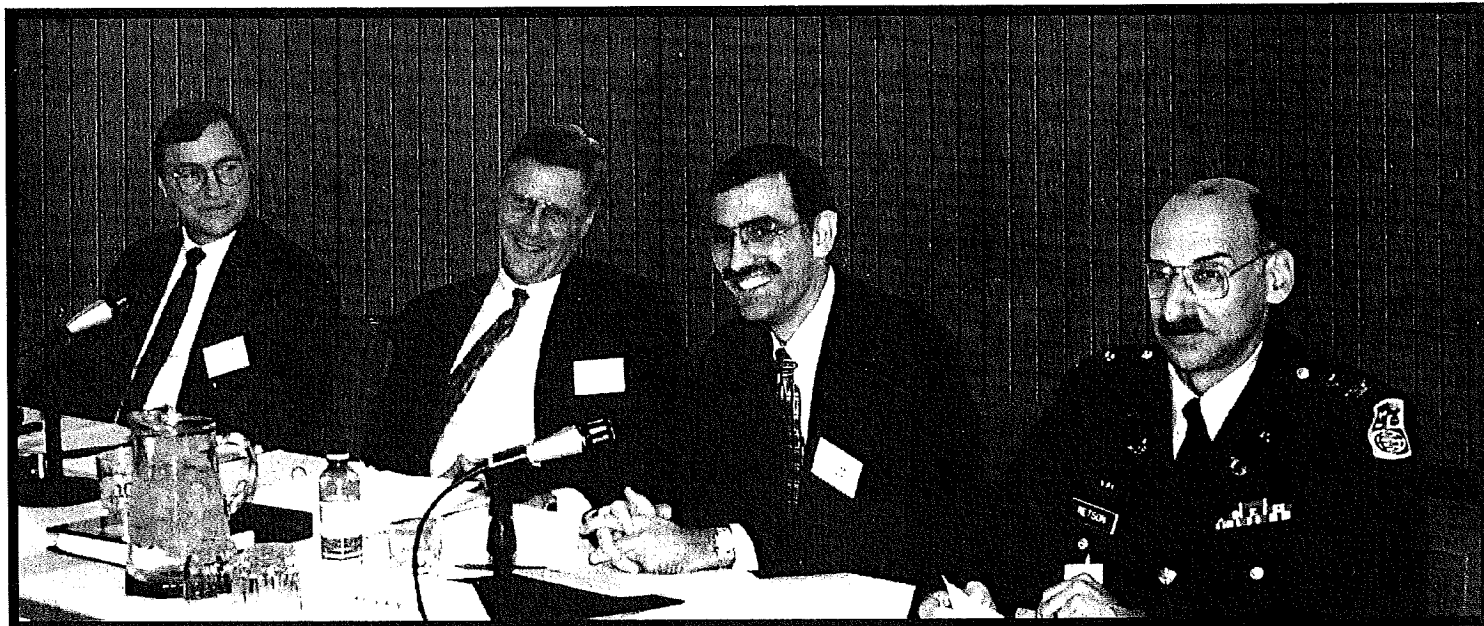


# The Clause

A QUARTERLY PUBLICATION OF THE BOARDS OF CONTRACT APPEALS BAR ASSOCIATION

Winter Issue, December 1995, Vol. V, Issue #4



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A Holocaust

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Cover: (left to right) Edward Gipple, Richard  
Duvall, Honorable Jack Delman, and  
Colonel Chip Retson

## PRESIDENT'S COLUMN

Laura K. Kennedy



Laura K. Kennedy

This year opened with a lively Annual Program. For a second consecutive year, Dave Metzger organized a superb day filled with debate over a variety of issues facing Government procurement. He also introduced a new segment of the program, a State of the Boards address, skillfully presented this year by Judge Gene Perry Bond, Chairman of the Department of the Interior Board of Contract Appeals. The luncheon speaker, Alan Chovtkin of AT&T, offered a thought-provoking analysis of why procurement reform is where it is today. In all, it was a rich program, well-attended by both the private and government bars, despite the newly imposed shutdown.

We now settle into the business of the Association. This year, we have reconstituted the Practice Committee. Roger Boyd of Crowell & Moring assumes the chairmanship of the Committee which will address both procedural as well as substantive aspects of practice before the board of contract appeals. Don Suica will continue to be active in procedural issues as a Vice-Chair of the Committee. Other Vice-Chairs will address emerging substantive issues involving information technology, health care and the

A new committee has been formed our Association. Carl Peckinpugh will the energy and ideas for stimulating growth

Our Annual Joint Training Program

tion of Public Contract Law is well into the ing with the ABA to organize the "Ninth Intensive Program on Trial Preparation and Advocacy in Federal Procurement." This six-day program will begin on February 25, 1996 at the National Courts Building in Washington, D.C. The attendees will have an opportunity to prepare and depose witnesses, argue pre-hearing motions, perform direct and cross-examination of fact and expert witnesses and review their performances using video replays.

On May 23, 1996, we will present a program at the Federal Circuit Bar Association meeting in Washington, D.C. Marcia Madsen is taking the lead to organize the two-hour break-out session for the program.

I look forward to working with the Committee chairs and Program Coordinators to invigorate this Association with ideas and activities that respond to the changing climate of federal procurement.

**A new committee has been formed to develop ways to expand the membership in our Association.**

to develop ways to expand the membership in chair this new Membership Committee. Carl has in our Association.

with the American Bar Association (ABA) Sec-

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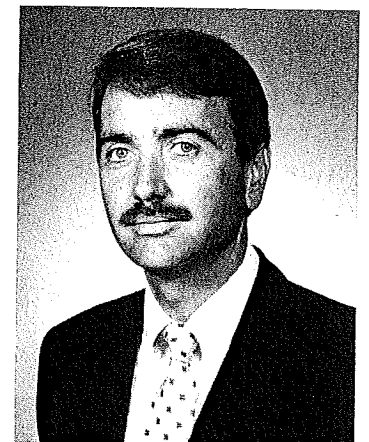
I look forward to working with the Committee chairs and Program Coordinators to invigorate this Association with ideas and activities that respond to the changing climate of federal procurement.

## EDITOR'S COLUMN WITH ANNUAL MEETING HIGHLIGHTS

*Professor Andre Long, CPCM  
Air Force Institute of Technology*

For those who braved the winter storm, worked through the government shutdown, and otherwise had an opportunity to attend, the BCABA's annual program and meeting on November 15, was a day very well spent. I am pleased to state, that everyone with whom I spoke stated that the programs more than surpassed their expectations. The Honorable Gene Perry Bond, Chairman of the Department of Interior Board of Contract Appeals, started the morning with the Bar Association's first ever "State of the Boards" speech. Judge Bond traced followed the long history of the Boards and more recent trends, developments, important precedents and the House bill known as "The Federal Acquisition Reform Act (FARA) of 1995", (H.R. 1670), which would establish the DOD Board of Contract Appeals and the Civilian Agency Board of Contract Appeals within the GSA as the two boards available to hear protests and disputes.

The Honorable Catherine B. Hyatt, Judge at the GSBICA, Arthur Hildebrandt, U.S. Navy Associate General Counsel, and Andrew DeCicco, Assistant General Counsel, ITT Defense, followed with a panel moderated by James A. Dobkin, Partner, Arnold & Porter, which conducted an insightful discussion of terminations for default and convenience. After a



Andre Long



coffee break, there was an interesting discussion on quantifying claims and other procedural and substantive law trial matters regarding cost and pricing issues. Roger N. Boyd, Partner, Crowell & Moring, moderated the panel consisting of Jerome C. Brennan, Litigation Counsel for DLA's Northeastern District, The Honorable Eunice W. Thomas, judge at ASBCA, and Roger Holbrook, Partner and National Director of Government Contract Services at Ernst & Young.

During Lunch, Alan L. Chvotkin, Esquire, Assistant Vice President for New Business Development for AT&T's Government Markets spoke about many of the on-going and proposed changes affecting law practice in front of the Boards. He covered at length the numerous and profound transformations that are challenging government contracts attorneys as never before. After lunch, Alan C. Brown, Miller & Chevalier, received The "Best Article of the Year" award for his excellent contribution in the winter 1995 **Clause** issue entitled "The New Time Limits On Contract Claims Under The Federal Acquisition Streamlining Act of 1994". James W. Taylor, Partner, Wilder & Taylor, chaired the selection committee comprised of himself, an individual from academia and another from government practice.

After lunch, Richard O. Duvall, Partner, Holland & Knight, served as moderator for a panel on advanced litigation tactics and strategies. The Honorable Jack Delman, Judge at the ASBCA, Colonel Chip Retson, U.S. Army Chief Trial Attorney, and Edward G. Gipple, Forensic Technologies International Corporation's Animation Services Manager, concluded the program with an exchanged of convincing ideas regarding the use and challenge of expert witnesses, the presentation of direct testimony and cross-examination, the use of demonstrative evidence and depositions at trial, and several other advocacy improving suggestions for board practioners.

Unequivocally, these experienced individuals made for an informative and exciting day and the BCABA and its members are very grateful for their participation. A special thanks is owed to the conference organizers, David P. Metzger, Partner, Holland & Knight, and Col. Riggs L. Wilks, Jr. Without their foresight and help, all these interesting lectures and discussions could not have taken place. Special thanks is also due to Martha Duvall, Holland & Knight, for helping to organize the many necessary operational details for the conference.

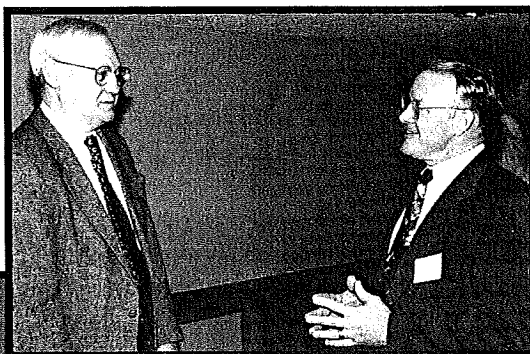
### **OTHER NEWS**

Carl J. Peckinpaugh, Winston & Strawn, has recently agreed to stimulate more participation and interest in our association by chairing the Membership committee. Please give him your support by encouraging your colleagues, associates and other attorneys and para-legals to join us. At \$25.00, membership in the BCABA is a bargain investment in your professional development that you cannot afford to skip! Carl's new responsibility as the Chairman of the Membership committee meant he had to step down as the Chairman of the Practice Committee. This void has been filled by Roger N. Boyd, Partner, Crowell & Moring. Even though David P. Metzger is now the Treasurer, he will retain his chairmanship of the Annual Meeting Committee until a replacement can be found.

Two future events that you will not want to miss involve a trial preparation and advocacy seminar for federal procurement, Feburary 25 - March 1, 1996, and the Federal Circuit Judicial Conference on May 23, 1996. Please contact Robert S. Brama, Esq., at (202) 429-9600 for further information about the trial program and Marcia Madsen (202) 467-7067 for information regarding the Judicial Conference.

Recently, I updated our membership data base for our 1996 directory and was amazed by the number of members who have switched firms/employers or changed addresses. For those who would like other members to know what they are up to and do not want to wait for the annual directory, please drop me a note at 10060 Atchison Rd., Dayton OH 45458, and I will try to publish it in "The Clause".

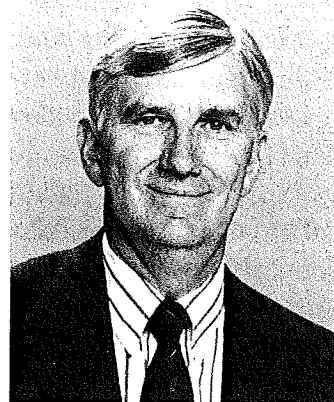
Also, please keep submitting your articles and ideas. I especially encourage associate members to contribute to the "Associate Member Briefs" column.



