5A-7.101-77 to 41 C.F.R. §5A-73.123-1). With respect to price reductions to commercial customers and federal agencies, the clause read as follows:

(a) *Reductions to Customers other than Federal Government.*

(1) If, at any time after the date of the offer which is subsequently accepted by the Government,
(*continued on next page*)

A Clause in Search of Meaning (cont'd):

(i) the Contractor changes the catalog, price list, price schedule, or other pricing document which was offered to and used by the Government to establish the prices in this contract so as to reduce (by granting a greater discount or otherwise) any price therein to any customer or class of customers (e.g., wholesalers, jobbers, retailers, etc.) for any article or service covered by this contract, an equivalent price reduction shall apply to this contract to the same extent and in the same manner as the commercial reduction and shall apply for the duration of the contract period or until the price is further reduced. For purposes of this paragraph, bonus goods or any other method by which the price is effectively reduced may constitute a price reduction.

(2) For the purpose of this paragraph (a), [a] reduction by a Contractor in its prices to States, the District of Columbia, and other political subdivisions shall have no application.

(b) *Reductions to Federal Agencies*. If, at any time after the date of the offer which is subsequently accepted by the Government, the Contractor reduces the price of any article or service covered by this contract to any Federal agency required to use the contract and the quantity involved or dollar amount of the purchase falls within the applicable maximum order limitation, an equivalent price reduction shall apply to the contract to the same extent and in the same manner as the initial reduction and shall apply for the duration of the contract period or until the price is further reduced. For purposes of this paragraph, bonus goods or any other method by which the price is effectively reduced may constitute a price reduction.

Id.

36. *See* Price Reductions, 37 Fed. Reg. 28,417 (Dec. 23, 1972). The 1972 clause introduced the concept of a temporary or promotional price reduction “that shall be made available to the Contracting Officer under the same terms and conditions as to other customers, except that in lieu of accepting bonus goods, the Contractor’s cost of such goods shall be deducted from the contract price.” *Id.*

37. 3M Bus. Prods. Sales, Inc., GSBCA Nos. 4722, 4878, 78-2 BCA ¶13,362, *aff’d on reconsideration*, 79-1 BCA ¶13,567.

38. Price Reductions, *supra* note 36, 37 Fed. Reg. at 28,417; 3M Bus. Prods. Sales, 78-2 BCA ¶13,362, at 65,304. With minor stylistic changes, the 1972 clause was updated in 1976. *See* Price Reductions Clause, 41 Fed. Reg. 27,037, 27,067–68 (July 1, 1976) (repositioning the clause from 41 C.F.R. §5A-73.123.1 to 41 C.F.R. §5A-73.217-5); *see also* Price Reductions Clause, 43 Fed. Reg. 1,347, 1,349 (Jan. 9, 1978) (further stylistic changes).

39. In September 2005, the FSS was merged into the GSA’s newly formed Federal Acquisition Service (FAS). *See* GSA Order ADM 5440.591 CHGE 1, Sept. 9, 2005, http://www.gsa.gov/Portal/gsa/ep/contentView.do?pageTypeId=8199&channelId=13830&P=XAE&contentId=21791&contentType=GSA_BASIC; *see also* General Services Administration Modernization Act, Pub. L. No. 109-313, 120 Stat. 1734 (2006).

40. 3M Bus. Prods. Sales, 78-2 BCA ¶13,362, at 65,308.

41. *Id.*

42. On July 7, 2004, the GAO was renamed the Government Accountability Office. *See* GAO Human Capital Reform Act of 2004, Pub. L. No. 108-271, §§ 8(a), 13(a), 118 Stat. 811, 814, 816.

43. 3M Bus. Prods. Sales, Inc., GSBCA Nos. 4722, 4878, 78-2 BCA ¶13,362, at 65,306.

44. *Id.*

45. *Id.* The GSBCA’s analysis is not necessarily accurate since it assumes that the initial GSA price is always less than the initial commercial price.

46. *Id.* at 65,308.

47. *Id.*

48. Racon Inc., GSBCA No. 3628, 73-1 BCA ¶9789.

49. *See also* Pennwalt Corp., GSBCA No. 3580, 72-2 BCA ¶9647, at 45,046 (rejecting the contractor’s contention that it is inappropriate to compare profitable wholesale prices with at cost or below-cost prices to the Government “in order to infer that a reduction in the profit margin on the profitable prices demands an increase in the loss on the below cost prices” and holding that the Price Reductions clause does not require the contracting officer or the GSBCA “to go behind the prices to determine profit margins or to ascertain other subjective determinations which [the contractor] entertained when formulating those prices in order to determine their comparability”).

50. *See* 44 Fed. Reg. 37,920, 37,927 (June 29, 1979) (revising 41 C.F.R. §5A-73.217-5). The 1978 clause appeared in GSA Form 1424 (9/78 edition) as Clause No. 80. *See* GSA Form 1424 (GSA Supplemental Provisions) (rev. 9/78) (on file with the *Public Contract Law Journal*).

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A Clause in Search of Meaning (cont'd):

51. 44 Fed. Reg. 37,920, 37,927 (June 29, 1979).
52. The MOL, which has been replaced by the maximum order threshold, *see infra* Part VII, was a dollar amount or unit quantity limit on schedule purchases.
53. 44 Fed. Reg. 37,920, 37,927 (June 29, 1979).
54. *Id.*
55. *Id.*
56. *Id.*
57. *Id.*
58. *Id.*
59. *Id.*; *see* Info. Handling Servs., GSBCA No. 7563, 88-2 BCA ¶20,789 (under schedule contract that apparently included the post-3M Price Reductions clause, the GSBCA upheld the GSA contracting officer's assessment of a price reduction where the schedule contractor had sold schedule items "off-schedule" during the term of its schedule contract to another federal agency at a reduced price).
60. 44 Fed. Reg. 37,920, 37,927 (June 29, 1979).
61. Multiple Award Schedule Procurement, 47 Fed. Reg. 50,242 (Nov. 5, 1982) [hereinafter MAS Procurement].
62. The new clause, Clause No. 390 (9/82), replaced Clause No. 80 in GSA Form 1424 (9/78 edition). Ultimately, a shortened version of the clause appeared as Clause No. 59 in the March 1990 version of GSA Form 2891 (Federal Supply Schedule Clauses). *See* GSA Form 2891 (Mar. 1990) (Federal Supply Schedule Clauses) (on file with the *Public Contract Law Journal*). The clause was not included in the GSAR. Oddly, however, the 1979 Price Reductions clause continued to appear in the *Code of Federal Regulations* until at least July 1, 1984. *See* 41 C.F.R. §5A-73.217-5 (1984).
63. MAS Procurement, *supra* note 61, 47 Fed. Reg. at 50,243.
64. *See id.* Proposed 1985 revisions to the MAS policy statement and certain 1986 proposed revisions to the GSAR would, however, have exempted sealed-bid, single-award contracts with state or local governments or the District of Columbia from the application of the clause.
65. *Id.* at 50,245.
66. The GSA ADPE schedule contracts were the predecessors to the current GSA Information Technology (Federal Supply Classification Group 70) schedule contracts.
67. MAS Procurement, *supra* note 61, 47 Fed. Reg. at 50,245–46.
68. *See id.* at 50,246.
69. *See* 50 Fed. Reg. 11,910 (Mar. 26, 1985); 50 Fed. Reg. 50,502 (Dec. 10, 1985).
70. *See* 51 Fed. Reg. 31,344 (Sept. 3, 1986).
71. Senate Bill 2619 would have modified the Price Reductions clause by providing for a price adjustment to a schedule contract only to the extent that such an adjustment was necessary to ensure that prices remained fair and reasonable throughout the schedule term. *See* Multiple Award Schedule Program Reform Act of 1992, S. 2619, 102d Cong., §2 (proposed adding section 113(b)(5)(A)–(C) to the Federal Property and Administrative Services Act of 1949 (FPASA)). Under the bill, a schedule price would have been subject to adjustment if there was (i) a general reduction in the schedule contractor's commercial catalog or market price for items included on the schedule contract; (ii) a general reduction in the prices offered to end user commercial buyers purchasing items included on the schedule contract; or (iii) any other change in the contractor's commercial discount or pricing policies supporting a determination that the schedule prices [were] no longer fair and reasonable. *Id.* (proposed section 113(b)(5)(B) of FPASA). A price adjustment would have been limited in amount to that deemed necessary to make the schedule price fair and reasonable as demonstrated by the contracting officer. *Id.* (proposed section 113(b)(5)(C) of FPASA).
72. *See* 58 Fed. Reg. 32,890 (June 14, 1993).
73. *Id.*
74. The 1982 Price Reductions clause required a schedule contractor to furnish a statement to the contracting officer within ten calendar days after the end of the contract period certifying either that (1) there had been no applicable price reduction during the period or (2) the contractor had reported any price reduction to the contracting officer. For each reported price reduction, the contractor had to disclose the date when the contractor had reported the price reduction to the contracting officer. The GSA's 1994 Price Reductions clause eliminated the

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A Clause in Search of Meaning (cont'd):

requirement for the contractor to submit a Contractor's End-of-Contract Statement of Price Reductions, and the requirement has not appeared in any subsequent clause.

75. *Id.* at 32,890–91.

76. *See* General Services Administration Acquisition Regulation; Multiple Award Schedule Price Reductions Clause, 59 Fed. Reg. 8,590 (proposed Feb. 23, 1994) [hereinafter MAS Price Reductions Clause I] (to be codified at 48 C.F.R. pts. 538, 552) (proposing new GSAR 552.238-76).

77. *See* General Services Administration Acquisition Regulation; Multiple Award Schedule Price Reductions Clause, 59 Fed. Reg. 52,450, 52,451–52 (Oct. 18, 1994) [hereinafter MAS Price Reductions Clause II] (to be codified at 48 C.F.R. pts. 538, 552) (adding GSAR 552.238-76).

78. The National Performance Review had recommended that line managers be given greater flexibility to buy the same or comparable MAS products for less than the GSA “rack rate.” *See* MAS Price Reductions Clause I, *supra* note 76, 59 Fed. Reg. at 8,591. In order to remove any disincentive for MAS contractors to offer a lower price to agencies on individual orders, the GSA determined to delete paragraph (c). *See id.*; *see also* FAR 8.405-4 (“Schedule contractors are not required to pass on to all schedule users a price reduction extended only to an individual ordering activity for a specific order.”).

79. *See* MAS Price Reductions Clause II, *supra* note 77, 59 Fed. Reg. at 52,452.

80. *See id.*

81. *Id.* In the supplementary information on the new rule, the GSA noted that two organizations had urged the GSA to eliminate the Price Reductions clause “because it is confusing and inconsistent with commercial practice.” *Id.* at 52,451. The GSA—while asserting that it had clarified the aspects of the clause that the commentators had found confusing—disagreed that the clause is inconsistent with commercial practice, observing that “[s]ome large commercial contracts contain similar price protection provisions.” *Id.*

82. *See* General Services Administration Acquisition Regulation; Streamlining Administration of Federal Supply Service (FSS) Multiple Award Schedule (MAS) Contracts and Clarifying Marking Requirements, 64 Fed. Reg. 4788, 4789 (Feb. 1, 1999) (to be codified at 48 C.F.R. pt. 552). The interim rule also slightly revised the Modifications (Multiple Award Schedule) clause, which requires the schedule contractor—when requesting a modification for a price reduction—“to indicate whether the price reduction falls under item (i), (ii), or (iii) of paragraph (c)(1) of the Price Reductions clause.” *See id.* at 4789–90 (amending GSAR 552.243-72).