## OPINIONS: FORUM SELECTIONS IN COMMERCIAL CONTRACTING

**JAMES F. NAGLE**

*Oles, Morrison & Rinker*



Jim Nagle

“Commercial contracting” is the present buzz phrase in government contracts. The assumption is that federal contracting is the pits and commercial contracting has evolved into a much better, quicker, and less expensive method of operation. No one would deny that the present federal contracting system has many problems, but in this headlong rush we should not lose sight of the excellence of the boards of contract appeals process.

We can all quibble about individual decisions and the length of time it takes to get a decision, but at least the federal system provides certainty and a level playing field which is not always present in the commercial arena.

Besides deciding which state’s laws will apply (It is important that every member of the team be bound to a uniform system of laws.), a prudent party in a commercial contract, especially a large one, will often decide the venue. One of the key provisions in any commercial contract is the forum selection clause. Such clauses set forth the parties’ election of the appropriate forum for resolution of disputes which arise on the project. The party who fails to secure a binding forum selection clause which applies to all claims by all parties may land in the uncomfortable position of having to litigate essentially the same claim in several different forums at the same time. Accordingly, one essential requirement of any contract is that all disputes be resolved in a single forum.

Therefore, by deciding not only the rules of the game but even the playing field, a party is at a distinct advantage. Consider the following example.

In Arrow Plumbing & Heating, Inc. v. North American Mechanical Services Corp., 810 F.Supp. 369 (D.R.I. 1993), the parties entered into a contract in which Arrow would be a subcontractor to North American. The subcontract contained the following provision: “The subcontract agreement and any claims arising under it shall be governed by the laws of the state of Texas and exclusive venue shall be proper in Bexar County, Texas.

The plaintiff began its Miller Act suit in the United States District Court for the District of Rhode Island because that was where the work was to be performed. The defendants moved to transfer the case to the Western District of Texas pursuant to the forum selection clause in the subcontract.

The court held that it was proper to transfer the action to the Western District of Texas. The court relied on the Fifth Circuit decision in In Re Fireman’s Fund Insurance Co., 588 F.2d 93 (5th Cir. 1979) that a valid forum selection clause can over-ride the Miller Act venue provision.

**One of the key provisions in any commercial contract is the forum selection clause.**

The case is interesting because the plaintiff argued that virtually all the witnesses in evidence were in Rhode Island and that it would be prohibitively expensive to transport witnesses to Texas for trial. The plaintiff also stated that

it was also involved in substantial court proceedings in the District of Rhode Island in connection with its bankruptcy filing. At oral argument, the plaintiff’s lawyer asserted that plaintiff would not be able to continue this action if it were transferred. The court said that the plaintiff faces a heavy burden in showing the trial in the selected forum is “seriously

inconvenient.” It must demonstrate that “trial in the contractual forum would be so gravely difficult and inconvenient that [it] ... will for all practical purposes be deprived of [its] day in court.” The Bremen v. Zapata Offshore Co., 407 U.S. 1 at 18 (1972). The court ruled that the plaintiff had failed to carry that burden.

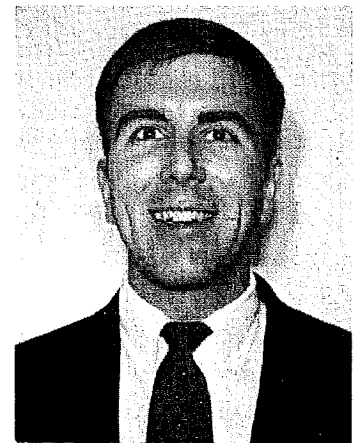
The Boards’ willingness to have telephonic prehearing conferences and to go where most of the witnesses are has enabled many small contractors to pursue claims that would not be feasible if they had to travel to the District of Columbia. Also the Board’s willingness to have contractors appear pro se regardless of

their business organization or the size of their claim has also aided tremendously, especially the willingness of the Boards to insure that pro se appellants are not blown away by “legal pyrotechnics” in the form of discovery and motions. The relative informality of the proceedings and the small claims procedures, especially now that they have been increased from \$10,000 to \$50,000 for the expedited procedure and from \$50,000 to \$100,000 for the accelerated procedure, are all models. Certainly, let us not forget the Rule 4 file which allows a wealth of information to come in without taking the time to laboriously lay a foundation for each document. Finally, the expertise of the Board by virtue of the statutory requirement that Board judges have at last five years experience in public contracts and their collegial decisionmaking have produced a wealth of scholarly opinions that are often relied upon by state courts.

*This is one area in which the commercial contracting could learn something from federal contracts.*

## TERMINATION FOR CONVENIENCE AND REFLECTONE: WHEN DOES INTEREST RUN?

*Peter F. Pontzer*<sup>1</sup>



Peter F. Pontzer

### I. INTRODUCTION

On July 26, 1995, the Federal Circuit reversed its holding in *Dawco Constr., Inc. v. United States*, 930 F.2d 872, 877-78 (Fed. Cir. 1991), by deciding *Reflectone v. Dalton*, 1995 60 F.3d 1572, 1578, that a dispute was not needed for a claim. The Federal Circuit also reviewed the requirements necessary to initiate a claim. A claim must be a “written demand seeking a sum certain (or other contract relief) as a matter of right, but not necessarily in dispute.”<sup>2</sup>

Removing the dispute requirement for claims may affect other areas of government contracts. This article will focus on one such area. In awarding a contract the Government maintains the right to terminate the contract for convenience.<sup>3</sup> After the Government ter-

minates a contract for convenience, the contractor submits a settlement proposal on a standard form. Before *Reflectone*, the clock would not start to run on interest with the submission of a settlement proposal because a dispute did not exist.<sup>4</sup> After *Reflectone*, an issue remains as of whether the settlement proposal starts to run the interest clock for a Contract Disputes Act (CDA)<sup>5</sup> claim.

<sup>1</sup>Peter F. Pontzer is a Commissioner with the Armed Services Board of Contract Appeals and a Captain in the U.S. Army. The opinions expressed within this article are those of the author and should not be construed as those of the Armed Services Board of Contract Appeals or the Department of Defense.

## II. JURISDICTION REQUIREMENTS

The Boards need a properly appealed claim in order to have subject matter jurisdiction. 41 U.S.C. §§ 605-607. FAR 33.201 defines a claim as:

a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to the contract. . . . [A] written demand or written assertion by the contractor seeking the payment of money exceeding \$100,000 is not a claim under the Contract Disputes Act of 1978 until certified as required by the Act and 33.207. A voucher, invoice, or other routine request for payment that is not in dispute when submitted is not a claim. The submission may be converted to a claim, by written notice to the contracting officer as provided in 33.206(a), if it is disputed either as to liability or amount or is not acted upon in a reasonable time.

The Federal Circuit has interpreted this definition to mean that a valid CDA claim has three requirements: “(1) the contractor must submit the demand in writing to the contracting officer, (2) the contractor must submit the demand as a matter of right, and (3) the demand must include a sum certain.”<sup>6</sup>

Prior to *Reflectone*, a party had to make at least two submissions to the Government to create a dispute.<sup>7</sup> After *Reflectone*, a party need only make one submission. The distinction is key because it starts the interest clock sooner. Pursuant to the CDA, “[i]nterest on amounts found due contractors on claims shall be paid to the contractor from the date the contracting officer receives the claim . . . .”<sup>8</sup> Contractors would like interest to begin as soon as possible. The Federal Circuit was clear that *Reflectone*’s non-routine request for equitable adjustment was a claim. *Reflectone*, 60 F.3d at 1576. One issue not before the Federal Circuit was how to deal with a settlement proposal when the Government terminates a contract for convenience (T4C).

## III. TERMINATION FOR CONVENIENCE

The Government may terminate a contract when it is in the Government’s best interest.<sup>9</sup> Once a termination for convenience decision is issued, the parties will need to close out the contract.

For both firm fixed-price and cost reimbursement contracts, “the contractor shall submit a final termination settlement proposal to the Contracting Officer in the form and with the certification prescribed by the Contracting Officer.”<sup>10</sup> With a firm fixed-price contract, “the contractor should promptly submit to the TCO a settlement proposal for the amount *claimed* because of the termination.”<sup>11</sup> The standard forms used for termination settlement proposals contain certification language.<sup>12</sup>

For example, on a Standard Form 1434 the contractor certifies that “[t]he undersigned personally and as a representative of the

Contractor, certifies this inventory Schedule . . . has been examined, and that in the exercise of the signer’s best judgment and to the best of the signer’s knowledge, based upon information believed by the signer to be reliable.” In addition, when submitting the SF 1439 the contractor certifies that “to the best knowledge and belief of the undersigned, the above statements are true and correct.”

In submitting a claim over \$100,000 a contractor must still certify that “the claim is made in good faith, that the supporting data are accurate and complete to the best of his knowledge and belief, and that the amount requested accurately reflects the contract adjustment for which the contractor believes the government is liable; and that [the signator to the certification is] duly authorized to certify the claim on behalf of the contractor.”<sup>13</sup> In the past, failure to properly certify a claim would result in an appeal’s dismissal.<sup>14</sup> The certification issue was resolved with the amendment of the Contracts Disputes Act so that the

[t]he contracting officer shall have no obligation to render a final decision on any claim of more than \$100,000 that is not certified in accordance with paragraph (1) if, within 60 days after receipt of the claim, the contracting officer notifies the contractor in writing of the reasons why any attempted certification was found to be defective. A defect in the certification of a claim shall not deprive a court or an agency board of contract appeals of jurisdiction over that claim. Prior to the entry of a final judgment by a court or a decision by an agency board of contract appeals, the court or agency board shall require a defective certification to be corrected.<sup>15</sup>

A defective certification can be corrected, but the complete absence of a certification would still bar jurisdiction.<sup>16</sup> The case law has not completely established what is the minimum certification needed to fall within the field of correctable defects, but it appears that almost any attempt at certification can be corrected to meet the Contract Disputes Act requirements.<sup>17</sup>

#### IV. IS A T4C SETTLEMENT PROPOSAL A CLAIM?

A termination settlement proposal looks very similar to a claim. One has to ask whether it meets all of the requirements. A settlement proposal is in writing, directed to the contracting officer, and contains a request for a sum certain of money. The money is sought as a matter of contractual right after the Government terminates the contract.

The settlement proposal forms contain certification language which does not meet the language of the Contract Disputes Act, but it may be correctable. Invariably, Government attorneys will be called upon to argue that the correctable certification language of the Contract Disputes Act only applies when a contractor intended to include language required by the Contract Disputes Act and that a settlement proposal's language does not serve the same intent. A contractor's retort would be that he would include whatever certification is necessary to start interest running and that the intent of modifying the CDA was to get past procedural arguments.

The biggest stumbling block in considering whether a termination settlement proposal is a claim is that a claim must be "non-routine". *Reflectone*, 60 F.3d at 1576-77. In *Reflectone*, the Federal Circuit explained that a request for equitable adjustment is not routine when "unforeseen or unintended circumstances, such as government modification of the contract, differing site conditions, defective or late-delivered government property or issuance of a stop work order, cause an increase in contract performance costs."<sup>18</sup>

An argument can be made that the termination procedure is a routine action of the Government to end a contractual relationship pursuant to the terms of the contract. However, modifications made pursuant to the changes clause or a stop work order, as listed above, are actions by the Government pursuant to the terms of the contract which the Federal Circuit could consider to be non-routine. Another contractor argument is that most contracts end with performance and the Government paying the contractor. The termination of a contract for convenience is an unusual event; therefore, the submission of a T4C settlement proposal is a non-routine event. Practitioners will need to wait for definitive answers, but must still advise clients in the interim.

#### V. PROTECTING YOUR CLIENT'S INTERESTS

While the law is in a state of flux, attorneys should take steps to protect a client's interests. The steps will vary for public and private attorneys.