83. *Compare* MAS Price Reductions Clause II, *supra* note 77, 59 Fed. Reg. at 52,452, *with* General Services Administration Acquisition Regulation, 64 Fed. Reg. 37,200, 37,253 (July 9, 1999) (to be codified at 48 C.F.R. pt. 552).

84. GSAR 552.238-75 (as amended by General Services Administration Acquisition Regulation; Federal Supply Schedule Contracts—Acquisition of Information Technology by State and Local Governments Through Federal Supply Schedules, 69 Fed. Reg. 28,063, 28,065 (May 18, 2004)).

85. *See* General Services Administration Acquisition Regulation; Federal Supply Schedule Contracts—Acquisition of Information Technology by State and Local Governments Through Federal Supply Schedules, 69 Fed. Reg. 28,063 (May 18, 2004) [hereinafter FSS Contracts] (to be codified at 48 C.F.R. pt. 552) (GSAR final rule implementing the E-Government Act of 2002). The E-Government Act of 2002 amended the FPASA to permit state and local governments to access the GSA multiple-award schedules to purchase information technology—so-called cooperative purchasing. *See* E-Government Act of 2002, Pub. L. No. 107-347, §211, 116 Stat. 2899, 2939 (codified as amended at 44 U.S.C. §3501 note) (adding 40 U.S.C. §502(c)). Where a schedule contractor is participating in the GSA’s cooperative-purchasing program, Alternate I of the clause is used. *See* GSAR 538.273(b)(2)(i).

86. *See* FSS Contracts, *supra* note 85, 69 Fed. Reg. at 28,063. The GSA’s interim rule that implemented cooperative purchasing had promulgated a previous version of the Price Reductions clause—the May 2003 clause. *See* General Services Administration Acquisition Regulation; Federal Supply Schedule Contracts—Acquisition of Information Technology by State and Local Governments Through Federal Supply Schedules, 68 Fed. Reg. 24,372, 24,381 (May 7, 2003) (to be codified at 48 C.F.R. pt. 552). This clause was less clear that a price reduction to a state or local government under the cooperative purchasing program would not trigger the Price Reductions clause even where the state or local government was a basis-of-award customer. *Compare id.* at 24,381, *with* FSS Contracts, *supra* note 85, 69 Fed. Reg. at 28,065.

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A Clause in Search of Meaning (cont'd):

87. See GSAR 552.238-76. In February 2007, the GSA opened the GSA schedules to state and local governments for the purpose of permitting them to purchase products and services to be used to facilitate recovery from a major disaster, terrorism, or nuclear, biological, chemical, or radiological attack. See General Services Acquisition Regulation; Federal Supply Schedule Contracts—Recovery Purchasing by State and Local Governments Through Federal Supply Schedules, 72 Fed. Reg. 4649, 4654 (Feb. 1, 2007) (to be codified at 48 C.F.R. pt. 552) (implementing the John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, §833, 120 Stat. 2083, 2332 (2006)). While the GSA did not promulgate a new Price Reductions clause in response to this initiative, the implementing regulations also require the use of Alternate I when a schedule contractor has elected to open up its schedule contract or contracts for disaster-recovery purchasing. *Id.* at 4653 (adding GSAR 538.273(b)(2)(ii)). Under Alternate I, therefore, a price reduction to a state or local government under either the cooperative-purchasing or disaster-recovery program will not trigger the Price Reductions clause. Under these programs, the definition of “[s]tate and local government entities” is very broad and includes, inter alia, “tribal governments” and “colleges and other institutions of higher education.” See GSAR 538.7001 (definition of “[s]tate and local government entities”).

88. Subparagraph (c)(2) of the clause—which uses the broad phrase “as extended to the commercial customer”—suggests a contrary conclusion, however. See note 128 *infra*; see also *Xerox Corp. v. Gen. Servs. Admin.*, GSBICA No. 15190, 01-2 BCA ¶31,528 (schedule contractor and GSA agreed that trade-in allowances would be outside the scope of the Price Reductions clause; “[t]hus, because the parties understood that the discounted price, net of the trade-in value, could become the actual sale price (albeit without triggering the price reduction clause), the [Industrial Funding Fee] should be applied to that net price, not the MAS list price”). *But cf.* Procurement Information Bulletin 90-24, *supra* note 3, at 3 (“The Government may pursue a claim under the Price Reduction Clause if it concludes that a trade-in is not a bona fide transaction, but simply a method of concealing a discount.”).

89. See *infra* Part VI.A.

90. See *ViON Corp., Comp. Gen.* B-275063.2, B-75069.2, Feb. 4, 1997, 97-1 CPD ¶53, at 3 (rejecting protestor’s complaint that the schedule contractor’s quoted prices were “‘one time spot discounts’ below its FSS contract prices [where] this is specifically permitted by FAR §8.404(b)(3) and Severn’s FSS contract, which provide that ‘MAS contractors will not be required to pass on to all schedule users a price reduction extended only to an individual agency for a specific user’”).

91. Telecommunications and ADPE schedule contracts were then and are now covered by Federal Supply Classification (FSC) Groups 58 and 70, respectively.

92. See *Photon Tech. Int’l, Inc. v. Gen. Serv. Admin.*, GSBICA No. 14918, 99-2 BCA ¶30,456, at 150,465. Because the GSBICA decided the case under its small-claims procedures, the case has “no value as precedent.” *Id.* at 150,466.

93. *Id.* at 150,469–70. The GSA occasionally updates a GSA order that lists organizations that are eligible to use GSA sources of supply and services, including GSA multiple-award schedules. See GSA Order ADM 4880.2E, Jan. 3, 2000, available at http://www.gsa.gov/gsa/cm_attachments/GSA_BASIC/Eligibility%20to%20Use%20GSA%20Sources_R2E-rKS_0Z5RDZ-i34K-pR.doc. Unfortunately, the GSA last updated the order in January 2000. While the order contains three long lists of executive agencies, “other eligible users,” and international organizations that, collectively, are deemed “eligible users,” the GSA notes that the lists are nonexhaustive. *Id.* ¶11. Thus, it would be a rare case indeed where a schedule contractor could safely eschew offering schedule pricing to an ordering office that has not identified itself as “GSA qualified” to receive the discounts.

94. See 2 U.S.C. §111b (2000). Given the evolution in the Price Reductions clause since 1994, this statute is presumably unnecessary today.

95. The proposed 1985 revisions to the MAS policy statement and certain 1986 proposed revisions to the GSAR would, however, have exempted sealed-bid, single-award contracts with state or local governments or the District of Columbia from the application of the clause. See *supra* text accompanying note 64.

96. See *supra* notes 86–88 and accompanying text.

97. In at least one “refresh” of the GSA’s request for proposals for the Information Technology (FSC Group 70) schedule, the GSA’s Information Technology Acquisition Center inserted an asterisk after the term “Contractor” where it first appeared in the Price Reductions clause. GSA Request for Proposals No. FCIS-JB-980001-B, Refresh #14, §C.28 (Price Reductions clause, June 14, 2004). The asterisked material advised dealer/reseller

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A Clause in Search of Meaning (cont'd):

offerors without significant sales to the general public that, for the purposes of the clause, the term “contractor” would include the offeror’s manufacturer where the offeror was offering items from the manufacturer expected to result in over \$500,000 in sales under the resulting schedule contract. *See id.*; *see also* GSAR 515.408(b)(5) (Commercial Sales Practice Format). The current “refreshed” version of the solicitation (Refresh No. 21 as of this writing) does not contain the asterisk and asterisked material, which perhaps constituted an impermissible “deviation” from the clause. *See generally* Letter from Molly Wilkinson, Chief Acquisition Officer, Gen. Servs. Admin., to Jan Frye, Deputy Assistant Sec’y, Office of Acquisition & Logistics, U.S. Dep’t of Veterans Affairs, & Craig Robinson, Executive Dir. & Chief Operating Officer, Nat’l Acquisition Ctr., U.S. Dep’t of Veterans Affairs 2 (Jan. 4, 2008) (on file with the *Public Contract Law Journal*) (rejecting proposed DVA Price Reductions clause that would require the tracking of the manufacturer’s commercial customers on schedule contract awards made to resellers that do not have significant commercial sales of the items being offered because “GSA does not contemplate third party tracking for price reduction purposes”); Letter from Robert L. Schaefer, Chair, Section of Pub. Contract Law, Am. Bar Assoc., to Laurieann Duarte, Gen. Servs. Admin., Regulatory Secretariat (VIR) 28–29 (Apr. 26, 2006) (on file with the *Public Contract Law Journal*) (comments in GSAR-revision initiative (GSAR ANPR 2006-N01) criticizing the definition of “Contractor” in the “refresh”).

98. Bases of award are, unfortunately, often cryptic. The author has seen one basis-of-award that reads as follows:

[T]his contract shall be predicated on “Dentist Participating in the Annual Buying Program and or Graduate Program.”] If on more than one occasion during the 5 year contract period additional discounts are offered to the agreed upon tracking customer, the price reduction clause is triggered and an equal discount must be extended to the government. The above mentioned terms apply to one order only, for the same product, for the same quantity as the Meet Competition customer for a period of 30 days.

The author has observed that, in postaward audits, the GSA and DVA Offices of Inspector General are increasingly requesting that schedule contractors identify their bases of award.

99. GSAR 538.271(c). Quite obviously, the basis of award should also clearly identify the pricelist used as the basis for negotiations and, optimally, the method of calculating a price reduction. The basis of award should also address when the schedule contractor’s grant of more favorable discounts and/or terms and conditions will trigger a category (ii) price reduction.

100. The GSA notes that, since “[t]he ultimate goal of the Government negotiator is to obtain discount/concessions which equal or exceed the supplier’s most favored customer (MFC),” “[t]here can only be *one* MFC.” Procurement Information Bulletin 90-24, supra note 3, at 5. The GSA reasons that “[w]hile it is common to find a number of customers receiving the same discount arrangements, in most cases, these collective customers represent a distinct category of customers, i.e., dealers, OEM’s, national accounts, distributors, state and local governments, educational facilities, etc.” *Id.* Accordingly, therefore, “any customer classified within these various categories of customers generally receive[s] the same discounts when certain preestablished terms and conditions are met.” *Id.* In such a case, “the specific category of customer who is receiving the best price/concessions from the supplier would be identified as the MFC, and the Government’s negotiations would be based on this customer, unless the offeror justifies that the terms and conditions which govern this MFC are significantly different from the Government’s.” *Id.*; *see also* GSAR 538.270(c), (d)(1) (stating the Government’s general proposition that it will seek the same price given to the MFC unless prices are otherwise “fair and reasonable”).

101. Admittedly, this practice seems to contradict the purpose of the schedules program to provide federal agencies with a simplified process of acquiring commercial supplies and services, see FAR 38.101(a), as well as the language of the Price Reductions clause, which refers to, inter alia, a change in the contractor’s “commercial” pricing or discount arrangement. GSAR 552.238-75(a); *see also* Fed. Acquisition Serv., Gen. Servs. Admin., Procurement Information Bulletin 2006-03, at 1 (2006) (on file with the *Public Contract Law Journal*) (“How to Handle Offers when the MFC is the Federal Government”), noting that, where the Federal Government is the offeror’s most favored customer, “the [pricing] relationship should be specified in the award document as it relates to the vendor’s closest commercial customer”). From a practical perspective, however, the GSA or DVA often

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A Clause in Search of Meaning (cont'd):

identifies a government contract or customer as the basis-of-award customer under a service offering because that customer or contract often is the most reliable tracking customer for preserving the benefit of the Government's bargain during contract performance. Where, however, the prospective service contractor submits cost-buildup information that is tantamount to cost or pricing data, it is arguable that the Price Reductions clause should not apply to the contract. *See* Procurement Information Bulletin 90-24, *supra* note 3, at 6 (where the GSA does not award a schedule contract on the basis of "the Most Favored Customer negotiation technique," the Price Reductions clause cannot be applied since no customer has been identified as the basis of the negotiation); *see also* Multiple Award Schedule Price Reduction and Economic Price Adjustment Clause (DEC 1987) (I-FSS-966) (apparently not currently used by GSA) ("When evaluation, negotiation, and award are based on factors other than discounts from an established commercial price list, paragraph (b) of the [1982] Price Reduction Clause and the entire Economic Price Adjustment Clause are inapplicable and therefore are deleted from the contract."). In addition, the GSA has taken the position that—where an offeror only sells to the Federal Government—the Price Reductions clause does not apply to a resulting schedule contract. *See* Procurement Information Bulletin 2006-03, *supra* note 101, at 3 (predicating analysis on subparagraph (d)(2) of the clause).

102. *See* Procurement Information Bulletin 90-24, *supra* note 3, at 5. The GSA's adherence to this policy has been somewhat uneven. *See* *Viacom, Inc.—Successor in Interest to Westinghouse Furniture Sys. v. Gen. Servs. Admin.*, GSBCA No. 15871, 05-2 BCA ¶33,080, at 163,961 (basis of award in 1985 GSA schedule contract for systems-furniture workstations predicated on "all classes of customers"); *see also* Letter from Kathryn Coulter, Dir. of Policy, Coal. for Gov't Procurement, to Laurieann Duarte, Gen. Servs. Admin., Regulatory Secretariat §7 (received Apr. 17, 2006) (on file with the *Public Contract Law Journal*) (noting that "[m]any companies are hectorated into accepting contracting officer demands for improperly broad tracking customer relationships in order to get a timely contract award").

103. *See* Procurement Information Bulletin 90-24, *supra* note 3, at 1.

104. Stated another way, there can be a "failure" of a basis-of-award customer.

105. Put another way, the schedule contractor may be required to pass along a price reduction to the Government on the basis of commercial activity that occurred before the contractor became a contractor.

106. Technically, as noted above, an offeror-cum-contractor also can trigger the clause by reissuing or revising its pricelist (with lower pricing) after the conclusion of negotiations.

107. Many schedule contractors have multiple commercial pricelists. An offeror will typically select one pricelist to serve as the basis for its offer. It is critical that the offeror/contractor monitor changes in its "pricebook" (pricelist) following submission of its offer and, indeed, throughout the entire term of the resulting schedule contract.

108. *See* GSAR 552.238-75(b).

109. During negotiations, however, a schedule contractor may attempt to exempt certain commercial transactions from the purview of the Price Reductions clause.

110. Contractor team arrangements under subpart 9.6 of the FAR and their variant, GSA sanctioned schedule contractor teaming arrangements, can present compliance issues with respect to category (iii) price reductions. Suppose, for example, that Schedule Contractors B and C enter into a team arrangement with Team Leader/Schedule Contractor A. Schedule Contractor B sells a schedule item at a deeply discounted price to Team Leader/Schedule Contractor A under a subcontract. Contractor A is a basis-of-award customer under Schedule Contractor B's schedule contract. Has Schedule Contractor B triggered the Price Reductions clause? The answer is probably yes. However, if the three schedule contractors had set up a GSA-sanctioned schedule contractor teaming arrangement in which each schedule contractor is in privity with the ordering activity, the answer would presumably be no.

111. Unlike subparagraph (c)(1)(ii) of the clause, which covers the grant of "more favorable discounts or terms and conditions" than those contained in the commercial catalog, pricelist, or other document upon which contract award was predicated, subparagraph (c)(1)(iii) of the clause only mentions the grant of "special discounts" to the basis-of-award customer, suggesting by negative inference that a schedule contractor's grant of more favorable terms and conditions to a basis-of-award customer would not trigger the clause. Schedule contractors would be well advised to ignore this suggestion since the GSA or DVA can always argue that a schedule contractor's grant of more favorable terms and conditions to a basis-of-award customer always constitutes an effective price

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A Clause in Search of Meaning (cont'd):

reduction, whether characterized as a “discount,” “concession,” or some other construct. See Maureen Regan, Counsel to the Inspector Gen., Dep’t of Veterans Affairs, Presentation at American Institute Conference on Government Contracting Compliance: Enforcement Update: A View from the Feds on Current Enforcement Priorities 6 (Mar. 27, 2007) (PowerPoint presentation on file with the *Public Contract Law Journal*) (“Different terms and conditions are *not* a basis for exclusion under the Price Reductions Clause if the customer is within the [Customer of Comparability].”); see also GSAR 538.272(a) (“[GSAR] Section 552.238-75, Price Reductions, requires the contractor to maintain during the contract period the negotiated price/discount relationship (and/or term and condition relationship) between the eligible ordering activities and the offeror’s customer or category of customers on which the contract award was predicated”); see generally GSAR 552.212-70 (Preparation of Offer (Multiple Award Schedule) (AUG 1997) defining “[d]iscounts” and “[c]oncession”); see *supra* text accompanying note 66 (1982 Price Reductions clause intended to maintain the Government’s relative term and condition advantage only with respect to ADPE and telecommunications schedule contracts).

112. Scope issues, however, can come into play. For example, where a schedule contractor has not elected worldwide scope-of-contract, it is strongly arguable that a commercial price reduction to a basis-of-award customer calling for delivery or performance outside the United States and Puerto Rico will not trigger the clause.

113. The GSA’s Modifications (Multiple Award Schedule) (JUL 2000) clause, GSAR 552.243-72, suggests that a category (ii) price reduction may be “published” or “unpublished.” Subparagraph (b)(3) of the clause requires the schedule contractor, when seeking a contract modification, to indicate whether the price reduction falls under category (i), (ii), or (iii). If the price reduction falls under category (ii) or (iii), the contractor must submit a copy of the applicable pricelists, bulletins, letters, or customer agreements that outline the effective date, duration, and terms and conditions of the price reduction.

114. The Section of Public Contract Law of the American Bar Association has argued, however, that subparagraphs (c)(1)(i) and (c)(1)(ii) of the Price Reductions clause should be read to apply only to triggering events affecting a basis-of-award customer. See Schaefer, *supra* note 97, at 26–27 (comments in GSAR-revision initiative (GSAR ANPR 2006-N01)) (on file with the *Public Contract Law Journal*).

115. An example can illustrate this point. Suppose that a schedule contractor submitted a commercial-products pricelist to the GSA that included its pricing for all of its categories of commercial customers (e.g., dealers, end-users, state and local governments, etc.), but it actually negotiated its schedule contract on the basis of its pricing to end-users (its basis-of-award customer). Suppose further that during contract performance, the schedule contractor reduces its prices to its dealers but does not reissue or revise its pricelist. Has the schedule contractor initiated a category (ii) price reduction?

116. As noted in Part VI.A *supra*, this customer need not be the basis-of-award customer. For example, a schedule contractor could negotiate its schedule contract on the basis of discounts from its dealer pricelist, but its basis of award could be a particular dealer or dealers.

117. A category (ii) price reduction also covers, of course, the grant of more favorable terms and conditions than those contained in the commercial catalog, pricelist, schedule, or other documents upon which contract award was predicated. For example, assume that a schedule contractor disclosed in its Commercial Sales Practices Format that its standard payment terms are “30 days ARO [After Receipt of Order].” Six months after contract award, the contractor extends sixty-day payment terms to several of its best customers. Has the contractor triggered the Price Reductions clause? In all probability, yes.

118. Where an MOL was established, ordering offices could not reduce or split their requirements simply to avoid an MOL; rather, they had to consolidate their requirements whenever possible to take advantage of price savings that were normally obtainable through definite quantity contracts for quantities exceeding the MOL. See 41 C.F.R. §101-26.106 (2007)(Federal Property Management Regulations). In this regard, the GAO held that MOLs apply to both a single delivery order and a series of delivery orders placed within a short period of time. Sec’y of the Army, 46 Comp. Gen. 713, 718, 1967 CPD ¶8 (1967). This rule prohibited agencies from evading an MOL by splitting a requirement into several smaller orders each within the dollar limit specified. See, e.g., Quest Electronics, Comp. Gen. B-193541, Mar. 27, 1979, 79-1 CPD ¶205 (award of nine consecutively numbered delivery orders for sound detection equipment totaling \$455,852 on the same day to a single schedule contractor with an MOL of \$250,000 held to be a violation).

119. MOLs and maximum orders applying to multiple-award schedules appear in the contractor’s schedule

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A Clause in Search of Meaning (cont'd):

pricelist and on its listing in GSA *Advantage!* and also ordinarily appear in the contractor's basis of award. MOLs and maximum orders may be established for each item as well as for the total order and are frequently established for individual special item numbers.

120. Prior to the GSA's elimination of its synopsizing requirements for federal-information processing (FIP) resources, an agency could not split its requirements for FIP resources in an effort to evade its obligation to synopsize an intended order in excess of \$50,000 in the former *Commerce Business Daily* (CBD). In *Digital Services Group, Inc.*, GSBCA No. 8735-P, 87-1 BCA ¶19,555, the GSBCA rejected an agency's argument that the synopsis requirement did not apply to six delivery orders because each order was for a different office. The evidence showed that the agency had placed thirteen orders within a four-week period from September 2 to September 30, 1986; that twelve of those orders were placed from September 17 to September 30, 1986; and that the six orders relating to the different offices were placed on two working days: Friday, September 26, 1986, and Monday, September 29, 1986. *Id.* at 98,838. The GSBCA concluded that the agency "split the requirement into separate orders to avoid the lapse at year's end of appropriations, a legally insufficient reason as [the agency's] officials knew well." *Id.*; see also *ISYX*, GSBCA No. 9407-P, 88-2 BCA ¶20,781 (an agency violated the CBD synopsizing requirement by issuing two separate delivery orders for automated data processing equipment (ADPE) against the same GSA schedule contract on the same day). *But cf.* *N. Am. Automated Sys. Co.*, GSBCA No. 9122-P, 87-3 BCA ¶20,208 (evidence that an agency made thirty-four purchases of ADPE in amounts of less than \$50,000 each for its various subdivisions did not prove that the agency had fragmented its requirements in an attempt to stay below the then-\$300,000 threshold for seeking a delegation of procurement authority from the GSA). The above decisions are instructive in the MOL context as well.

121. As a practice tip, it is prudent for corporate counsel to review such agreements with skilled government contracts counsel.

122. See 41 C.F.R. §5A-73.217-5(c) (1979) (added by 44 Fed. Reg. 37,920, 37,927-28 (June 29, 1979)).

123. *Id.*

124. The DVA frequently uses a slightly different methodology: it will establish a matrix for the schedule items that includes the commercial list price, the tracking customer's price, the tracking customer's discount off of the commercial list price, the ratio of the tracking customer's price to the commercial list price, the Government's discount off of the commercial list price, the Government's net price, and the ratio between the tracking customer's price and the Government's net price. The DVA schedule contractor must maintain the latter ratio throughout the contract period.

125. These examples are simple of course. For a more complex hypothetical, consider the following: Bunko Corporation (Bunko), a manufacturer of hand tools, is on the GSA schedule with a basis of award of "all commercial customers." Bunko is offering a special commercial sales promotion whereby it will "bundle" three contract items with five noncontract items. Under the terms of the promotion, Bunko will offer two of the three schedule items at list price but will give away the third item. Bunko will sell three of the five nonschedule items at list price but will give away the other two items. How do you compute the price reduction that will apply to further sales to federal agencies? Hint: Unless the addition of the five noncontract items is essential to consummate a sale of the contract items, you can ignore the "gift" of the two nonschedule items. Can you argue that the commercial "bundle" represents different terms and conditions than the GSA schedule contract and that, therefore, sales of the "bundle" should not trigger the Price Reductions clause? Probably not successfully.