Government counsel will need to be concerned whether a claim exists. The contracting officer still has the authority to determine the format for a settlement proposal. In determining the for-

mat, the contracting officer can state that the certification will not be considered a CDA certification. This would put the contractor on notice that the certification will not start the interest clock; however, this position may not work because the Government may not have complete control of when a claim is filed.<sup>19</sup> Further, if the contractor does submit a settlement proposal with a defective certification, the contracting officer can request a proper certification within sixty days before having to evaluate the the proposal as a claim.<sup>20</sup>

If a T4C settlement proposal is a non-routine request, contractors need to consider that the contracting officer does have the authority to dictate the format of the settlement proposal. Failure to follow this format might be considered a breach of contract and could result in a Government claim for contractor delay or the Government issuing a unilateral decision. To protect a client's interests, a contractor may want to file the settlement proposal as required and consider filing a parallel CDA claim at the same time.

If a T4C settlement proposal is eventually determined to be a routine request for payment the simultaneously filed claim would be moot because a dispute would not have existed when it was filed. A contractor would then need to file a subsequent claim and be able to show the existence of a dispute.

Filing a CDA claim simultaneously with the settlement proposal may start the interest clock and would be based on the same "sum certain" contained in the settlement proposal. Until this matter is settled, contractors will want to consider filing parallel or protective CDA claims.



## Endnotes

<sup>1</sup> *Id.*

<sup>2</sup> FAR 49.101.

<sup>3</sup> *Phoenix Systems & Technologies, Inc.*, ASBCA No. 44223, 94-2 BCA ¶ 26,835 at 133,473.

<sup>4</sup> 41 U.S.C. §§ 601-613.

<sup>5</sup> *H.L. Smith v. Dalton*, 49 F.3d 1563, 1565 (Fed. Cir. 1995), *reh'g en banc denied*, *H.L. Smith, Inc. v. Dalton*, 1995 U.S. App. Lexis \*13898 (Fed. Cir. June 1, 1995).

<sup>6</sup> *Dawco* 930 F.2d at 878.

<sup>7</sup> 41 U.S.C. § 611.

<sup>8</sup> FAR 49.101.

<sup>9</sup> Standard Contract Clauses. FAR 52.249-2 TERMINATION FOR CONVENIENCE OF THE GOVERNMENT (FIXED-PRICE) (APR 1984) (d) and FAR 52.249-6 (COST-REIMBURSEMENT) (MAY 1986) (e).

<sup>10</sup> FAR 49.206-1(a), emphasis added.

<sup>11</sup> See FAR 49.602-1 and FAR 49.602-2 for a listing of forms used for settlement proposals. FAR 49.206-1 also requires that either an SF 1438 or SF 1439 be used for firm fixed-price contracts.

<sup>12</sup> 41 U.S.C. § 605(c)(1).

<sup>13</sup> *E.g., Spartan Bldg. Corp.*, ASBCA Nos., 43849 and 44431, 93-1 BCA ¶ 25,506, *recons. granted in part, Spartan Bldg. Corp.*, 94-1 BCA ¶ 26,336.

<sup>14</sup> 41 U.S.C. § 605(c)(6). The Federal Courts Administration Act of 1992, P.L. No. 102-572, § 907(a), 106 Stat. 4506, 4518 (29 October 1992), amended the certification requirements of the CDA, 41 U.S.C. 605(c), so that "a defect in certification of a claim shall not deprive a court or an agency board of contract appeals of jurisdiction over that claim." See also, *SAE/American-Mid-Atlantic, Inc. v. General Services Administration*, GSBCA No. 12294, 94-2 BCA ¶ 26,890.

<sup>15</sup> *Eurostyle, Inc.*, ASBCA No. 45934, 94-1 BCA ¶ 26,458 at 131,654.

<sup>16</sup> H.R. Rep. No. 1006, 102nd Cong., 2d Sess. 1, at 28 (1992), *reprinted in* 1992 U.S.C.C.A.N. 3921, 3938.

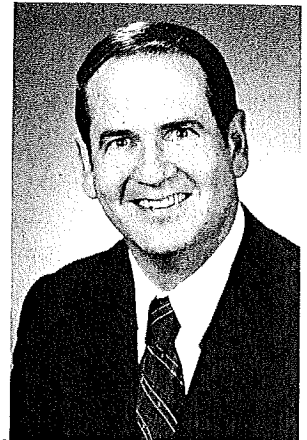
<sup>17</sup> *Reflectone*, 60 F.3d at 1577.

<sup>18</sup> *Id.* at 1582.

<sup>19</sup> 41 U.S.C. § 605(c)(6).

## "THE EMPIRE STRIKES BACK": NEW OBLIGATIONS UNDER THE RETIREMENT PROTECTION ACT

Peter A. McDonald  
C.P.A., Esq.  
Coopers & Lybrand



Peter A. McDonald

The Retirement Protection Act — why should this be important to government contractors? This legislation and the subsequent release of proposed rules mean that compliance with the new pension plan requirements may increase pension costs for government contractors with underfunded plans. Unfortunately for government contractors, these increased costs will not be recoverable where they are incurred under an existing fixed-price contract, or where an indirect cost ceiling under a cost reimbursement contract would be exceeded.

### Background

The underfunding of private pension plans has become a serious and growing problem for the U.S. government<sup>1</sup>. To address this, Congress enacted the Retirement Protection Act<sup>2</sup> as part of last year's General Agreement on Tariffs and Trade (GATT) legislation. This Act authorized the federal agency that oversees and insures private pension plans, the Pension Benefit Guaranty Corporation (PBGC), the devise implement-

ing regulations. For participants of defined benefit plans that terminate with inadequate assets, the PBGC guarantees benefits up to a certain amount. That level of coverage, however, is usually less than the participant's full pension benefit.

On July 6, 1995, the PBGC issued proposed regulations<sup>3</sup>. The statute accelerates required funding of underfunded plans, raises the PBGC insurance premiums for underfunded plans proportionate to their level of underfunding, and significantly strengthens PBGC's enforcement powers. This article discusses some of the more prominent requirements.

Readers' interest in this topic will vary greatly from "just tell me what I need to know" to "I want to know more," so this article is stratified into the following levels"

**Novice** — Those government contractors who only want to know how the provisions of the new statute will affect their business need only read the conclusion.

**Journeyman** — Those who want to know more about the major provisions of the new pension plan rules, without being weighed down by all the minutiae, should read the whole article.

**Expert** — STOP! Those who want to know every little detail about the new pension plan requirements (all the exceptions, elective transition rules, and so on) should read this article for background only. Then obtain, for your reading enjoyment, a copy of the Retirement Protection Act and the PBGC's proposed regulations.

### The Problem

The Retirement Protection Act's legislative history amply lays out the growing public policy problem Congress sought to address.

Prior to this legislation, employers could establish a pension plan under the Employee Retirement Income Security Act (ERISA), which specified minimum funding level requirements. Because of the loss of federal tax revenues attributable to qualified plans, the Internal Revenue Code (IRC) limited favorable tax treatment (deductibility of contributions) to a definable maximum funding level. Employers were accorded great leeway in determining their annual plan contributions and could use different funding methods and actuarial assumptions. Unfortunately, underfunding of defined benefit plans became a problem. This problem impacted not only plan participants, who lost their pension benefits when underfunded plans terminated, but also the PBGC, which paid affected participants up to their guaranteed amounts.

As of September 30, 1993, the PBGC has a deficit of \$2.9 billion in its single-employer insurance program. Moreover, the PBGC estimated in its 1993 annual report that the unfunded liability of single-employer defined benefit plans in 1992 amounted to \$53 billion<sup>4</sup>. However, the actual liability was probably much higher, based on a 1992 General Accounting Office (GAO) study, which found that unfunded liabilities at termination were almost 60 percent *greater* than the plan's most recent IRS filing (Form 5500).<sup>5</sup> Moreover, the problem

was getting worse because underfunding among single-employer plans appeared to be increasing. In addition, minimal reporting requirements enabled plan sponsors to provide only summary information to plan participants. For this reason, plan participants were usually unaware of their plan's underfunding, and were equally unaware that their plan's benefits were not fully insured by the PBGC. The PBGC deficit itself was partially caused by the fact that the insurance premiums paid to the PBGC by plan sponsors (employers) were not adequate to cover pension plan terminations for which the PBGC bore some liability. If these trends continued, Congress would have been faced with a bailout of the PBGC (similar to the savings and loan fiasco) to pay the insured pension benefits of pensioners adversely affected by terminations of underfunded plans.

### The Solution

In a climate of budget cutting, a taxpayer bailout of a failed program was not politically acceptable. Instead, Congress struck back by imposing more palatable measures to reduce PBGC's losses: increase the funding of single-employer defined benefit plans; increase PBGC insurance premiums for underfunded plans; require more informative annual notices to plan participants in underfunded plans; and accord the PBGC greater enforcement powers.

Becoming knowledgeable and conversant with the nuances of pension plans does not require an undergraduate degree in actuarial sciences — you are just at a severe disadvantage without one. For that reason, it is enough merely to note the new developments. It cannot be overemphasized, however, that the subject matter is *extremely* complex, and expert advice and guidance is absolutely vital to resolving issues that may arise.

### Overview

The new statute established enhanced disclosure, reporting, and funding requirements that will be costly and time-consuming for many contractors to meet. In addition, PBGC premium costs will also increase for many plan sponsors. What follows is a brief discussion of some of the more salient features.

### New Funding Rules

Unfortunately, the normal funding rules were not able to ensure that pension plans would be adequately funded. For this reason, a special funding rule was enacted through legislative amendments in 1987 (collectively

called the Pension Protection Act). This rule added a special additional minimum funding requirement that increased the *rate* plans were funded at and applied to all single-employer underfunded defined benefit plans except small plans. (Small plans were defined in the Act as those having not more than 100 participants on any day in the preceding plan year.)

Among other things, the Retirement Protection Act amended the shortcomings in the 1987 amendments that enabled some plan sponsors to keep their plans underfunded. As a result of the Retirement Protection Act, this will no longer continue, as most (but not all) employers with underfunded plans will be required to increase their contributions. Plans that are at least 90 percent funded (applying certain assumptions) are exempt from these new requirements.

The Retirement Protection Act also altered the manner in which the required contribution is computed. One change concerned how a plan calculated its current liability in order to determine its additional minimum funding requirement. Plans covered by the new rules must now utilize certain mortality assumptions and range of interest rates, both of which are less liberal than was previously permitted. A second change increased the rate at which contributions must be paid, while another significant change affected how a plan's full funding limitation was determined.

### Liquidity

For single-employer defined benefit plans with more than 100 participants some underfunded plans with nonliquid assets will be affected by a new liquidity rule. Essentially, certain underfunded plans not meeting the liquidity requirement will need to make a liquidity determination every 3 months. This will compare the amount of liquid assets (cash, marketable securities, and so on) with a figure equal to triple the amount disbursed by the plan during the previous 12 months. If the plan does not meet the liquidity test, an employer may either convert some nonliquid assets to liquid assets or make an additional contribution of liquid assets. Affected plans failing to meet the liquidity requirement face additional excise taxes that increase up to 100 percent) for each quarter of noncompliance.

### Insurance Premium

ERISA required all covered plans to annually contrib-

ute a fixed amount per plan participant (known as the flat rate). Under an ERISA amendment, the current flat rate was increased to \$19 per plan participant.

The 1987 amendments required all underfunded plans to also pay an annual premium of \$9 for every \$1,000 of underfunding up to a limit of \$53. This sliding scale caused this additional premium to vary depending on the level of underfunding, which is why it is called the variable rate premium.

The Retirement Protection Act removed the \$53 cap on the variable rate premium by phasing it out over three years, starting with plan years beginning on or after July 1, 1994. The transition rules are as follows:

Plan Year	Premium Amount
July 1, 1994 - July 1, 1995	\$53/participant + 20% of premium amount > \$53
July 1, 1995 - July 1, 1996	\$53/participant + 60% of premium amount > \$53
July 1, 1996	no maximum limit <sup>7</sup>

To demonstrate how these transition rules work, assume a covered defined benefit plan with 125 plan participants has unfunded vested benefits of \$5 million. The *flat* rate would be \$19 per participant, so the flat rate premium amounts to  $125 \times \$19 = \$2,375$  (simple enough).