126. See generally *Gelco Space*, GSBCA Nos. 7916, 7917, 91-1 BCA ¶23,387 (GSBCA remanded a government claim under the Price Reductions clause to the contracting officer for a calculation of the amount due to the Government because, even though the Government had purchased both schedule and nonschedule items, the Government was only entitled to a price reduction with respect to sales of the schedule items, and the GSBCA was unable to determine the amount of such sales).

127. As mentioned in notes 85 and 87 *supra*, the Alternate I version of the Price Reductions clause is used where the schedule contractor has elected to participate in cooperative purchasing and/or disaster-recovery purchasing. Alternate I substitutes the phrase "eligible ordering activities" for the word "Government" in subparagraph (c)(2) of the clause. Given the breadth of entities that are eligible to use GSA multiple-award schedules, see *supra* note 93 (citing GSA Order ADM 4880.2E), including, for example, various international entities, the standard Price Reductions clause should probably use this phraseology as well.

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A Clause in Search of Meaning (cont'd):

128. The use of the phrase “as extended to the commercial customer” in subparagraph (c)(2) of the clause, GSAR 552.238-75(c)(2), creates an ambiguity as to precisely when a triggering price reduction is effective for the Government. Assuming that a mere quotation or offer does not trigger the clause, see *supra* note 88, and accompanying text, the question remains whether the effective date of the price reduction for the Government is tied to the schedule contractor’s receipt of the commercial order, its formal acceptance of the order, or some other event. The best view is to regard the date of the commercial sale—ordinarily the date of the schedule contractor’s acceptance of the commercial order—as dispositive.

129. Assuming that the Price Reductions clause is triggered, each temporary commercial price reduction must, of course, be reflected in a contract modification.

130. Under GAO decisions interpreting prior versions of the Price Reductions clause, see, e.g., *United Info. Sys., Inc.*, Comp. Gen. B-282895, B-282896, June 22, 1999, 99-1 CPD ¶115, at 2, a schedule contractor was not required to submit a general price reduction to the GSA, Veterans Administration (VA), or DVA prior to offering the reduction to an agency, and, conversely, there was no requirement that the GSA, VA, or DVA accept such a price reduction before it became effective. *Lanier Bus. Prods., Inc.*, Comp. Gen. B-211641, Oct. 25, 1983, 83-2 CPD ¶493; see also *Kaset Int’l*, Comp. Gen. B-255084, Feb. 7, 1994, 94-1 CPD ¶ 76 (a contractor may offer a price reduction at any time and by any method, even without approval by the GSA). On the other hand, the schedule contractor was required to notify ordering offices of price reductions that the GSA, VA, or DVA had accepted. *Dictaphone Corp.*, Comp. Gen. B-210692, June 27, 1983, 83-2 CPD ¶26. In *Dictaphone Corp.*, Comp. Gen. B-254920.2, Feb. 7, 1994, 94-1 CPD ¶75, the GAO determined that the DVA, after issuing delivery orders to the protestor and then concluding that the agency’s request for quotations did not specify all of the DVA’s minimum needs, properly took corrective action by suspending performance of the delivery orders, advising the firms that initially submitted quotations of the agency’s additional requirements, requesting revised quotations from these firms, and accepting a revised quotation that offered a price reduction. The GAO noted that, while the protestor objected to the DVA’s consideration of the price reduction because it was approved by the GSA after the initial closing time for the receipt of quotations and after the original delivery orders were issued to the protestor, a schedule contractor may offer a price reduction at any time and by any method without prior or subsequent approval by the GSA.

131. Other than for voluntary governmentwide price reductions (or in the relatively unusual case where a government customer or customers and/or government contract or contracts serve as the basis of award), this requirement does not apply to price reductions to government customers.

132. A schedule contractor’s defective-pricing liability ordinarily sweeps in much if not all of its price-reductions liability. See generally *Viacom, Inc.—Successor in Interest to Westinghouse Furniture Sys. v. Gen. Servs. Admin.*, GSBGA No. 15871, 04-2 BCA ¶32,639, at 161,507, *aff’d in part*, 05-2 BCA ¶33,080 (“[price reductions which entirely eliminate defective pricing are obviously relevant to a determination of whether there are remaining defective prices to be adjusted”]; conversely, “[p]rice reduction modifications which do not eliminate defective pricing may be considered in conjunction with the quantum determination of defective pricing”).

133. See generally Ron R. Hutchinson, *Oversight of GSA Federal Supply Schedule Contracts: From Internal Compliance Programs to Civil False Claims Actions*, 37 Pub. Cont. L.J. 569 (2008).

134. Under the Examination of Records by GSA (Multiple Award Schedule) (July 2003) clause, GSAR 552.215-71, the GSA Office of Inspector General is empowered to conduct postaward audits of a schedule contractor’s compliance with the Price Reductions clause. See generally *Viacom, Inc.*, 05-2 BCA ¶33,080, at 163,963 (finding that, in a negotiation to settle alleged price-reductions violations, “[t]he Government presented its proposed [contract] modification to Westinghouse and threatened a post-award audit if it did not accept the Government’s terms”).

135. Under the Cancellation (Sept. 1999) clause, GSAR 552.238-73, either party may cancel the schedule contract in whole or in part by providing written notice to the other party. The cancellation takes effect thirty calendar days after the other party receives notice of the cancellation.

136. 31 U.S.C. §§3729–3733 (2000).

137. *Id.* §3729(a); see 28 C.F.R. §85.3(a)(9) (2007).

138. 31 U.S.C. §3729(a) (2000).

139. *Id.* §§3801–3812.

140. *Id.* §3803(c)(1)(A).

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A Clause in Search of Meaning (cont'd):

141. *Id.* §3802(a)(1)(A); *see* 28 C.F.R. §85.3(a)(10) (2007).

142. 31 U.S.C. §3801(a)(1) (2000).

143. 18 U.S.C. §1001 (2000 & Supp. V 2005).

144. 18 U.S.C. §287 (2000).

145. In March 2005, the GSA submitted its most recent request to the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995, 44 U.S.C. ch. 35, for the renewal of the OMB's clearance of the information-collection requirement of the Price Reductions clause; i.e., the reporting of price reductions to the contracting officer. *See* General Services Administration Acquisition Regulation; Information Collection; Price Reductions Clause, 70 Fed. Reg. 10,404 (Mar. 3, 2005) [hereinafter Information Collection]; Supporting Statement for Paperwork Reduction Act Submission 3090-0235—Price Reductions Clause 552.238-75 (Mar. 8, 2005) (on file with the *Public Contract Law Journal*) [hereinafter Supporting Statement]. Using time and cost estimates “based on professional judgment using data industry survey and data from the Federal Supply Service FSS-19 contract/order writing system,” the GSA estimated the number of respondents as 16,680, the total number of responses as 33,360, the average hours per response as 7.5 hours, and the total burden hours as 250,200 hours. *Id.* at 4; *see* Information Collection, *supra*, at 10,404. In its statement supporting the need for an extension of the clearance, the GSA noted that “[w]ithout the notice of price reductions under the clause, . . . the Government's ability to achieve the pricing goal set forth in the Competition in Contracting Act for the MAS Program, i.e., that orders and contracts result in the lowest cost alternative, would be impaired.” Supporting Statement, *supra*, at 1.

146. The GSA obviously disagrees. In January 2000 the FSS issued a revised version of its *Anthology of Commercial Terms and Conditions* (first published in 1996). *See* Fed. Supply Serv., Gen. Servs. Admin., Commercial Item Acquisitions: An Anthology of Commercial Terms and Conditions, available at http://www.gsa.gov/gsa/cm_attachments/GSA_BASIC/Anthology2_R2G42T_0Z5RDZ-i34K-pR.pdf. In preparing the revised version—described as “bigger and better than ever,” *id.* at 5, the GSA contacted the purchasing officials of Fortune 500 companies to obtain information regarding the terms and conditions normally used when acquiring supplies and services similar to those purchased by the GSA. *See id.* at 9. The GSA compiled over 200 pages worth of such commercial clauses in the *Anthology*. Perhaps not surprisingly, the *Anthology* includes twenty-two “Most Favored Customer” clauses—commercial analogs to the GSA's Price Reductions clause. *See also* Office of Inspector Gen., U.S. Gen. Servs. Admin., Effect of Procurement Reform Proposals on Some Aspects of the Multiple Award Schedule Program 4, 19, 22–23, 26, available at <http://oig.gsa.gov/reform1.htm> (last visited Feb. 14, 2008) (recommending a legislative or regulatory statement “recognizing that the price reduction clause is commonly included in private sector commercial contracts and will be included in MAS contracts” and finding that, of forty-one commercial purchase agreements reviewed, twenty-three contained Price Reductions clauses; also noting that “[i]t is really the very existence of the price reduction clause which allows MAS contracts to be of longer duration than the more typical one-year supply contract”).

147. On June 1, 1999, the Government Electronics and Information Technology Association (GEIA) submitted a petition to the Office of Federal Procurement Policy (OFPP) to remove (1) the Examination of Records by GSA (Multiple Award Schedule) and (2) the Price Adjustment—Failure to Provide Accurate Information clauses from the GSAR. *See* Richard J. Wall & Robert J. Sherry, *Industry's Appeal to OFPP to Remove the GSAR Clauses: What's All the Fuss About?* 72 Fed. Cont. Rep. (BNA) 161, 161 & n.1 (Aug. 2, 1999). The GEIA initially intended to challenge the Price Reductions clause as well but ultimately decided not to do so, “opting instead to offer recommendations for making that clause more consistent with customary commercial practice.” *Id.* The OFPP denied the petition on October 12, 1999, noting, inter alia, that “the challenged safeguards are consistent with commercial practice to the maximum extent practicable given the current objectives of the MAS program.” *See* James J. McCullough & Jonathan S. Aronie, *Check or Checkmate?: OFPP's Recent Decision Affirming the Legality of GSA's Post-Award Audit Clause*, Cont. Mgmt., Dec. 1999, at 10 (citing OFPP's October 12, 1999, decision denying the petition); *see also* Coulter, *supra* note 102, §7 (strongly recommending the elimination of the Price Reductions clause from the GSAR because, inter alia, “[i]n today's intense government market, no contractor can afford to have prices too high relative to their competition, regardless of what their Price Reductions Clause says”).

148. *See* Roger D. Waldron, *Time to Update Schedules*, Legal Times, Oct. 8, 2007, at 31–32 (arguing that the Price Reductions clause is “at odds with commercial best practices today and current trends in the MAS program,”

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A Clause in Search of Meaning (cont'd):

in which services now account for almost 70 percent of overall schedule volume, and should be eliminated). Mr. Waldron was a member of the Acquisition Advisory Panel (and its working group on commercial practices) that submitted a massive report on acquisition reform to the OFPP and the Congress in January 2007. *See* Acquisition Advisory Panel, Report of the Acquisition Advisory Panel to the Office of Federal Procurement Policy and the United States Congress iii (2007) [hereinafter Report]. Under the Services Acquisition Reform Act of 2003, title XIV of the National Defense Authorization Act for Fiscal Year 2004, the Panel was charged with reviewing laws, regulations, and governmentwide acquisition policies regarding “the use of commercial practices, performance-based contracting, the performance of acquisition functions across agency lines of responsibility, and the use of Government-wide contracts.” National Defense Authorization Act for Fiscal Year 2004, Pub. L. No. 108-136, §1423(a), 117 Stat. 1392, 1669 (2003). The Panel recommended, *inter alia*, that the GSA establish a new Information Technology schedule for professional services under which negotiation of the schedule contracts would be limited to terms and conditions other than price. Report, *supra*, at 102. The Price Reductions clause would be eliminated under the proposed new schedule, and prices would be determined at the order level based on competition for the specific requirement to be performed. *Id.* at 102–03. The Panel found that “[t]he use of Most Favored Customer and Price Reduction clause mechanisms are not conducive to commercial practices for pricing services” and that “the use of the Price Reductions Clause today for professional IT labor rates produces little benefit—the facts driving the cost of the project are the proficiency of the personnel and the mix of skills.” *Id.* at 104.

149. *Cf.* Waldron, *supra* note 148, at 31, 32 (referring to the Price Reductions clause as “an irrelevant trap for the unwary”); Vacketta, Jaffe & Warren, *supra* note 4, at 1 (noting that “the clause is difficult to understand and especially difficult to apply to the business environment”).

150. In offering these suggestions, I submit—perhaps “concede” would be a better word—that the Price Reductions clause will continue to be a fixture in the MAS program for the reasonably foreseeable future, particularly given the interest of the GSA Office of Inspector General in preserving the clause. But then again, I could be wrong. *See* Multiple Award Schedule Advisory Panel, 61 Fed. Reg. 16,683 (Mar. 28, 2008) (announcing the GSA’s creation of the GSA Multiple Award Schedule Advisory Panel, a federal advisory committee tasked with reviewing “MAS policy statements, implementing regulations, solicitation provisions and other related documents regarding the structure, use, and pricing for the MAS contract awards”); *GSA Forms Advisory Committee to Review Multiple Award Schedule Pricing Policies*, 89 Fed. Cont. Rep. (BNA) 425 (Apr. 22, 2008) (Panel tasked with providing “definitive guidance” on the Price Reductions clause).

151. The Price Reductions clause is, of course, silent on this point. Interestingly, however, the Economic Price Adjustment clause that the GSA prescribes for use with schedule products and/or services that are not awarded based on a commercial catalog price addresses this issue, but the Economic Price Adjustment clause that the GSA prescribes for use with products and/or services that are awarded based on a commercial catalog price does not. *Compare* Economic Price Adjustment Clause (Jan. 2002) (I-FAS-969) (applicable to schedule products and/or services that are not awarded based on a commercial catalog price), with GSAR 552.216-70 (Economic Price Adjustment—FSS Multiple Award Schedule Contracts (Sept. 1999) (ALT I—Sept. 1999) clause applicable to schedule products and/or services that are awarded based on a commercial catalog price). The former clause provides that “[i]n the event the application of an economic price adjustment results in a price less favorable to the Government than the price relationship established during negotiation between the MAS price and the price to the designated customer, the Government will maintain the price relationship to the designated customer.” Economic Price Adjustment Clause (Jan. 2002) (I-FAS-969), ¶(h). Clearly, the Price Reductions clause should cover this topic.

152. *See* FAR 9.508 (providing nine noninclusive examples that illustrate situations in which organizational conflicts of interest may arise).

153. As previously noted, at least one commentator has argued that the Price Reductions clause should not apply to professional services. *See* Waldron, *supra* note 148, at 31, and accompanying text.

154. Under the pre-3M Price Reductions clause, the GSBCA concluded that a schedule contractor’s definite-quantity commercial contracts over the MOL were not relevant data in considering the application of the Price Reductions clause because the over-MOL contracts were not within the quantity scope of the schedule contract. *See* Viacom, Inc.—Successor in Interest to Westinghouse Furniture Sys. v. Gen. Servs. Admin., GSBCA No. 15 871, 05-2 BCA ¶33,080, at 163,974 (2005) (citing 3M Bus. Prods. Sales, Inc., GSBCA Nos. 4722, 4878, 78-2 BCA ¶13,362, *aff’d on reconsideration*, 79-1 BCA ¶13,567).

The Proper Exercise of FAR's 52.217-8 Clause

by
Ernesto Corrales*

The Federal Acquisition Regulations (FAR) authorize the use of various contract options. Options provide the Government with a vehicle for extending an existing contract. Options also allow the Government to obtain necessary goods or services without having to initiate burdensome procurement procedures. However, the Government may not exercise an option capriciously and both the Competition in Contracting Act (CICA) and FAR limit its usage.

CICA's Limits to the Use and Exercise of Options

All Government procurements must adhere to CICA. Procurements must be conducted utilizing full and open competitive procedures. 10 U.S.C. §2304(a)(1)(A). The procedures used must be the best available under the circumstances. 10 U.S.C. §2304(a)(1)(B). However, CICA contains various exemptions that permit the use of less than full and open procurement procedures. These exceptions include: (1) when only one source will satisfy an agency's requirements [10 U.S.C. §2304(c)(1)]; (2) when an unusual and compelling urgency exists [10 U.S.C. §2304(c)(2)]; (3) when there is a need for an industrial mobilization [10 U.S.C. §2304(c)(3)]; (4) when an international agreement trumps CICA [10 U.S.C. §2304(c)(4)]; (5) when authorized or required by statute [10 U.S.C. §2304(c)(5)]; (6) when justified by a national security need [10 U.S.C. §2304(c)(6)]; and (7) when it is in the public's interest (requires written determination by the Secretary of the Navy and Congressional notification prior to award). [10 U.S.C. §2304(c)(7)].

To utilize a CICA exception, the Government must justify its use in writing, certify the accuracy and completeness of the justification, and obtain required approvals. FAR §6.303-1(a). Each justification must include a description of the agency's needs, anticipated costs, and the reasons why an exception is needed. 10 U.S.C. §2304(f)(3).

FAR's Limits to the Use and Exercise of Options

The FAR also contains several rules that limit when and how an option may be exercised. A Government contracting officer may only include an option in a contract when it is in the Government's interest to do so. FAR §17.202(a).¹ Options may not be in the Government's interest when the anticipated need is foreseeable and no urgency exists. FAR §17.202(b). Options shall not be used if the contractor will incur undue risks, if the market prices for the supplies or services involved are likely to substantially change, or if the option represents known requirements for which funds are available. FAR §17.202(c). Just because an option proves unprofitable to a contractor does not mean the option imposed an undue risk. A contractor cannot sign a contract which allocates the risk to it and then, having lost its gamble, claim that the Government imposed an undue risk. *Aspen Helicopters, Inc. v. Dept. of Comm.*, GSBGA 13258-COM, Sept. 30, 1999.

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Proper Exercise of FAR's 52.217-8 Clause (cont'd):

An option may only be exercised “in exact accord with the terms of the option.” *Green Management Corp. v. U.S.*, 42 Fed. Cl. 411, 442-443 (1998). The Government contracting officer must provide written notice of its decision to exercise an option within the time period specified in the contract. FAR §17.207(a).² If an option triggers a price adjustment, the Government must determine the effect of the price change. FAR §17.207(b). An option may be exercised only if appropriated funds are available, the goods or services fulfill an existing Government need, and the exercise of the option is the “most advantageous” method of satisfying the Government’s need. FAR §17.207(c). Factors that must be considered when determining whether exercising an option is in the Government’s interest include price and the need to avoid delays in operations. *Canadian Com. Corp. v. Dept. of Air Force*, 442 F. Supp. 2d. 15, 21 (2006). The Government is accorded broad discretion in making this determination. *Matter of Antmarin Inc.; Georgios P. Tzanakos; Domar S.r.l.*, Comp. Gen. B-296317 at 3, Jul. 26, 2005.

FAR 52.217-8 – Extending an Existing Contract

Government contracts routinely include a FAR 52.217-8 clause. This clause allows the Government to extend an expiring contract. FAR §17.208(f). The text of the option should be substantially similar to the model clause provided in FAR §52.217-8. *Id.* The model clause provides in part “the Government may require continued performance of any services within the limits and at the rates specified in the contract.... The option provision may be exercised more than once, but the total extension of performance hereunder shall not exceed 6 months.” FAR §52.217-8. The primary rationale for extending an existing contract is to avoid the possible delays associated with negotiating short term extensions. FAR §37.111. The FAR recognizes that the Government's need for continuity of operations and the potential cost of disrupted support justifies the extension of a contract beyond its initial term. FAR §17.202(d). Unsatisfied contractors have filed various claims and bid protests, relying on CICA and the FAR, to challenge the exercise of a 52.218-8 clause.

How Dash Eight Clauses Operate Within the Rules of CICA and the FAR

Although the use of a 52.217-8 clause is specifically authorized by the FAR, parties often challenge its validity claiming its use violates CICA’s requirement of full and open competition or that it fails to meet a FAR requirement. The boards of contract appeals and various courts have taken different approaches to these challenges. Some opinions have held that options are not subject to CICA because they are not new procurements. Others have authorized the use of the clause even when holding that it is subject to CICA’s full and open competition requirement.

The Use of a 52.217-8 Clause Does Not Create New Procurement

To determine whether an exercising option is outside the scope of the original contract, the Court of Federal Claims applies the “cardinal change doctrine”. *Chapman Law Firm Co. v.* (continued on next page)

Proper Exercise of FAR's 52.217-8 Clause (cont'd):

U.S., 81 Fed. Cl. 323, 326 (2008). A modification is within the scope of the original contract if the work remains “essentially the same work as the parties bargained for when the contract was awarded.”³ *Green Management Corp.*, 42 Fed. Cl. at 430 (“if the function or nature of the work, as changed, remains generally the same, the change or changes will be held to fall within the general scope of the contract.”). In determining whether the work to be done is essentially the same as what was bargained for, courts look at whether the modifications were foreseeable when the parties entered into the contract. *Chapman*, 81 Fed. Cl. at 327. No cardinal change occurs if the parties are adequately advised of the potential for modifications. *Id.*

The Federal Circuit has held that options in Government contracts are “part of the original and only contract.” *Varilease Tech. Group, Inc. v. U.S.*, 289 F. 3d 795, 799-800 (Fed. Cir. 2002) (court rejected the argument that options create separate and distinct contracts). Federal district courts have similarly rejected the argument that an option creates a new contract. Clause 52.217-8 only extends an existing contract and does not create a new contract. *Storage Tech. Corp. v. CCL Serv. Corp., et al.*, 94 F. Supp. 2d. 697, 702 (D. Md. 2000). “This type of contract provision is merely incidental to, and is not separable from, the original contract.” (quoting *Ocean Tech., Inc. v. U.S.*, 19 Fed. Cl. 288, 291-292 (1990)).

If a court holds that options do not create a new contract, a 52.217-8 clause would likely not violate CICA. If the original contract was subject to full and open competitive procedures, a bid protest based on CICA would likely fail. The protesting company would have had a fair opportunity to compete for the full contract, which included the possibility of a six month extension and a court would likely be unwilling to offer it a second chance.

If a party enters into a Government contract containing a 52.217-8 clause and tries to file a claim seeking additional compensation, based on CICA, the claim would also likely fail. A company that enters into a contract containing such a clause assumes the risk that the Government will exercise it. Exercising the option would not change the work the parties bargained for when the contract was awarded. A court is unlikely to allow a company to wrestle additional compensation from the Government merely because it entered into a deal that proved less profitable than anticipated.