Consistent with the above table, the determination of the *variable* rate premium for the first phase-in year would be \$53 per participant ( $125 \times \$53 = \$6,625$ ), *plus* 20% of the variable rate premium in excess of \$53 (recall that is \$9 in premium for every \$1,000 of underfunding). To find the variable rate premium for the unfunded liability of \$5 million, divide \$5 million by 1,000 and multiply by \$9, or  $\$5 \text{ million} \div 1,000 = 5,000 \times \$9 = \$45,000$ . Accordingly, the variable rate for the plan is  $\$45,000 \div 125 \text{ participants} = \$360$ , so the transition amount would be  $20\% \text{ of } (\$360 - \$53) = 20\% \times \$307 = \$61.40$ .

Restating all of the above, the PBGC insurance premium for this plan sponsor in the first transition year would be:

fixed rate	\$19.00/participant
variable rate	\$53.00/participant
+ (20% x \$307)	\$61.40/participant
<b>Total</b>	<b>\$133.40/participant</b>

The total premium due would be  $125 \times \$133.40 = \$16,675$ . By way of contrast, this plan's premium with-

out the Retirement Protection Act would only have been  $(\$19 + \$53) \times 125 = \$72 \times 125 = \$9,000$ .

Under the same facts, the second transition year's premium would be calculated as follows:

flat rate	\$19.00/participant
variable rate	\$53.00/participant
+ (60% x \$307)	\$184.20/participant
<b>Total</b>	<b>\$256.20/participant</b>

The total premium due would be  $125 \times \$256.20 = \$32,025$ . Again, without the Retirement Protection Act the premium due would only have been \$9,000.

For the third and final year (in which the cap is totally removed), the premium would be calculated as follows:

flat rate	\$19.00/participant
variable rate	\$53.00/participant
+ (100% x \$307)	\$307.00/participant
<b>Total</b>	<b>\$379.00/participant</b>

The total premium due would be  $125 \times \$379 = \$47,375$ , as opposed to \$9,000 without the Retirement Protection Act, assuming no change in the level of unfunded vested benefits (\$5 million) or number of participants (125). Plans that do not increase their funding may see their PBGC variable premium rise in two years to an amount more than five times what it is today. Obviously, plans with significantly larger unfunded amounts (whose variable rate premiums had been capped before the Retirement Protection Act), and that do not increase their plan funding, can expect to pay commensurately larger premiums.

### New Reporting Requirements

For some underfunded plans, the Retirement Protection Act imposes three new reporting requirements. As described briefly in the next section, affected underfunded plans will have to issue notices to plan participants setting forth certain information. Second, plans with large underfunding may have to render a lengthy report to the PBGC (discussed in the section after next). Finally, major companies with underfunded plans will be required to inform the PBGC 30 days in advance of certain company events (see the last section).

### Notices to Plan Participants

Congress found that the annual notices to plan participants were inadequate, particularly with respect to the funding level and PBGC coverage.<sup>8</sup> For most

underfunded plans, plan administrators will now have to annually notify plan participants of the following:<sup>9</sup>

- plan's funded status;
- the maximum benefits payable by the PBGC guarantee in the event of plan termination; and
- certain additional information.

All underfunded plans, including small plans (those with 100 or fewer participants), will use the same notice, although this requirement is not applicable to small plans in FY 1995.

### Disclosure to the PBGC

Some of the underfunded plans will now be required to submit an annual report to the PBGC listing specific actuarial and financial data. The particular requirements of these reports are set forth in the proposed regulations announced July 6th. Assuming the proposed rules become final (which is expected to occur before the end of this calendar year), the new rules will apply to employers that meet any *one* of the following criteria:

- The total unfunded vested benefits of all plans maintained by the members of a controlled group exceed \$50 million;
- The plan is subject to a PBGC lien because its unpaid required minimum payments exceed \$1 million under Internal Revenue Code (IRC) Section 412; or
- An IRS minimum funding waiver in excess of \$1 million has been granted to any plan maintained by any member of a controlled group, but a portion of that waiver remains unpaid.

The disclosures required of employers under the proposed regulation fall into three categories:

- identifying information, which is administrative in nature;
- detailed actuarial information; and
- audited financial statements.

Of these, the actuarial data will almost certainly be the most costly to provide (in terms of both time and money), especially for the first year such a report is required.



## Advance Notice for Large Underfunded Plans

Some companies with large underfunded plans are required to give advance notice to the PBGC whenever certain company developments occur (discussed below). These events, which require the PBGC to be informed 30 days beforehand, apply to single-employer defined benefit plans with less than 90 percent funding and whose unfunded vested benefits exceed \$50 million.

Illustrative examples of company developments that trigger the advance notice requirement are a liquidation in bankruptcy, an extraordinary dividend, or a stock redemption greater than 10 percent.

## Government Contractor Implications

Government contractors caught in fixed-price contracts will be unable to pass their increased pension costs along to their federal agency customers. Keep in mind that these cost increases will not be a mere 5 percent or 20 percent, but will multiply the obligation several times over (in the illustrative example above, costs went from \$9,000 to \$47,375 in two years, and assumed no change in the level of unfunded vested benefits or number of participants). Contractors with cost reimbursement contracts may be similarly afflicted where their pension cost increases cause cost ceilings to be exceeded. Affected contractors expecting to negotiate forward pricing rate agreements will also need to know their pension costs to achieve full cost absorption. For all these reasons, it is imperative for contractors with underfunded pension plans to undergo the tedious and time consuming task of ascertaining their future obligations.

## Contractors: Review Your Pension Plan Costs and Reporting Requirements

There are virtually dozens of other facets to the Retirement Protection Act that this article does not address, largely because the numerous, technically complex provisions are not broadly applicable. Undoubtedly, implementation of the Retirement Protection Act will cause some cost allowability and allocability issues to arise under both FAR Part 31 and the Cost Accounting Standards. These matters, however, lie beyond the scope of this article.

Under the new rules, government contractors working under fixed-price regimes will experience an increase to their pension plan costs without receiving a commensurate

increase in their revenue. Cost reimbursement contractors may or may not be able to recover their increased costs, depending on their circumstances. In any event, affected contractors will face two unpalatable choices: either draw these additional costs from profits, or (if possible) amend their plans to reduce benefits. (Amending pension plans will not reduce the costs of benefits that have vested, but can reduce costs in future years).

In any case, it is very important for any contractor to soon ascertain what its pension plan costs and reporting requirements are going to be as a consequence of the Retirement Protection Act. Therefore, calling in the pension benefit experts would be highly worthwhile and comparatively inexpensive first step.

## Notes

1. H.R. No. 103-826(I), p. 202. ("The chronic underfunding of some defined benefit pension plans poses a serious risk to the PBGC.")
2. The Retirement Protection Act amended numerous provisions of both the Internal Revenue Code (IRC) and the Employees Retirement Income Security Act - (ERISA). For this reason, the Retirement Protection Act is not found in any one location in the U.S. Code. Where this article refers to a particular section of the Retirement Protection Act, the pertinent U.S. Code section will also be provided.
4. H.R. No. 103-826(I), p. 202.
5. "Hidden Liabilities Increase Claims Against Government Insurance Program," GAO/HRD-93-7, December 30, 1992.
6. "Pension Reform Legislation Enacted with GATT Trade Package Affects Funding Requirements," by Gretchen Young and Jeff Davis, *The Journal of Corporate Accounting and Finance*, p. 71, Summer, 1995. The author wishes to thank Gretchen Young for her generous assistance with this article.
7. Retirement Protection Act, Secs. 774(a)(1) and (2)(ERISA Sec. 4006(a)(3)(E)) and 774(b)(1) and (2)(ERISA Sec. 4006(a)(3)(E)(iii)(I)).
8. H.R. No. 103-826(I), p. 204. ("Despite these varied reporting requirements, participants are not given clear and understandable information about (1) the extent to which their plan is underfunded and (2) which of their benefits are insured by the PBGC, and the extent to which such benefits are insured, should their underfunded plan terminate.")
9. Retirement Protection Act, Sec. 775 (ERISA Sec. 4011).

# TREASURER'S REPORT



Cheryl Rome

*Cheryl Rome*  
*Department of the Interior*  
*Board of Contract Appeals*

BCA Bar Association  
 Statement of Financial Condition  
 For the Period Ending October 31, 1995

Beginning Balance		\$5,898.52
Fund Income:		
Dues	6,125.00	
Reception		
Joint Ethics Program		
Total Fund Income		+6,125.00
Subtotal	\$12,023.52	
Fund Disbursements:		
Newsletter (Summer)	1,155.52	
D.C. Bar	618.23	
Postage	368.68	
Mailing Lists	141.07	
	2,283.50	
Total Fund Disbursements		-2,283.50
Ending Cash Balance		\$9,740.02

## BCA BAR ASSOCIATION BOARD OF GOVERNORS

The nine members of the BCA Bar Board of Governors serve staggered three-year terms. Each year, the terms of three members expire and three new members are elected to replace them (see section 4.5, BCA Bar Association Constitution). Elections coincide with the annual meeting in November. Our congratulations to the following new members of the Board of Governors.



**Peter A. McDonald**  
 Coopers & Lybrand  
 1751 Pinnacle Dr., Suite 1000,  
 McLean, VA 22102  
 (W) 703-918-3705  
 (F) 703-918-3764

**Hon. Elizabeth A. Tunks**  
 ASBCA, Skyline Six, 7th Floor  
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 Falls Church, VA 22041  
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 (No Photo)

# WICKHAM CONTRACTING: A HOLOCAUST



Gregory L. Fordham

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Gregory L. Fordham

*Gregory L. Fordham, CPA, CIA*  
*President, K&F Consulting, Inc.*  
*Smyrna, GA*

## I. Introduction

On January 6, 1994 the Federal Circuit decided the case of *Wickham Contracting Co., Inc v. Dennis J. Fischer*, Acting Administrator, General Services Administration.<sup>1</sup> The decision involved the use of the Eichleay formula for computing delay damages. Although Courts and Boards of Contract Appeal have been making decisions involving the Eichleay formula for more than 30 years, this decision is significant because for the first time ever a Court decided that the, "Eichleay formula is the only proper method of calculating unabsorbed home office overhead."

While many observers have cheered or silently acquiesced in this decision, it is an abomination for plaintiffs and defendants alike. Even more amazing is how such a decision could even be reached, since for more than 30 years after Eichleay Courts and Boards had held for just the opposite--that there is not one particular method for computing delay damages.

Consequently, the decision raises serious questions for everyone. The answer to those questions is the focus of this article. As such, this article will turn first to the issue of delay damages and unabsorbed overhead. Next, there is a review of the Wickham decision followed by an identification of its many problems. Finally, the author provides explanations for how such a decision could occur before concluding with recommendations.

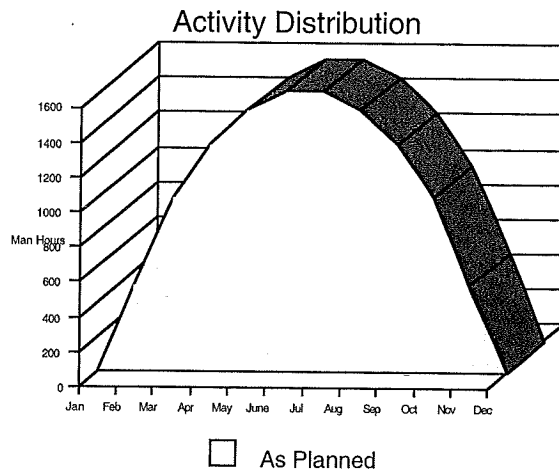
## II. Delays and Unabsorbed Overhead

Contract delays are as common as invoices. They occur with exceptional frequency and with virtually every contract change. Nevertheless, they also provide the basis for some of the most contentious issues to plague the legal landscape. To some extent this is understandable, since delay damages can often dwarf all other aspects of a contract breach or change quantification.

Surprisingly, the concept is rather simple--costs are time dependent. Consequently, when a delay occurs that increases a contract's performance time, a contractor's costs of performing that contract also increase. The following sections explore this simple principle and how something so straight forward could become mired in such controversy.