The Use of a 52.217-8 Clause When Subjected to CICA

52.217-8 clauses often survive CICA challenges even when treated as new procurements. CICA contains seven exceptions which permit the use of noncompetitive procurements. See 10 U.S.C. §2304(c)(1)-(7). CICA permits noncompetitive procurements whenever Government agencies need for goods or services provides a compelling justification. *Matter of Research Analysis & Maintenance, Inc.*, Comp. Gen. B-296206 at 3, Jul. 12, 2005.⁴ Where exigent circumstances create the need for continued performance courts will uphold a 52.217-8 clause. *Matter of Akal Security, Inc.*, Comp. Gen B-244386 at 4, Oct. 16, 1991. CICA also permits noncompetitive procedures when the Government would be seriously injured if an agency were forced to comply with CICA’s open and competitive procedures requirement. See *Matter of* (continued on next page)

Proper Exercise of FAR's 52.217-8 Clause (cont'd):

Colbar, Inc., Comp. Gen. B-230754 at 2, Jun. 13, 1988.

If the Government can justify its extension of a contract using any of the seven CICA exceptions, any bid protest or claim would likely be rejected.

Bid Protests and Claims: Complying with the FAR

Under CICA, when a bid protest is filed the Government must direct a contractor to cease performance under the contract while the protest is pending. *Sierra Military Health Serv., Inc. v. U.S.*, 58 Fed. Cl. 573, 574 (2003). Notwithstanding this rule, performance can continue when doing so is in the Government's best interest or when urging and compelling reasons require continued performance. *Id.* Reversal of the Government's decision to override a stay of performance should only occur "where such a decision is shown to have been made with gross impropriety, bad faith, fraud, or conscious wrong doing." *SDS Intern., Inc. v. U.S.*, 55 Fed. Cl. 363, 365 (2003). Regardless of whether a stay is issued or lifted, a protester must prove that the Government exercised a 52.217-8 clause improperly in order to win a bid protest or claim.

Options are exercisable at the discretion of the Government. *Matter of AAA Engineering & Drafting, Inc.*, Comp. Gen. B-236034 at 3-4, Apr. 6, 1993. A disappointed bidder bears a heavy burden of showing that an award decision had no rational basis. *Impresa Construzioni Geom. Domenico Garufi v. U.S.*, 238 F. 3d 1324, 1333 (Fed. Cir. 2001). Courts will not question the Government's exercise of an option unless a protester can show the decision to exercise the option was unreasonable. *Washington Consulting and Mgmt. Assoc., Inc.*, Comp. Gen. B-243116 at 2, Jul. 19, 1999. Broad discretion is granted to the Government's determination that exercising an option is in its best interest. *Id.*

The Government's decision may be found to be arbitrary and capricious if the decision failed to consider an important aspect of the problem or runs counter to the evidence before it. *Keeton Corrections, Inc. v. U.S.*, 59 Fed. Cl. 753, 755 (2004). Courts have objected to the decision to limit competition when the Government's claim of a "compelling and urgent" reason lacked a reasonable basis. *Matter of Honeycomb Co of America*, Comp. Gen. B-227070 at 2, Aug. 31, 1987. Courts have also opposed the use of a 52.217-8 clause when the Government's failure to plan for procurement caused the urgency that justified the extension. *Matter of Laidlaw Environ. Serv., Inc.*, Comp. Gen. B-249452 at 3, Nov. 23, 1992. Judges will not substitute their judgment for that of the Government if the Government makes a rational decision based on accurate information. *Keeton Corrections, Inc.*, 59 Fed. Cl. at 755.

Courts have also shown little sympathy for contractors who file claims seeking additional compensation based on the Government's exercise of a claim. If a contractor agrees to enter into a contract that contains an option, the contractor assumes the risk that the option will be exercised at its detriment. *See Griffin Serv. Inc.*, ASBCA 52280, Aug. 2, 2002.

If the Government decides that extending a contract using a 52.217-8 clause is in its best interest, when price, urgency of need, and likelihood of delays are considered, a court will
(continued on next page)

Proper Exercise of FAR's 52.217-8 Clause (cont'd):

likely uphold its usage. A court will likely look at whether the reasons offered by the Government to extend the contract fit the evidence presented. Because courts typically grant the Government broad discretion on how to meet its needs, the Government's decision would likely survive any challenges as long as the decision was not clearly against the Government's interest.

Conclusion

52.217-8 clauses are useful tools that may be exercised any time there is a need to extend an existing contract. Before exercising this clause, the Government should ensure that doing so is in its best interest. Although courts accord the Government broad discretion in determining whether exercising an option is in its best interest, doing so may be held improper if the Government fails to consider CICA and FAR rules. When faced with a bid protest or claim, courts will consider whether a protestor was deprived of fair consideration and whether the Government's decision to exercise the option was reasonable. If the Government's decision to extend a contract is exempt from CICA, falls under any of the seven CICA exceptions, or is justified by a reasonable belief that doing so is in the Government's best interest, a court is unlikely to rule that the decision was improper.

* - Ernesto Corrales is a third year law student at the Florida International University College of Law. This year, he interned at the U.S. Navy's Office of the General Counsel.

Endnotes

¹ - See also: *Information Ventures, Inc.*, Comp. Gen. B- 241441, Jan. 29, 1991 (a CO may include an options in a contract whenever the agency has reasonably determined that it is in the Government's best interest to do so).

² - See also: *Padilla v. U.S.*, 58 Fed. Cl. 585, 590 (2003) ("Government may require continued performance *only if* the Contracting Officer provides the contractor with written notice within a specified period.").

³ - Also used to test for cardinal changes: the degree of work disruption and increase in cost stemming from the change. (quoting John Cibinic, Jr. and Ralph C. Nash, Jr., *Administration. of Government Contracts*, 386 (3d ed.1995)).

⁴ - For example, if an agency reasonably believes only one company can deliver goods by a required date.

Your Checklist for Outside Counsel Legal Service Agreements

by
John “Johnny” E. Miller*

[Note: Reprinted with permission from the National Contract Management Association, *Contract Management*, July 2008.]

In your contracts management activities, it’s likely that you could be asked by your company to review an outside counsel legal services agreement.

Once it passes through the exclusive domain of in-house attorney review, outside counsel legal services agreements are often additionally reviewed today by a company’s contract management personnel in order to potentially surface additional issues than may not have been considered by in-house counsel. Sometimes this additional contract review is requested by your chief financial officer or your procurement management. As with any substantive agreement executed by your company, outside counsel legal services agreements are important contracts that need to be properly reviewed. Companies typically spend more on their outside counsel arrangements than on their own in-house law departments.

In my 30-year contracts management career, I have reviewed many legal services engagement agreements with outside counsel. In order to systematically cover the multitude of unique issues in a typical outside counsel agreement review, over the years I have developed a practical Outside Counsel Legal Services Agreement Checklist that I use in reviewing outside counsel legal services agreements.

1. Consider the use of a multi-year (e.g., three-year) master agreement with separately authorized/signed statements of work for each legal matter. Development of the specific statement of work for each legal matter would address: the effective date of the specific legal services matter; confirmation that any conflicts have been resolved; names and contact information for applicable attorneys for each party; and a clear and complete scope of the legal services matter, which includes the background, objectives, duties, obligations, requirements, tasks, deliverables, schedule, assumptions, your company’s responsibilities, budget, staffing plan, statement of work pricing type (fixed price, hourly rates), etc.

2. Use an ownership/use of legal services/work products provision.

3. Use a SOX 307 reporting requirements provision.

4. Include diversity requirements.

5. Consider including pro bono requirements.

6. Address conflicts (actual, potential, or subject matter) and establish a conflict waivers procedure.

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Checklist for Legal Service Agreements (cont'd):

7. Address confidentiality of your company information.
8. Address attorney–client privilege.
9. Address data privacy.
10. Add a Termination for Convenience provision.
11. Address publicity constraints.
12. Add a document retention provision.
13. Address business continuity.
14. State governing law.
15. Consider a convergence on several preferred outside counsel providers that can provide the full range of legal practice areas in return for discounted rates and volume discounts.
16. Consider the use of alternative billing when applicable (discounted rates, volume discounts, cap on annual hourly rate increases, incentive billing, value-based billing, performance billing, firm fixed fee, blended rates, etc).
17. Consider risk-sharing provisions.
18. Consider the use of off-shore, outside counsel firms by your company and outside counsel.
19. Consider the use of e-billing by outside counsel tied to in-house concurrent of matter management.
20. Use centralization of outside counsel authorizations by only in-house legal, or else resulting invoices will not be valid.
21. Use of better outside counsel project management techniques, such as statements of work, periodic progress reports (to include an assessment of the current merits of the matter, range of current liability exposure, estimate of settlement value, cost of going to trial), engagement plans, and designated engagement and relationship attorneys for both outside counsel and in-house for each matter.
22. Use periodic outside counsel performance assessment/scorecards.

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Checklist for Legal Service Agreements (cont'd):

23. Use of matter budgets with monthly spend versus budget versus progress analysis.
24. Use monthly skill versus task analysis for each matter.
25. Use contractual prior approval control gates for outside counsel expenses/disbursements.
26. Obtain periodic range of exposure reports from outside counsel for each matter.
27. Consider potential use of contract attorneys by your company and by outside counsel.
28. Consider the use of actual and virtual secondment of outside counsel.
29. Consider the use of virtual outside counsel firms.
30. Require a monthly write-off hours report from outside counsel.
31. Consider adding a provision of free continuing legal education (CLE) for in-house counsel provided by outside counsel.
32. Consider making outside counsel responsible for complying with your company policies and guidelines.
33. Require that the outside counsel be knowledgeable about your company.
34. Require outside counsel (on each invoice) to report monthly professional fees and expenses and disbursements, total year-to-date professional fees, total year-to-date expenses and disbursements, total inception-to-date professional fees, and total inception-to-date expenses and disbursements.
35. Require a negotiated contractual budget with each legal matter.
36. State that in the event of conflicts between the master engagement agreement and the applicable statement of work, the statement of work will prevail.
37. Require that outside counsel discuss potential alternative dispute resolution methods for matters with your company at the outset of a legal matter engagement.
38. Set up a one-outside-counsel-lawyer rule for meetings, negotiations, depositions, and court appearances, unless otherwise agreed to by your company in advance.
39. State that your company does not pay for replacement attorney learning time or
(continued on next page)

Checklist for Legal Service Agreements (cont'd):

other ramp-up learning costs.

40. Prohibit duplication of effort.

41. Require that charges for outside counsel interoffice conferences be minimized unless discussing meaningful direction or strategy.

42. Require run-rate forecasts of anticipated future costs reports on a matter at any time if so required by your company.

43. State that attorney fee rates are firm for one year. Use a percentage cap (e.g., 3 percent) on annual attorney fee increases.

44. Require additional volume percentage discounts at the end of each year to apply for the next year.

45. Require timely monthly reports of accrued but unbilled (pending) charges if so required by your company.

46. Require compliance with all applicable insider-trading laws, the Foreign Corrupt Practices Act (FCPA), anti-boycott laws, and export compliance laws and regulations.

47. Consider the use of a prompt payment discount.

48. Consider reasonable charging limits, such as no more than 10 hours per day for a given attorney (unless approved in advance).

49. Address how travel time will be handled (e.g., no attorney fees for travel time).

50. Consider requiring (1) prior approval on air travel, (2) compliance with your company travel policy, and (3) use of company-approved hotels.

51. Require timely prior written notification to your company if outside counsel becomes aware that the matter budget will be exceeded.

52. Prohibit formula billing (e.g., \$100 for a letter).

53. Require compliance with equal opportunity, antidiscrimination, affirmative action, etc.

54. Consider stating that charges for computer research (Lexis Nexis, WestLaw, etc.) are not billable.

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Checklist for Legal Service Agreements (cont'd):

55. Consider stating that photocopy costs in excess of \$X require prior approval from your company. (Perhaps require the use of your company-approved photocopy supplier.)

56. State that nonbillables include office supplies, local telephone charges, per-page fax charges (excluding long distance charges), routine mail, etc.

57. Require the use of your company-approved couriers.

58. State that there is no alcohol reimbursement.

59. State that there is no overtime transportation for outside counsel personnel.

60. Prohibit phone charges at hotel rates.

61. Require the use of good judgment on business meals.

62. Consider the use of videoconference instead of travel, if reasonable.

63. Attach a list of all of your company's affiliated entities that are to be covered by the agreement.

64. Seek most-favored-customer pricing.

65. Use service level agreements (if appropriate).

66. Potentially use an audit rights provision.

67. Consider prohibiting your company's responsibility for third-party invoices.

68. Address how attorney fee disputes will be handled (via arbitration, litigation, etc.).

69. Require that copies of all pleadings, correspondence, and memos be provided to your company.

70. Include a partnering provision to proactively help discover mutually beneficial ways to improve the outside counsel relationship, as well as to discover ways to further enhance communication, innovation, technology improvements, performance, risk-reduction, continuous improvement, and spend/cost savings with outside counsel,

The goal of an outside counsel legal services engagement agreement is to facilitate a win-win in-house/outside counsel relationship. This Outside Counsel Legal Services Agreement Checklist is not exhaustive. Every outside counsel engagement arrangement for legal services has some unique aspects that may not be addressed in this checklist.

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Checklist for Legal Service Agreements (cont'd):

However, if you routinely use this Outside Counsel Legal Services Agreement Checklist as one of several resources when you review a legal services agreement with outside counsel, you will be pleasantly surprised with the large number of substantive, material, risk-reduction, performance-improvement, and cost-savings issues that will be surfaced for proper resolution.

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Endnotes

1 - 2005 ACCA/Serengeti Managing Outside Counsel Survey: Assessing Key elements of the In-House Counsel/ Outside Counsel Relationships, 14.

2 - Excerpted from Ronald F. Pol, “Get More Value from Outside Counsel; Show Them the Flipside,” ACCA Docket, April 2003. Accessed at www.acca.com/protected/pubs/docket/am03/flipside1.php.

**Change Order Accounting:
Why Contracting Officers Should Require It;
Why Contractors Should Do It Any Way**

by

Jeffrey P. Hildebrant and Peter A. McDonald*

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To almost anyone but an accountant, the topic of change order accounting might sound deceptively dull and arcane. However, the amount of money potentially at stake that depends on the existence of good change order accounting should be enough to spark the interest of even the most jaded contracting officer or contractor.

For contractors, implementing a system of change order accounting appropriate to the size of a change order claim is always a good idea. This is because the burden of proof to substantiate a claim always rests with the contractor. For contracting officers, change order accounting should be required whenever permitted—without it, the government may be held liable for claims based on contractor estimates that are inherently less reliable than actual costs.

What is Change Order Accounting?

Change order accounting refers to the accounting procedures that a contractor uses to segregate its costs to perform the work identified in a particular change order from the other costs it incurs to perform the contract. Change order accounting helps the parties determine the amount that the contract price should be adjusted (up or down) for changed work. To understand how best to implement change order accounting, one must first understand the basis for claims by the contractor for a contract price adjustment, known under the Changes clause as a request for an equitable adjustment (REA).

Equitable Adjustments Under the Changes Clause

Regardless of the type of contract, the most frequent type of claim made under a government contract is one arising under the applicable Changes clause, and this has long been the case. Notwithstanding its widespread occurrence, change orders are addressed in one of the shortest parts of the *Federal Acquisition Regulation (FAR)*, Part 43.

The *FAR* contains five different changes clauses for differing types of contracts.¹ All of these clauses essentially provide that the contracting officer (1) is authorized to make certain types of changes within the general scope of the contract; and (2) will make an equitable adjustment to the contract price (and/or delivery schedule) if the change causes an increase or decrease in the cost of, or time required for, performance of the contract.² This clause is the basis for contractor claims to increase the contract price, and for government claims to decrease the price, whenever a change occurs. Under the clause, the contractor asserts its right to a claim by submitting a REA that justifies the price and/or schedule adjustment that it seeks. Good change order accounting can provide the data the contractor needs to substantiate its position.

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Change Order Accounting (cont'd):

There are two types of changes recognized by courts and boards: actual and constructive:

Actual Change Orders

Actual changes occur by direction of the contracting officer in accordance with the Changes clause, as previously stated. This is normally a two-step process. The first step is for the contracting officer to issue a change order (usually via a *unilateral* modification). The change order specifically describes the change in work. The second step is the execution of a supplemental agreement. The supplemental agreement, which is a *bilateral* modification to the contract, makes changes to the price and schedule.

Constructive Changes

Under long-standing judicial precedent, constructive changes occur when work is performed beyond the contract requirements without a formal order, either due to an informal order or through the fault of the government.³ For example, a constructive change may arise when a government inspector wrongfully rejects conforming goods, or where a government engineer provides defective site maps.

A contractor adversely affected by either an actual change or a constructive change should be able to rely on its accounting system for the information necessary to attain full recovery of its additional costs of performance.

Implementing Change Order Accounting

As previously noted, the Changes clause requires an adjustment to the contract price if a change increases or decreases the cost to perform the work. With change order accounting, the task of determining the additional costs is largely one of extracting the data from the accounting system.

If the change order requires new work that was not contemplated in the original contract, then the contractor should set up specific accounts to record labor, purchases of materials, intracompany transfers, and other costs incurred to perform the new work. For example, suppose a contractor uses a job-costing system in which a NASA contract is coded "4117." Employees working under that contract would charge their time to "4117," personnel in the purchasing department would charge materials bought for that contract to "4117," and so on. When a change order occurs, the affected employees would be instructed to still charge their time to "4117" when working on the contract, but to charge their time to "4117a" or some other unique number when working on the change. In like manner, the purchasing department would charge "4117" when buying items for the contract, but would charge "4117a" when getting additional materials for the change.

These new costs, minus any costs that the contractor avoided due to the change, would form the basis for the contractor's REA. If the change requires only the *deletion* of work, then new account numbers would not *necessarily* be required because no new costs are to be incurred due to the change. However, depending upon the magnitude of the deleted work, a contractor may
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Change Order Accounting (cont'd):

want to use entirely new accounts to show the decrease in contract expenditures due to the change.

The Unattractive Alternative to Change Order Accounting

A contractor that submits an REA for a substantial change without instituting change order accounting is at a severe disadvantage in two respects.

First, the contractor may be unable to ascertain the actual costs it incurred to perform the changed work. Without actual costs, the contractor may be unable to prove its claim. Courts generally prefer that contractors prove their claims using the actual cost method for the following compelling reason:

[The actual cost method] provides the court, or contracting officer, with documented underlying expenses, ensuring that the final amount of the equitable adjustment will be just that—equitable—and not a windfall for either the government or the contractor.”⁴

Estimating actual costs may occasionally be used as an alternative. Such estimates may be based, for example, on contractor testimony as to the hours expended or on purchase orders for materials similar to those that were used. However, estimates are less credible than actual costs and are easily challenged.

An alternative is to use the total cost method, which simply calculates the difference between the contractor’s bid and its higher actual costs. It is easy to imagine that a contractor could have incurred at least some increased costs for reasons unrelated to the changed work. This could happen, for example, if its bid was too low or other problems emerged that were not the government’s fault. For this reason, courts will reject a claim based on the total cost method, unless the contractor can prove: (1) the impracticability of proving its actual losses directly; (2) the reasonableness of its bid; (3) the reasonableness of its actual costs; and (4) lack of responsibility for the added costs.⁵ Case law shows that proving these elements is very difficult and, accordingly, successful total cost method claims are rare.

The second disadvantage to developing claims without change order accounting is that isolating actual change order costs or developing credible estimates can be a difficult and costly process. Isolating change order costs after they already have been incurred can require, for example, a detailed review of payroll records, purchase orders of materials, modifications of subcontractor agreements, project progress charts, and similar documents.

Usually, a detailed cost analysis is too complex or time consuming to perform in-house. However, even if the contractor’s staff is capable of developing the necessary data, the effort required to do so and resulting disruption to normal operations could exceed the cost that the contractor would have incurred to set up a relatively simple change order accounting procedure.

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Change Order Accounting (cont'd):

Disaster Recovery and Records Reconstruction

Sometimes, contractors do not possess their actual cost data in whole or in part when it is needed because of a natural disaster, equipment malfunction, or procedural error. Fortunately, it is frequently possible for accountants to reconstruct lost data. Disaster recovery measures can be physical, such as retrieving data from a damaged hard drive. However, disaster recovery can also involve data reconstruction.

In general, data reconstruction refers to the methodologies undertaken by accountants to determine, with reasonable precision, what the lost numbers should have been. To illustrate, suppose a factory burns to the ground the day before payday, and all the payroll records are lost. Despite the fact that virtually none of the payroll records are available, accountants likely can reconstruct the entire payroll with a high degree of accuracy by referring, for example, to each employee's most recent federal and state tax withholding information. By a process of reverse engineering, the payroll amounts can then be reliably ascertained. Not surprisingly, there are many other instances where lost data may be similarly reconstructed by reference to collateral sources.

Change Order Accounting Required by the Contracting Officer

In complex contracts, the contractor may be required under the Change Order Accounting clause to implement change order accounting for changes expected to exceed \$100,000. The presence of the clause affects the type of evidence that a court or board will accept in support of a contractor's claim. Case law indicates that if the clause is in the contract *and* the contracting officer requires change order accounting, the contractor will be required to support its claim with actual costs—not with estimates or the total cost method. Conversely, if the contracting officer could have included the clause, but did not (or did not require the contractor to implement change order accounting), then the contractor will not be required to support its claim with actual costs, provided the alternate basis for its claim is reasonable.

FAR Clause

The contracting officer is permitted to insert the Change Order Accounting clause, FAR §52.243-6, into a supply or research and development contract if the contract is of significant complexity and where numerous technical changes are anticipated, or into a construction contract whenever "appropriate."⁶ The clause provides as follows:

The contracting officer *may* require change order accounting whenever the estimated cost of a change or series of related changes *exceeds \$100,000*. The contractor, for each change or series of related changes, shall maintain separate accounts, by job order or other suitable accounting procedure, of all incurred, segregable direct costs (less allocable credits) of work, both changed and not changed, allocable to the change. The contractor shall maintain such accounts until the parties agree to an equitable adjustment for the changes ordered by the contracting officer or the matter is conclusively disposed of in accordance with the Disputes clause.⁷

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Change Order Accounting (cont'd):

Note that the contracting officer “may” require change order accounting. This means that there is no duty to perform change order accounting due to the mere presence of the clause in the contract. Rather, the contract must contain the clause *and* the contracting officer must specifically require change order accounting on a change or a series of changes expected to exceed \$100,000. There is no requirement for change order accounting on a change or series of changes less than \$100,000.

What Happens if the Contractor Fails to Comply with the Clause?

Case law shows that a contractor who fails to comply with the clause regarding a particular change may forfeit its claimed price adjustment for lack of proof. For example, in *Phoenix Control Systems, Inc.*,⁸ the contractor’s \$400,000 claim for differing site conditions (conditions the government agreed existed) was denied in significant part because the contractor failed to account for the actual costs incurred as a result of the changed condition, as required by the contract. Unfortunately, the contractor’s remaining evidence was considered unreliable. Similarly, in *Mergentime Corp. v. WMATA*,⁹ the court rejected the plaintiff’s claim calculations in favor of the government’s lower estimate due, in part, to the plaintiff’s failure to account for the increased costs required by the change order accounting clause.