### A. Unabsorbed Overhead Explained

When a contract is performed it usually requires a contractor's commitment of resources such as facilities, equipment and personnel. As the project begins the commitment of these resources is minimal but it increases as performance continues. The commitment of resources may then level off or could recede as contract performance draws to a close. Such a situation is depicted in Figure 1.



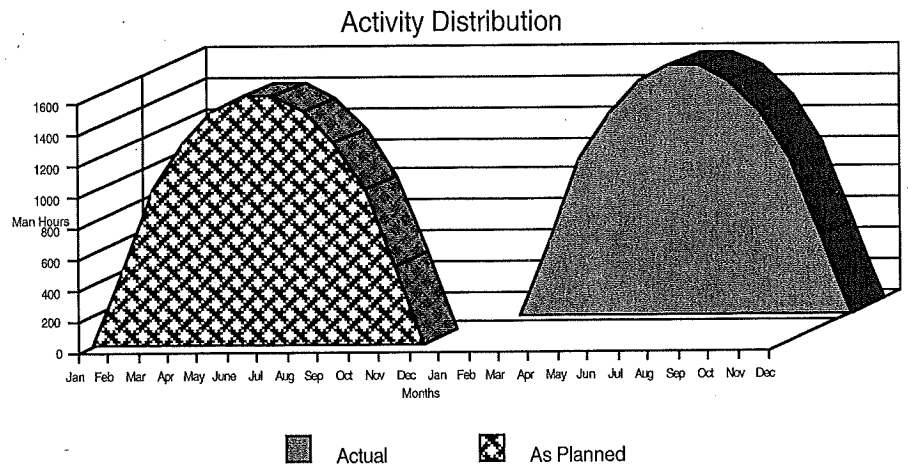
Figure

Naturally, the company must have adequate resources to perform at the maximum level of required effort. Once that peak has passed, however, the company can begin reducing its resource commitments by selling off excess equipment, subleasing factory space or laying-off unnecessary personnel. At the end of the contract the company may even totally liquidate its investment and seek other business opportunities through reinvestment of the contract profits and proceeds from the liquidation.

The consequence of delaying all or some part of the contract work is generally to reduce the amount of planned contract activity in the original performance period. The activity would then actually be performed in a later period of performance.

Figure 2 depicts a delay situation where the actual performance period is one year later than the planned performance period as a result of some customer caused action.

This delay not only causes performance of the work to occur in later time periods but the company must also retain the capability to perform the maximum level of effort necessary to complete the contract over a longer period of time. The result is that a contractor's costs are increased because there is a cost consequence of providing the capability to perform the work over a longer period of time.



**Figure 2**

The dependency between cost and time is pervasive and numerous examples can be observed. A personal computer purchased ten years ago is of little use today even if it has never been used. Since the company cannot recover its purchase price it is a loss or cost to the company. For another example, a worker hired yesterday is still owed his wages for his day's work even though that worker never performed the work that he was hired to perform. This, too, represents another expenditure, albeit wasteful, on resources to perform work. So clearly, even though work was not performed this does not mean that costs were not incurred in order to perform the work.

While a company may be able to mitigate its damages during a delay this option is also time dependent. An unskilled worker in a crowded labor market can be removed and replaced at will. A building, a piece of special equipment or a president's salary may not be so easy to eliminate and replace. Furthermore, if the duration of the delay is uncertain then the company may be limited in the actions that it can take in order to mitigate the increased costs that it will incur. For example, with an uncertain delay it might not be prudent for the company to try and sublease its unused factory space. In highly uncertain delays it may not even be prudent for a company to reduce the size of its workforce. This occurs because these resources are required for the performance of the contract and by not retaining these resources contract performance could be impaired. Consequently, there is a clear relationship between the contract and a contractor's costs that is dependent on time.

Although the relationship between a contractor's costs and its contracts is time dependent, the cost allocation structure for most companies is premised on the idea that costs are incurred as progress is made and not with the passage of time. An example of such a performance based allocation system is where overhead costs are allocated on the basis of direct labor dollars or where general and administrative expenses are allocated on the basis of total cost input. Clearly, neither of these methods recognize that costs such as rent or depreciation that are contained in either the overhead cost pool or the general and administrative costs pool are actually time dependent and not work dependent.

In such allocation structures, the consequence of a delay is to reduce the planned pattern of fixed indirect cost allocation (absorption) for the delayed contract. The result is that indirect costs are misallocated to other contracts. This misallocation of indirect cost has been termed "unabsorbed overhead".



**Example A**

	<b>Contract A</b>	<b>Contract B</b>
<b>Direct</b>	<b>\$75</b>	<b>\$25</b>
<b>Indirect</b>	<b>\$200</b>	

**Example B**

	<b>Contract A</b>	<b>Contract B</b>
<b>Direct</b>	<b>\$75</b>	<b>\$25</b>
<b>Indirect</b>	<b>\$150</b>	<b>\$50</b>

**Example C**

	<b>Contract A</b>	<b>Contract B</b>
<b>Direct</b>	<b>\$75</b>	<b>\$0</b>
<b>Indirect</b>	<b>\$200</b>	<b>\$0</b>

**Figure 3**

Figure 3 above is provided to help illustrate the concept of unabsorbed overhead. Example A of the above table illustrates that there is a total amount of indirect costs of \$200 which must be allocated between final cost objectives--contracts A and B. The ratio of indirect costs to the performance based allocation base is 200%<sup>2</sup>. Thus, Contract A would receive \$150 of allocated indirect costs and Contract B would receive \$50 of allocated indirect costs as shown in Example B. Example C demonstrates that by reducing Contract B's performance based allocation base, the ratio increases to 266% and all of the indirect costs are allocated to Contract A.<sup>3</sup>

Thus, in the above example, it is clear how a performance based allocation method, which is typically used by companies, fails to consider the relationship between cost and time. The resulting misallocation does not mean that the costs were not incurred or that the delayed contract did not benefit from the extended period over which the capability was provided. It simply shows that despite their frequency contract delays are not usually considered when companies develop their cost structures and allocation methods.

## **B. Damages Theory**

Delay damages generally arise because the contractor has a duty to standby and provide the benefit of its capability to the buyer for a longer period of time than originally bargained. In such situations, various Courts and Boards of Contract Appeals have recognized that a contractor's costs are time dependent. As a result, they have allowed contractors to recover the increased costs arising from a delay regardless of whether the resources represented by those costs were actually used to make progress on the job. After all, they were made available for the contract and now as a result of the delay they are being made available for a longer period of time thereby increasing a contractor's cost of that contract.<sup>4</sup>

Over the years the concept of delay damages has sustained numerous challenges. Most have focused on the idea that the contractor was not damaged by the delay. The creators of such arguments have focused on the same allocation process used in the example above. As described above, this is a process that generally does not even consider the consequence of time. Consequently, such detractors will be able to show how the company did not experience any increased costs.

Clearly, these techniques simply overlook the fundamental principle that costs are time dependent and that any allocation method that fails to consider the time dependent nature of the cost ignores the consequence of a contract delay and the damages incurred by the contractor. Needless to say, Courts and Boards have realized that allocation is not the same as recovery and have ignored such defenses.<sup>5</sup>

This is not to say that contractors claiming delay damages are not without certain burdens. Contractors have a duty to mitigate damages by reducing their costs where reasonably practicable and by finding substitute work.<sup>6</sup> Substitute work is not simply any new work but work that could only have been performed had the delay not occurred.<sup>7</sup>

The fact that the company would have incurred the cost anyway should not be a defense. Such an argument seems predicated solely on the idea that the seller's expectation interest is not effected by the delay.<sup>8</sup> In government contracts, however, delay damages are expressly provided for in the contract, since under the government's clauses for changes, suspensions and etc., it promises to pay the contractor's increased costs arising from those events. As a result, the seller also has a reliance interest that could be the basis for enforcement of the government's promise.<sup>9</sup> Even outside of government contracts there could be a restitution interest, since the buyer will have benefited from the seller's capacity being made available for a longer period of time.

Simply stated, therefore, delay damages are the old "use it or lose it" principle. After having struck the deal the buyer must make use of what it has bargained or pay extra for another ride on the carousel.

## **C. The Eichleay Formula**

The Eichleay formula is only one of several methods that through the years has been used for computing a contractor's damages from delays. This method is perhaps the most accepted and most often used technique.

### **1. Historical Perspective**

The Eichleay formula can be distinguished from many other formulas and approaches because of its use of a periodic rate. The formula essentially computes a periodic amount of recoverable overhead and then multiplies that rate by the number of periods of delay.

The process on which the Eichleay formula is based appeared as early as 1945 in the case *Fred R. Comb Co. v. United States*, 103 Ct. Cls. 174, 184 (1945). In that case the contractor computed a periodic rate based on months and then multiplied that rate by the number of months of delay. The periodic rate was computed as total overhead for a year period times the ratio of contract revenue divided by total revenue for the year. Similar procedures for computing delay damages were also used in *B-W Construction Company v. United States*, 104 Ct. Cl. 608 (1945) and *Houston Ready-Cut House Co. et al. v. United States*, 96 F.Supp. 629 (1951)

This approach has some merit, since by computing a periodic rate it recognizes the manner in which costs are time dependent. In addition, for construction companies performing bonded work the method of allocating costs between jobs based on billings also has merit, since in such situations a construction company's bonding capacity is often a function of its billings.

The Eichleay technique derives its name from a later BCA case bearing its name, *Eichleay Corporation*, ASBCA No. 5183, BCA 60-2, ¶2688 (1960). The Eichleay case involves a contractor's entitlements, including unabsorbed overhead, resulting from a government imposed delay under the Suspension of Work clause. The issue for that dispute was succinctly characterized by the board as follows.

*"The problem out of which this dispute arises is how to allocate home office expenses incurred during a period of suspension of work. These expenses continue during temporary or partial suspensions, and it was in this case not practical for the contractor to undertake the performance of other work which might absorb them."*

## **2. The Formula**

As described in Eichleay, the formula involves the computation of a daily overhead rate allocated to the contract on the basis of sales price and then multiplication of the daily rate by the number of days of delay.

*"Appellant has based its claim on an allocation of the total recorded main office expense to the contract in the ratio of contract billings to total billings for the period of performance. The resulting determination of a contract allocation is divided into a daily rate, which is multiplied by the number days of delay to arrive at the amount of the claim."*

The Eichleay formula was one method devised to compensate for the reduced allocation base for allocating indirect costs. Under Eichleay this weakness is overcome by using billings as a surrogate for allocating indirect cost between contracts. The Eichleay formula is reproduced below.

<b>Eichleay Formula</b>				
<u>Contract Billings</u>				
Total Company Billings	x	Fixed Overhead	=	Allocated Overhead
Allocated Overhead	÷	Contract Period of Performance	=	Daily Overhead Rate
Daily Overhead Rate	x	Days of Delay	=	Unabsorbed Overhead

## **D. Other Methods**

While Eichleay followed the concepts laid down by another construction company in *Fred R. Combs*, delay situations have not been limited to construction companies. Many years prior to the Eichleay case a manufacturing company also blazed a trail in the field of unabsorbed overhead. While the goal was the same, the method was different.

*Carteret Work Uniforms*, ASBCA No. 1647, 6 CCF P61561 (1954) was a manufacturer who showed that it was able to manage its resources with relative consistency. As a result, its method for computing damages was the difference between its normal overhead rate and the rate actually experienced during the delay. The rate differential was then applied to total base costs. This method became known as the Carteret method.

While the Carteret method provides a certain simplicity and appeal its fundamental principles do not consider the time dependent nature of a contractor's costs. For this reason, one could argue that this method is less desirable than Eichleay.

After *Carteret* there was yet another manufacturer wrestling with the problems of unabsorbed overhead. The method it used was similar to *Carteret* because it utilized a burden fluctuation method but the mechanics were entirely different.

This case, *Allegheny Sportswear Company*, ASBCA No. 4163, 58-1 BCA 1684 (1958), also resulted in a formula which bears its name. This case involved a contractor's entitlements, including unabsorbed overhead, resulting from the government's failure to supply government furnished materials in accordance with the contract schedule. As a result of this failure by the government, the contract was delayed and completed 161 days behind schedule. As permitted under the Government-Furnished Property clause the contractor submitted a proposal for an equitable adjustment in contract price.

Subsequently, the Army Audit Agency performed two audits of the contractor's proposal using different auditors. The first auditor recommended an amount that was "predicated on the difference in overhead rates between the actual period of performance and the originally expected period of performance." The second auditor divided the contract performance into two periods, the delay period and the stretch-out period. Then by showing that the contractor had suffered an increase in allocated fixed overhead during the "delay" period of \$5,960 while experiencing a decrease in allocated fixed overhead during the "stretch-out" period of \$10,516, the auditor "proved" that the contractor had benefited from the delay and recommended that the contractor's proposal be denied in its entirety.

The first method used by the Army Audit Agency was ultimately accepted by the Board. The second method, and still utilized today by various audit organizations, was characterized by the Board as "manifestly untenable" and rejected.

So the first method became what is known as the Allegheny formula. It involves computing the difference in overhead rates between the actual contract performance period, including the delay, and the anticipated contract performance period. The resulting rate difference is then multiplied by the amount of base contract costs in order to compute the unabsorbed overhead.

Despite its frequent usage, the Allegheny formula possesses one fundamental deficiency--it does not compute the increased costs incurred by a contractor as a result of a delay. Applying the rate difference to only the contract base costs has the same affect as fracturing the cost base and understating the amount of unabsorbed overhead. After all, the rate difference is computed using the total cost base; therefore, all of the components of the cost base are now sharing proportionately in the consequence of the delay. Why then should the rate difference be applied to only the cost base of the delayed contract. It is like computing a rate, like G&A, based on total cost input and then applying that rate to labor only to compute the G&A costs of a particular contract.

So, the Allegheny method is seriously flawed because it does not apply the rate differential to the total base costs as does Carteret. For this reasons, one could consider the Allegheny method to be inferior to Eichleay.

### **III. Analysis of Wickham**

Wickham was under contract with the General Services Administration (GSA) to renovate the Federal Post Office and Courthouse in Albany, New York. During the contract GSA ordered numerous delays in the work because of structural concerns about the building. Essentially, there was no dispute that these delays had occurred and that the GSA was responsible, although GSA and Wickham differed slightly in the duration of the delay.



The contracting officer for GSA had awarded Wickham \$333,084 for unabsorbed overhead; however, Wickham believed that the method used to compute its unabsorbed overhead, the Eichleay formula, resulted in too low a percentage of overhead being allocated to the Albany project. At the time, Wickham also had two other projects under contract; a West Point project and the Foley project.

The Eichleay formula resulted in approximately 34% of Wickham's overhead being allocated to the Albany project but Wickham believed that the correct percentage should be more like 80%. Wickham initially sought relief before the GSBICA and then before the United States Court of Appeals, Federal Circuit.

### A. The GSBICA

The GSBICA was the first to hear Wickham's tales of woe about how the sales ratio for allocating overhead costs were not representative of the costs actually incurred by Wickham for the Post Office project. The decision is not instructive about why Wickham believed that the Eichleay results were unfair. The decision is also not instructive about who decided to use the Eichleay formula. It simply states that,

*"In June of 1986, the Government's contracting officer awarded appellant the additional sum of \$333,084, plus interest, on its claim for extended home office overhead, based on the 969 day Government delay. This award was calculated using the Eichleay formula."*

So it is not clear whether Wickham provided some other method and the contracting officer settled on the Eichleay formula or whether Wickham initially provided an Eichleay computation or some modification thereof. It would appear, however, that Wickham must have utilized an Eichleay like approach deviating only in the computation of the ratio computation, since the decision is completely void of any discussion about the Wickham method.

In its decision, the Board provided a lengthy and perhaps skeptical discussion about unabsorbed overhead in general and the Eichleay formula in particular. Its discussions begin with an erroneous understanding of overhead wasted during a delay.

*"The theory is that a certain amount of overhead (principally the cost of home office personnel) is incurred by the contractor whether or not its projects are proceeding on schedule. With respect to a delayed project its 'share' of the home office overhead is 'wasted' because it could have supported another project which would have contributed to the gross revenues of the contractor while the stalled project does not."*

The term "waste" has been used to describe what happens to overhead during delays. The term waste is meant to recognize that when a contract is delayed it wastes the capability that is being provided by the contractor. In reality, the overhead or capability is wasted by the buyer not the seller, since the buyer has not made use of what it has bargained. The seller is simply performing its contract, albeit in the wasteful manner directed by the buyer.

From its erroneous perspective, the Board overlooks a contractor's reliance interest and trivializes the entire theory of delay damages on the idea that a contractor might be inefficient and therefore be wasting overhead anyway.

*"The idea is entirely theoretical. It assumes that the contractor, at the moment that one of its projects is delayed, is engaged in exactly the optimum number of projects for the equipment, talent, people and financing then on hand. This, of course, is almost never the case. At any given point in the adequacy of its home office staff to handle the business of the company: (1) it will have the correct number of projects for the staff available to handle the work, or (2) it will have a larger number of projects than the available staff can handle, or (3) it will have a smaller number of projects than the available staff can handle."*

The Board then uses its three pronged analysis to make the point that the Eichleay formula is overly simplistic and cannot make a precise computation of delay damages, since it has no means to distinguish between waste or delay damages and inefficiency.

*"It is true that if there are only two causes of overhead waste and both result from delayed projects, it is possible to compute the individual effects by modifying the mathematics of the Eichleay formula. But where the second source of overhead waste does not result from a project delay but is caused by the fact that the contractor does not have enough work for the overhead to 'support' there is no way to make a mathematical proration. This is so because an essential part of the Eichleay calculation compares the total billings under the delayed contract to the total billings under all contracts. If the home office overhead is underutilized because of a simple lack of business there will be no numbers to calculate with."*

Because it finds the Eichleay formula to be an imprecise method of computing delay damages, the Board concludes that precision is irrelevant when using Eichleay.

*"In the case before us appellant contends that the Eichleay calculation produces a proration figure that is unfair because it does not equal the actual percentage of appellant's overhead that was devoted to the delayed project. The answer to this position is simple. It make no difference what the actual overhead effort was. We are here dealing with theoretics which produce approximations because more precise results cannot be obtained. If appellant invokes Eichleay's benefits it must suffer Eichleay's limitations."*

This is really a disappointing decision for two reasons. First, the Board provides an appearance of reason in its decision by discussing concepts of waste and inefficiency. Ultimately, it finds the prospect for inefficiency so compelling that this becomes the excuse on which it will hang a great deal of its opinion. The problem here is that a contractor's efficiency is not relevant to the computation of damages for contract changes.<sup>10</sup> The government has promised to pay the contractor's increased costs. Those costs are determined based on the criteria for allowability stated in FAR 31.201-2 and efficiency is not part of those criteria. So, such an excuse for faulting Eichleay is simply inexcusable.

Second, while the Board is correct when it claims that theoretics are involved and approximations are being used because no more precise results can be obtained, there are still differing degrees of precision even with approximations. Furthermore, theoretics are present even in the most simplistic of quantum determination. In this case, the Board simply seems unable to evaluate the situation on its merits and arrive at a rational decision. So, it gives up and uses the concept that damages need not be proved with precision as a broom to brush aside matters that it would prefer not to consider.

## **B. The Court of Appeals**

After an unsuccessful motion for reconsideration, Wickham appealed the Board's decision to the United States Court of Appeals for the Federal Circuit. The Appeals court considered four arguments. First, the use of the Eichleay formula. Second, whether direct costs should be included in the cost pool for allocation under Eichleay. Third, whether Wickham was actually entitled to a longer delay period for computing delay damages under Eichleay. Finally, whether Wickham was entitled to interest on its equity capital. The latter two will not be addressed in this writing.

In the appeals decision, it is learned that the reason Wickham believed that the Eichleay results were unfair and that an 80% ratio computation was more accurate was that the project management for the Albany job was performed at the corporate office while the management for the other projects was performed on the jobsite. As a result, Wickham believed that a larger portion of the home office costs--essentially comprised of the president, a construction engineer, a project engineer and three secretaries--should be allocated to the Albany project. This fact is essentially what was addressed in the second point being considered by the Court involving direct costs. The Court believed that these costs were direct costs of the project and should not be included as part of the overhead cost pool to be allocated under the Eichleay formula.

*"Wickham's argument fails for a fundamental reason--Wickham confuses direct and overhead costs."*

This conclusion by the Court would have had a devastating effect on Wickham's delay damage recovery, since based on the Court's findings they should have been removed from the Eichleay overhead pool. The Court did not make such a reduction, however, since,

*"[It] would lack jurisdiction under the CDA to do so because there were no contracting officer and board decisions denying such costs as direct costs. Therefore, there is no fact finding or ruling for us to review; and, of course, as an appellate court we may not make fact findings or initial rulings, generally or in the circumstances of this case."*

As for the use of the Eichleay formula, the Court went astray from the outset. It was acting under the notion that,

*"The Board rejected Wickham's theory of recovery on the basis that unabsorbed overhead is always calculated according to the Eichleay formula when a contractor meets the Eichleay requirements after government-imposed delay."*

This belief by the Court is erroneous. All the Board ever said was that when one invokes the Eichleay formula one must suffer its limitations. The Board's opinion never forbade the use of any other method.

Wickham believed that the Eichleay method would not properly reflect its situation. Wickham, therefore, argued that the Eichleay formula should be used only when a better method for allocating delay costs was unavailable. In support for its argument Wickham cited *Miles Construction*, VABCA 1674, 84-1 BCA P16967, 1983 WL 13694 (Nov. 30, 1983), although it could have cited numerous decisions including Eichleay itself that hold for the position that there is no one particular method for computing delay damages.<sup>11</sup>

In *Miles*, the Eichleay formula would have resulted in a 100 percent recovery of the contractor's overhead on the delayed contract. However, some unexplained entries in the contractor's accounting records raised doubt about the accuracy of the result that would be reached using an Eichleay approach. Since the contractor did not provide any explanation for unexplained entries, the Board adopted a jury verdict approach and awarded the contractor 90 percent of its overhead to the delayed contract.<sup>12</sup> Apparently then, Wickham used this case to argue that Eichleay should not be slavishly followed to the exclusion of all reason.

The Court in *Wickham* apparently believed otherwise. It chose to differentiate *Wickham* from *Miles* based on the Jury Verdict approach used in *Miles*. Apparently to the Wickham Court Jury Verdict is not an approach. So, therefore, the Board's use of that method in *Miles* does not count as an alternative for computing delay damages.

The Wickham Court went on to justify the exclusive use of the Eichleay formula by citing cases where methods other than Eichleay had been rejected.

*"Moreover, board decisions since Miles, including those of the Veterans Board, have uniformly rejected the use of other formulas in place of the Eichleay formula. See Bridgewater Constr. Corp., VABCA No. 2956, 91-3 BCA P24272, 1991 WL 160881 (Aug. 12, 1991) (rejecting an alternative calculation that gave a significantly higher daily rate of overhead than the Eichleay formula); Berkeley Constr. Co., VABCA No. 1962, 88-1 BCA P20259, 1987 WL 45887 (Oct. 27, 1987) (rejecting a 'total cost' formula); G.S. & L. Mechanical & Constr. Inc., DOT CAB No. 1640, 86-3 BCA P19026, 1986 WL 19793 (May 22, 1986) (rejecting a modified Eichleay formula); Stephenson Assoc., Inc., GSBCA No. 6573, 86-3 BCA P19071, 1986 WL 19955 (Mar. 27, 1986) (rejecting a 'simulated work' formula)."*

In *Bridgewater Construction* the contractor submitted a claim that included delay damages that were computed on the basis of a daily rate times the number of days of delay. The decision does not explain, however, how the contractor derived its daily rate. The Board ultimately adopts the Eichleay formula, which perhaps is the manner by which the contractor computed its delay damages. The debate over appropriate methods involves the method adopted by the government's auditors, the Defense Contract Audit Agency (DCAA). The DCAA had devised a daily rate that did not consider the size of one contract to another and thus was insensitive to the fact that one contract might benefit more from a contractor's resources than another. This flaw proved fatal as the Board rejected the DCAA daily rate computation and instead adopted an Eichleay approach.<sup>13</sup>

Thus, in *Bridgewater Construction* the alternative method was rejected because it did not adequately portray the causal or beneficial relationships between contracts and a contractor's costs. This would be a requirement of any indirect allocation under FAR 31.203 or its predecessors. Eichleay, therefore, was not selected because of its status as the only method for computing delay damages but rather by default.