What Happens if the Contracting Officer Could Have, But Failed to, Require Change Order Accounting?

The government’s failure to require change order accounting when it could have done so has been held to be sufficient cause to allow a contractor to support a price adjustment with estimates, rather than actual cost records.¹⁰ This occurred, for example, in *Advanced Engineering & Planning Corporation, Inc.*,¹¹ where the board overruled the government’s objections that the contractor did not support its numerous claims with actual costs. The board remanded the claims to be calculated on the basis of the contractor’s estimates, using rates approved by the Defense Contract Audit Agency. Similarly, in *United States v. Service Eng’g Co.*,¹² the court did not require the contractor to substantiate its claim using actual cost data based on the contractor’s “justifiable inability” to record such data. Under the circumstances, the court found, the costs for the changed work could not easily be segregated from the underlying contract costs. However, the court indicated that this inability would have been the contractor’s problem, not the government’s, if the contracting officer had included the change order accounting clause.

Note that including the change order accounting clause in the contract is not enough to require the contractor to institute change order accounting. The contracting officer must *also* direct the contractor to implement change order accounting on a particular change order. In *Bath Iron Works Corp.*,¹³ the contract contained the clause, but the change modification failed to require the contractor to implement change order accounting for that particular change. Consequently,

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Change Order Accounting (cont'd):

the government's objections to the contractor's failure to substantiate its claims with actual costs were rejected. The contractor was permitted to substantiate its claims with estimates that the board deemed to be reasonable. In each of these cases, the actual cost method usually preferred by courts was not required because the government failed to require change order accounting.

Conclusion

Change order accounting benefits both the contractor and the government. For the contractor, change order accounting reduces the costs the contractor would incur to substantiate its change order claim by contemporaneously documenting the contractor's increased costs. For the government, insisting on change order accounting requires the contractor to use its actual costs, rather than estimates of suspect reliability.

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Endnotes

1 -

<u>Clause</u>	<u>Type of Contract</u>
FAR 52.243-1, Changes - Fixed Price	Supply; Ind. Del.; SAP
FAR 52.243-2, Changes - Cost Reimbursement	Supply; Service, Construction
FAR 52.243-3, Changes - Time and Materials or Labor Hours	T&M; LH
FAR 52.243-4, Changes	Fixed price construction; DDR
FAR 52.243-5, Changes and change conditions	Fixed price construction; DDR

SAP: Simplified acquisition procedures

DDR: Dismantling, demolition or removal of improvements

Under the Uniform Contract Format, all Change clauses appear in Section I.

² - Of course, if a change would cause the contractor to exceed the limits under a Limitation of Funds or Limitation of Costs clause, the contractor would have no obligation to continue performance beyond those limits.

³ - *See., e.g., Len Co. & Assocs. v. United States*, 385 F.2d 438, 443 (1967).

⁴ - *Propellex Corp. v. United States*, 342 F.3d 1335 (Fed. Cir. 2003), quoting *Dawco Construction, Inc. v. United States*, 930 F.2d 872, 882 (Fed. Cir. 1991), overruled in part on other grounds, *Reflectone, Inc. v. Dalton*, 60 F.3d 1572 (Fed. Cir. 1995) (en banc).

⁵ - *Propellex Corp., id.* (citing *Servidone Constr. Corp. v. United States*, 931 F.2d 860, 861 (Fed. Cir. 1991)).

⁶ - FAR §43.205(f).

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Change Order Accounting (cont'd):**Endnotes (cont'd)**

⁷ - FAR §52.243-6 (emphasis added).

⁸ - IBCA No. 2844, 96-1 BCA ¶28,128.

⁹ - Civ. Action No. 89-1055, 1997 U.S. Dist. LEXIS 23408 (D.D.C. 1997).

¹⁰ - *See* Advanced Engineering & Planning Corporation, Inc., ASBCA Nos. 53366, 54044, 2005-1 BCA ¶32,806, citing Service Engineering Co., ASBCA No. 40274, 93-1 BCA P 25,520, recons. granted in part on other grounds, 93-2 BCA ¶25,885.

¹¹ - *See* n.8.

¹² - No. C-93-2591-VRW, No. C-94-0271-VRW, 1994 U.S. Dist. LEXIS 13596 (N.D. Cal. 1994).

¹³ - ASBCA Nos. 44617, 45232, 97-2 BCA ¶29,073.

Fair Value Accounting— And Why Government Contractors Should Care

by
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This article, written for non-accountants, explains a recent accounting rule concerning fair value accounting. The new rule may interest many government contractors because it could enable them to reappraise their assets, and such reappraisals could materially impact the contracts of government agencies.

I. Background

The Financial Accounting Standards Board (FASB) is the primary authoritative body that regulates the generally accepted accounting principles (GAAP).¹ FASB's reach is great because all financial statements subject to audit must comport with GAAP.² FASB issues a rule in the form of a Statement of Financial Accounting Standard (SFAS), and SFAS 157 (Fair value measurements) is the subject of our attention.

For decades, the value of property on balance sheets has been listed in terms of its cost. This is referred to as the cost principle, which uses the transaction price as the basis for recorded value. However, for financial statements issued on or after November 15, 2008, companies (including government contractors) choosing fair value accounting will be able to apply new valuation rules for their assets and liabilities. Because fair value accounting changes the rules for how assets and liabilities are valued on balance sheets, the financial impact may be great.

II. Fair Value

Up to now, GAAP used by government contractors was based on historical cost accounting. Historical cost accounting, long the traditional basis by which assets and liabilities have been measured, is a valuation methodology that uses acquisition costs to determine value. For example, assume Spacely Sprockets purchased land for \$1 million dollars in fiscal year (FY) 1985. In its FY 2008 balance sheet, the land would still be carried at its acquisition cost of \$1 million, because land does not depreciate. In contrast, fair value accounting uses certain methodologies (discussed below) to determine the *current* value of assets and liabilities. Accordingly, under SFAS 157 the land could be shown on the balance sheet at its *present* fair value. Consider a second example, this time involving an intangible asset such as software. SFAS 157 could permit the fair value of software to be determined by considering the total cash flow of the license fees over its economic life.

Fair value is defined in SFAS 157 as follows:³
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Fair Value Accounting (cont'd):

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

SFAS 157 provides guidance on the required disclosures that accompany financial statements, and also establishes a hierarchy of permissible valuation techniques. Specifically, fair value measurement valuations are categorized as Level 1 (the most preferred) where a ready market exists, i.e., where quoted prices for *identical* assets or liabilities exist in active markets. A Level 2 valuation is where such a market does not exist, but where quoted prices for *similar* assets or liabilities exist in active markets. If neither Level 1 nor Level 2 valuations are possible (i.e., there is little or no market activity for the asset or liability), then valuations are performed using the best information available (Level 3). Because Level 3 valuations are the most subjective, they are the least preferred.

With this elementary understanding of SFAS 157, let us now turn to its application to government contracts.

III. Government contracts

Government contractors maintain cost accounting systems that differ from GAAP-based commercial cost accounting systems. These differences generally ensure compliance with cost measurement, assignment, and allocation requirements found in the Cost Accounting Standards (CAS), as well as the cost allowability requirements of Federal Acquisition Regulation (FAR) Part 31. FAR cost allowability and CAS cost measurement requirements apply to cost-based federal contracts (which means contracts for which the Federal Government pays the contractor based on costs incurred), and requires the incurred costs to be properly tracked and allocated. Obviously, cost-based federal contracts use historical cost accounting, not fair value accounting.

There are already limits to the scope of fair value accounting in government contracts. In the FAR, for example, there are provisions that prohibit the application of fair value accounting in certain circumstances. FAR 31.205-52 (Asset valuations resulting from business combinations) prohibits asset write-ups or write-downs for assets involved in a merger or acquisition. Similarly, FAR 31.205-16(h) and (i) disallow gains or losses from the sale or exchange of capital assets, or the impairment of assets. For CAS-covered contracts, among the many unknowns is whether the adoption of fair value accounting would constitute a change in accounting practice. CAS 404 (Capitalization of tangible assets) uses acquisition costs to determine a tangible asset's value. Along the same lines, CAS 411 (Accounting for acquisition costs of material) essentially incorporates acquisition or production costs in the allowable inventory costing methodologies, but does not recognize fair value accounting as an inventory costing method.

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Fair Value Accounting (cont'd):

IV. Impact

GAAP will very soon incorporate the valuation methodologies of fair value accounting, and fair value accounting may dramatically change the valuation basis of assets and liabilities. With vast quantities of undervalued assets, government contractors in some industries may plunge headlong into fair value accounting like penguins into the sea. One need not be especially clairvoyant to see that fair value accounting may have a significant impact.

The implementation of FAS 157 will present many problems, not all of which can be foreseen. In fact, implementation of fair value accounting even in the private sector has not been without difficulty. For example, in the first quarter of this year the Securities & Exchange Commission (SEC) sent 30 guidance letters to companies that had applied fair value accounting in their SEC filings.⁴

Government contractors incorporating fair value valuation methodologies can reasonably expect to encounter similar problems with government regulators. Indeed, there are many unsettled questions concerning how fair value accounting should be applied to accounts such as pensions, employee benefit plans, and contingent liabilities.⁵ In like vein, government contractors with intangible information technology (IT) or intellectual property (IP) assets may also experience difficulties as they seek to reconsider their undervalued assets. For such contractors, SFAS 157 has greater significance because intangible assets have become more and more dominant on the balance sheet with the growth of the service economy, and neither CAS 404 nor CAS 411 apply to intangible assets.

Looking at the broad picture, it is reasonable to assume that government contractors possess widely diverse assets for which no ready market exists, and for which undesirable Level 3 valuations will be necessary. Finally, accounting-related litigation is expected to increase in the private sector,⁶ a development that is likely to be mirrored in the government contract market as the adoption of fair value accounting will be fertile ground for disagreement between government contractors and government auditors.

Finally, some problems may be caused merely by lack of familiarity with the subject matter. On this point, it is unlikely that there are very many government auditors trained in fair value accounting. The situation is not much better at public accounting firms, where it is uncommon to find auditors who are knowledgeable in this area. To be sure, the proper implementation of fair value accounting is a new skill set almost all accountants will need to acquire.

VI. Conclusion

There are no ready answers to the turmoil that lies ahead. SFAS 157 presents a new valuation measurement system, and some government contractors have a powerful economic incentive to quickly implement its terms. There will almost certainly be many implementation
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Fair Value Accounting (cont'd):

issues to be resolved (either with or without litigation). Until the dust settles, the adoption of fair value valuation methodologies should be a matter of interest to government contractors and a matter of concern to their agency customers.

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Endnotes

1 - The Securities and Exchange Commission (SEC) has the legal authority to determine GAAP for publicly-held companies, but historically has ceded that authority to the FASB, a non-profit organization headquartered in Norwich, Connecticut.

2 - For audits of publicly-held companies, the SEC enforces GAAP compliance. For privately held companies, banks contractually enforce GAAP compliance as a general rule for loans.

3 - "SEC Wants Firms to Explain Fair-Value Choices," by Sarah Johnson, *CFO.com*, March 31, 2008.

4 - "Facing Up to Fair Value," by Marie Leone, *CFO Magazine*, February 1, 2008. *See also* "Is Fair Value Accounting Really Fair?", by Emily Chasan, Reuters, February 26, 2008.

5 - "Facing Up to Fair Value," by Marie Leone, *CFO Magazine*, February 1, 2008. *See also* "Is Fair Value Accounting Really Fair?", by Emily Chasan, Reuters, February 26, 2008.