In *Berkeley Construction* the contractor used a "total cost" method that included unallowables, direct costs and provisions for costs that were neither incurred nor accrued by the contractor. Naturally this method had to be rejected for almost anything else. The Board selected Eichleay, since the government had used an Eichleay type analysis without objection from the contractor.

Thus, in *Berkeley Construction* two methods were part of the record. One was acceptable while the other was not. The Board selected the acceptable method, which happened to be Eichleay, because the other method was not acceptable. So, in this case Eichleay was not chosen because it was the only or even the preferred method for computing delay damages.

In *G.S. & L Mechanical* the DCAA adopted a percentage markup approach for computing a contractor's delay damages--an approach that has been repeatedly rejected for more than 30 years.<sup>14</sup> On the other hand, the contractor computed its delay damages using what it called a modification of the Eichleay formula. This modification consisted of computing G&A expenses using the same 15% rate used by the contractor in bidding the job and then dividing the original period of performance into the resulting product in order to compute a daily rate. That daily rate was then multiplied by the number of days of delay.

Needless to say the Board in *G.S. & L. Mechanical* was no kinder to DCAA in this decision than they were in all of the decisions preceding this one.<sup>15</sup> As for the contractor's modified Eichleay approach, the Board was concerned that this method did not consider a contractor's overhead, whether smaller or larger, after the initial period.<sup>16</sup> Consequently, it had reservations about whether such a method could adequately reflect a contractor's delay damages.

The decision is void of any expert testimony regarding the appropriateness of the method particularly in contrast with the original Eichleay. Since the record contained only unacceptable methods the Board was forced to craft its own or choose from those available. In this case, it chose Eichleay.

So the Board's decision should not be interpreted as a rejection of every method other than Eichleay, since it acknowledged the existence of several acceptable formulas for computing delay damages.<sup>17</sup> If anything, this decision should be interpreted to stand for everything that the Appeals Court in *Wickham* is against, since in *G.S. & L. Mechanical* the Board stated,

*"The ultimate test of any formula to compute the amount of home office overhead chargeable to a contract during a suspension period remains that of reasonableness, and it is a contractor's task to convince us that its proposed method of computation is reasonable. Under the circumstances of this case, the appellant has failed to do this. . . . Regardless of whatever formula is used for the computation, the goal, as stated above, is to provide compensation to a contractor which is reasonably equal to the proportion of actual total overhead costs incurred which is allocable to this contract. It is recognized that a perfect allocation is not attainable. However, if any formula departs from this goal when applied to a specific set of circumstances, then however acceptable it may have been in other cases, it is not appropriate for use when those specific circumstances are present"*

In *Stephenson Associates* the contractor had originally submitted an Eichleay computation but while waiting for trial, the decision in *Capital Electric I*<sup>18</sup> had caused the contractor to jettison its method and adopt the simulated work method advocated by Wright and Bedingfield. While still waiting for trial the *Capital Electric II*<sup>19</sup> decision revived the Eichleay formula but the contractor decided to stay with its simulated work method. Remarkably by the time of trial the government had also developed its own simulated work method.

In this case the Board rejected both methods on the record and adopted Eichleay. This choice was not because it found fault with the methods presented but simply because *Capital Electric II* had decided that Eichleay was an



acceptable method.<sup>20</sup> So perhaps still gun shy after the results of Capital Electric, the GSBCA was apparently reluctant to exercise its own judgment when formulating equitable results. Consequently, it simply adopted Eichleay.

If anything, the *Stephenson Associates* decision is the only decision of those cited by the Wickham court where a clear preference to Eichleay was exercised. In all of the rest of the decisions cited by the Wickham court the decision to use Eichleay was the result only after the Boards had considered but dismissed the improper quantification methods of the litigants. So, these other decisions simply follow the requirements of any quantum determination and by default apply the Eichleay method after those presented failed the test. Consequently, should the fact that the Board selected an acceptable method that happened to be Eichleay be twisted to stand for the principle that Eichleay is the only proper method?

In the final analysis, Wickham received an equitable result even if it was not the best result. The case is instructive in that the Eichleay formula is not a remedy for improper cost allocation or claims quantification. It demonstrates that a party cannot simply use Eichleay as an autopilot to recover costs that are best recovered as other parts of an equitable adjustment. Unfortunately in the process, the Court has done appellants and defendants alike a great disservice. Eichleay is not a magic carpet but after starting with such a false impression, the Court had to take everyone for a ride.

## **IV. The Problems with Wickham**

Although Wickham has its good points, its decision that Eichleay is the only method for computing delay damages is incredibly poor. Not only does the formula have a multitude of problems, the Court's decision is an impediment to equity. Also, it is contrary to more years of precedent than any might imagine.

### **A. Eichleay's Quantification Problems**

Despite its overwhelming widespread acceptance, the problems with the Eichleay formula are many and well documented.<sup>21</sup> The most obvious deficiency is the formula's reliance on sales dollars for the allocation of costs. Clearly sales price has only a chance relationship with actual damages. Thus, delayed contracts can receive considerably more or less than actual damages depending on the ratio of profit margins for the delayed contract to non-delayed contracts.

The problems encountered as a result of the Court's decision in Wickham are many but no where are they more obvious than in situations such as where a contractor substantially underbids the work, perhaps even to the extent of performing the original scope of work for free. Such situations are not unusual and in the manufacturing world highly common with development programs that will be followed by production contracts. In the case where the development work is done for free how would a contractor be compensated under the Eichleay formula when its development contract is delayed. There would be no billings. Is there no delay damage?

This is the same result that would have resulted had the contractor's normal percentage markup approach been used for computing delay damages. It is a result that Courts and Boards of Contract Appeal have found untenable. Can one conclude, therefore, that the Court's decision in Wickham is also untenable?

Consider also the situation of a protest after award. After the suspension is lifted and a contractor resumes work there would be no billings. Does this mean that the contractor would have no delay damages? Must it wait until the end of the contract before its damages accrue to maturity?

Even in the absence of the above extremes the court's decision in Wickham is foolhardy. While Eichleay could arguably be appropriate for construction companies as indicated in earlier sections, its relevance would further degrade as the contractor's cost structure becomes more complex. In construction situations the Eichleay formula is generally being used to allocate a single home office cost pool. In other types of business environments such as manufacturers the cost pool activities become more disparate and consequently can involve a mass of different

cost pools. The activities represented by some pools may not have even been effected by a contractor's delay but would the Eichleay formula not automatically require their inclusion or must each pool be subjected to the Eichleay prerequisites? And what will happen if there are no billings associated with the efforts from that pool with which to make an allocation?

In addition, if *Eichleay* and *Combs* had picked billings as the allocation surrogate for a contractor's capacity simply because that element was essentially intertwined with its bonding capacity, how does this square with manufacturers who might have totally different methods of measuring production capacity? For that matter, construction companies performing non-bonded work might also have better measures of capacity constraints for making allocations of fixed costs than billings.

Finally, Eichleay was developed in the 1950s before modern computers and the adoption of sophisticated collection, measurement and analysis techniques that are often used in modern organizations. For them mathematical models far more complex than the Eichleay formula could yield more precise results.

Clearly the concept that it is not necessary to prove a specific amount but only to determine a fair allocation for the purpose of compensating a contractor for delay by the Government is no more obvious than with the Eichleay formula. Consequently, the formula's result should be considered as being neither good nor bad but rather merely one very rough, albeit acceptable, method for trying to fairly compensate the contractor for a government imposed delay. The method is not a panacea and its results should not be sustained in the face of convincing evidence to the contrary.

## **B. Inequity**

Until the Appeals Court's decision in *Wickham* every judicial forum was settling delay situations using commonly accepted principles of damages quantifications. While Eichleay may be an accepted method for quantifying delay damages, a contractor who could show a better quantification method could do so.

The fact that so many decisions have involved Eichleay does not mean that better methods are not available and have not been used. If anything, it is only a testament that the litigants in those cases have had difficulty in proving their case at the negotiation level. In many cases this difficulty is directly attributable to the screwball methods that they employed either for quantifying the costs, computing the delay period or the composition of the costs to be allocated. In the remaining cases, the problem is the result of defendants trying to avoid their responsibilities despite the appellant's clear entitlement.

The decision in *Wickham* has thrown the baby out with the bathwater. While previously many Eichleay decisions were justified on the basis that no more precise method was available, now with *Wickham* a more precise method is prohibited. Is this what the *Wickham* Court intended--justice without equity?

## **C. Conflict with Prior Decisions on Unabsorbed Overhead**

In short, the decision by the Appeals Court in *Wickham* that the Eichleay method is the exclusive method for computing unabsorbed overhead is nothing short of horrific. Not since *Capital Electric I* has such a decision been rendered in the field of unabsorbed overhead.

First, for more than 30 years Courts and Boards of Contract Appeal have been deciding cases dealing with the concept of unabsorbed overhead. Throughout those years numerous methods have been employed for solving the problems associated with the allocation of fixed costs during contract delays otherwise known as unabsorbed overhead. The names Eichleay, Carteret and Allegheny are often used to describe several computational formulas used to measure unabsorbed overhead.

The variety of different methods evidence that over the years there have been many suitable solutions to the unabsorbed overhead problem. Furthermore, it has been stated that there is no one method for making such an

allocation<sup>22</sup> and that future cases should depend on the facts and circumstances of each case.<sup>23</sup> The decision in Wickham has now jettisoned more than 30 years of such decisions.

Besides its poor justification for slavishly embracing Eichleay with the citation of the four cases, the Court failed to mention those cases since Miles where Eichleay had been rejected by the Boards. In *Do-Well Machine Shop, Inc.*, ASBCA 35922, 92-2 BCA 24843 the Board stated,

*“The Eichleay formula was fashioned to deal with extended and unabsorbed home office overhead on construction contracts. Whereas the practice before this Board has been to apply this formula in construction cases where the Government delay precluded a contractor from taking other jobs to absorb the overhead, we have used different formulas in the case of manufacturing contracts. See for example, The Entwistle Company, ASBCA No. 14918, 75-2 BCA par. 11420, aff’d and modified on recons., 76-2 BCA par 12,108; Therm-Air Manufacturing Company, Inc., ASBCA No. 16453, 73-1 BCA par. 9983; Allegheny Sportswear Co., ASBCA No. 4163, 58-1 BCA par. 1684. Accordingly, appellant’s claims for unabsorbed overhead on these contracts should be recomputed in accordance with the guidance provided in these manufacturing contract cases.”*

Similarly in *So-Pak-Co., Inc.*, ASBCA 38906, (July 8, 1993), the Board stated that the application of an Eichleay formula to other than construction contracts was rare.

*“Application of an ‘Eichleay formula’ recovery of unabsorbed overhead and G&A costs to a manufacturing contract, like [this contract], is rare but was employed in Therm-Air Manufacturing Co., Inc., ASBCA 16453, 73-1 BCA ¶ 9983.”*

So clearly, the Eichleay formula cannot be, “the exclusive means for compensating a contractor for unabsorbed overhead.” To do so would conflict with more than 30 years of precedent. If this Court could find fault with *Capital Electric I* for jettisoning that many years of binding precedent should it not fault its own decision in this case for similar reasons?

## V. How Could This Happen

If the Wickham decision is so devastating one might wonder how could such a catastrophe occur. In the mind of this author there are two contributors. The first is an ever increasing close minded approach to solving unabsorbed overhead cases. Another is a false sense of security brought by over 30 years of favorable decisions.

### A. The Ghost of Capital Electric

In 1983 the GSBCA rendered a decision in *Capital Electric Company*, GSBCA No. 5316, 5317, 83-2 BCA ¶16548. This case, referred to as *Capital Electric I*, tried to cut new ground and abolish the concept of extended overhead in general and the acceptance of the Eichleay formula in particular. The Board tried to distinguish between unabsorbed overhead and extended period overhead. Extended period overhead was the result of time dependent costs as would be quantified by an Eichleay formula. While, unabsorbed overhead was the result of a burden fluctuation computation such as Allegheny.<sup>24</sup>

Despite a number of cases involving extended period overhead and finding in favor of the contractor, the Board jettisoned this precedent. It found instead that a contractor was only entitled to unabsorbed overhead. In addition, it rejected the Eichleay formula finding it inappropriate and citing *Berley Industries, Inc. v. City of New York*.

The case was appealed to the Court of Appeals for the Federal Circuit, *Capital Electric Company v. United States*, 729 F.2d 743 CAFC (1984) and is referred to as *Capital Electric II*. This is the same court that decided Wickham. The Court of Appeals was reluctant to abandon the many precedents believing them still to be binding.<sup>25</sup> In addition, the Court was quick to point out that damages need not be quantified to a mathematical certainty and that

at least with respect to Capital Electric the requirements for unabsorbed overhead had been satisfied.<sup>26</sup>

Clearly, the Court did not fault the GSBCA for not using the Eichleay formula but rather for rejecting its use even though the prerequisites for its use existed. Furthermore, it did not advocate a preference for the Eichleay method over any other method. In fact, while it rejected the modified approach used by Capital it accepted the modified approach used by Capital's subcontractor, Poole and Kent.<sup>27</sup>

Nevertheless, numerous decisions offer a different slant on Capital Electric. Namely, Eichleay is the preferred method.<sup>28</sup> As a result, there has been a hesitancy by judicial forums and legal practitioners to use any method other than the Eichleay formula when computing unabsorbed overhead. But a preferred method is still a far cry from "the only proper method".

## **B. Misplaced Reliance**

For more than 30 years the Eichleay formula has survived repeated challenges. Perhaps for this reason alone practitioners and judicial forums are comfortable with its result. But, is this just a false sense of security?

Few of the cases argued have actually considered the adequacy of the formula itself despite its many flaws. Sure, some have attacked the formula directly and still failed. In those cases, however, the formula survived not because of its genius but often because the opponent's objective was total denial of entitlement rather than a better method of quantification. So while they opposed Eichleay they offered no better solution. Without any better method of quantification offered by the opponent, the forum was left only with Eichleay.<sup>29</sup>

In a few cases there may actually have been some diversity over quantification methods. Those, however, are also commonly decided in favor of the Eichleay formula but not because of its genius but because the opponent's objective was simply a smaller number.<sup>30</sup>

In most cases, however, the formula is not even challenged. Instead, the arguments focus on entitlement for the most part. After winning on the entitlement issue the forum is frequently left with the Eichleay formula either because it was what was presented or because the appellant failed to prove that its method properly represented the principles of a delay damages claim.<sup>31</sup>

In short, the Eichleay formula is a paper lion. Its survival is not because of genius but rather the incompetence of its detractors and the great fortune of a benevolent judiciary that permits damages quantifications without greater degrees of precision.

## **VI. Conclusion**

Wickham Contracting is a horrendous mistake that borders on holocaust. Although the concepts of delay damages are elusive, the Court has decided in favor of wholesale slaughter rather than equitable analysis. Not since *Capital Electric I* has such a mistake occurred. Consequently, defendants and appellants alike are now faced with some difficult choices.

First, they could suffer under Eichleay. Second, litigants with reasonable solutions to delay damage quantifications that have sizeable financial interests can try their arguments in other jurisdictions where the flaws in the opinion by the Federal Circuit are likely to be recognized. Litigants should realize that there are burdens, however. They must have a solution for the forum to consider and not simply argue that Eichleay is unfair. They must prove that the solution recognizes the dependency between cost and time. They must prove that it satisfies the applicable cost principles. They must be able to show how their method is superior to Eichleay and they must show that it accomplishes all of these things without pointing to the outcome.

In the opinion of this author Eichleay is an approach. It is simple to use and consequently it is ideal for situations where the costs of perfecting a more precise approach outweigh the benefits to be achieved or where the data for developing a more precise approach is simply not available. While some might expect the Wickham decision to signal the rebirth of Eichleay, this author anticipates the decision will mark the beginning of its end. Prior to Wickham reason could prevail. Litigation was not always necessary and Eichleay could avoid the adverse publicity of serious attack by seasoned killers. Now I am not so sure.

<sup>1</sup>. *Wickham Contracting Co. Inc.*, 12 F.3d 1574, 39 CCF ¶76,608.

<sup>2</sup>. Total fixed indirect costs of \$200 ÷ (Contract A \$75 + Contract B \$25) = 200%

<sup>3</sup>. Total fixed indirect costs of \$200 ÷ (Contract A \$75 + Contract B \$0) = 266%

<sup>4</sup>. *Fred R. Comb Co v United States*, 103 Ct. Cl. 174 (1945), "So the contractor, instead of saving the [fixed expense] which is attributable to this contract, is obligated, in effect to waste it, and to spend a similar amount at the end of the contract for the extra time made necessary by the delay." See also *Eichleay Corporation*, ASBCA 5183, 60-2 BCA ¶2688 (1960), "It has, however, been sufficiently demonstrated by the mere fact of prolongation of the time of performance, and the continuation of [fixed] expenses, that more of such expenses were incurred during the period of performance than would have been except for the suspensions." And also *Capital Electric Company v United States*, 729 F.2d 743 (1984), "Where performance of a contract has been delayed, the overhead expenses of performing that contract continue for the additional time. A portion of the total overhead for that additional period accordingly is allocable as a cost of performing that contract."

<sup>5</sup>. *R. G. Beer Corporation*, Eng BCA 4885, (May 15, 1986), "Allocation is not synonymous with recovery in a fixed price contracting environment. Likewise, the fact that indirect costs accruing during the delay period would, of necessity, have been allocable to other on-going contracts should not be interpreted as meaning that they were 'recovered' in the contract price of those other contracts. Instead, they are a true 'cost' of the delayed contract."

<sup>6</sup>. *Restatement (Second) Contracts* §350, Avoidability as a Limitation on Damages "Rule 1: Except as stated in Subsection (2), damages are not recoverable for loss that the injured party could have avoided without undue risk, burden or humiliation. Rule 2: The injured party is not precluded from recovery by the rule stated in Subsection (1) to the extent that he has made reasonable but unsuccessful efforts to avoid loss."

<sup>7</sup>. *Restatement (Second) Contracts* §347, Comment: f. Lost Volume- "Where a subsequent transaction is a substitute for the broken contract sometimes raises difficult questions of fact. If the injured party could and would have entered into the subsequent contract, even if the contract had not been broken, and could have had the benefit of both, he can be said to have 'lost volume' and the subsequent transaction is not a substitute for the broken contract."

<sup>8</sup>. *Restatement (Second) Contracts*, §347, Comment: a. Expectation interest- "Contract damages are ordinarily based on the injured party's expectation interest and are intended to give him the benefit of his bargain by awarding him a sum of money that will, to the extent possible, put him in as good a position as he would have been in had the contract been performed."

<sup>9</sup>. *Restatement (Second) Contracts*, §90, Promise Reasonably Inducing Action or Forbearance, Rule 1: "A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires."

<sup>10</sup>. *Bruce Construction Corp. v United States*, 163 Ct. Cl. 97, 324 F.2d 516 (1963), "Since the purpose underlying such adjustments is to safeguard the contractor against increased costs engendered by the modification, it appears patent that the measure of damages cannot be the value received by the Government, but must be more closely related to and contingent upon the altered position in which the contractor finds himself by reason of the modification" See also *James Ppolito & Co., Inc.*, ASBCA No. 14538, 70-2 BCA 8386, "But reasonable cost under Bruce [Construction] does not mean an abstract standard of top flight efficiency and economy but efficiency and economy in the operations of a particular contractor."

<sup>11</sup>. *Miles Construction*, VABCA 1674, 84-1 BCA 16967 "There is no exact method to determine the amount of such (home office) expenses to be allocated to any particular contract or part of a contract. It has been held a number of times that it is not necessary to prove a specific amount, but only to determine a fair allocation for the purpose of compensating a contractor for delay by the Government." See also, *Dawson Construction Company*, GSBCA 4956, 79-2 BCA 13989, "[W]e are not ready to say that the Eichleay formula is the only fair method of allocating home office overhead incurred by a contractor during a suspension. However, the Eichleay formula is more precise than the method proposed by the Government which fails to take into consideration the period of delay and the impact of that delay over the term of the contract." See also, *Allied Materials and Equipment Co. Inc.*, ASBCA 17318, 75-1 BCA 11150 "The amount claimed by the appellant was arrived at by what appellant terms the 'allocation method' for determining unabsorbed burden. The concept was recognized by this Board in the appeal of *Eichleay Corp.*, ASBCA No. 5183, 60-2 BCA par 2688: '... There is no exact method to determine the amount of such expenses to be allocated to any particular contract or part of a contract.'" See also, *The Entwistle Company*,

ASBCA No. 14918, 76-2 BCA 12108, "As we pointed out in our decision, in the past the Board has taken various approaches in determining the amount of indirect expenses due to a contractor because of Government-caused delay, but always with the objective of placing the contractor 'as nearly as possible in the position he would have been with respect to these indirect costs had there been no compensable delay.'"

<sup>12</sup>. *Miles Construction*, "Given these unexplained activities, we cannot conclude that 100% of Appellant's overhead should be allocated to the VA contract. At the same time we do not believe that using Miles 1980 revenues (of which the VA contract constituted only 63%) would fairly compensate him for the loss experienced because of Government delays. Accordingly, we believe this situation justifies use of a 'jury verdict' approach."

<sup>13</sup>. *Bridgewater Construction Corp.*, "We decline to adopt the figures above because the auditor's method of allocation treats all contracts as if they were of equal value. . . . The Eichleay formula, on the other hand, takes into account the relative values of the contracts by using the ratio of instant contract billings to the Contractor's total billings during the contract performance."

<sup>14</sup>. *Eichleay Corp.*, ASBCA 5183, 60-2 BCA 2688, "The Government's theory stresses the conventional percentage relationships between overhead and direct costs, and between the Government contract work and commercial work. On the other hand, the vary nature of this claim is such that these relationships must of necessity be distorted because of the relatively small direct costs incurred during and as a result of the period of delay. In accordance with these considerations, we conclude that appellant's method of computation offers a realistic method of allocation of continuing home office expenses, which has been approved in cases similar to this one."

<sup>15</sup>. *G.S. and L. Mechanical and Construction, Inc.*, "The approach argued is simply not acceptable, for we shall not apply the thoroughly discredited approach of applying a G&A rate to direct costs incurred during the suspension period. This approach has been rejected by the courts, and we reject it again."

<sup>16</sup>. *G.S. and L. Mechanical and Construction, Inc.*, "To use the modified Eichleay formula gives us pause, for it establishes a daily dollar overhead amount based upon the total overhead costs during the original (i.e., non-suspended, contemplated) contract period, and spreads that over the total performance period. It ignores the fact that during the period of the extension, actual overhead costs may have increased or decreased. The Board is of the opinion that, when the overall period of performance of a contract is increased because of a Government suspension of work, the Government should bear its proportionate share of the overhead costs incurred during the full period between commencement of work and conclusion of work, no more and no less. The modified Eichleay formula will not necessarily accomplish this."

<sup>17</sup>. *G.S. and L. Mechanical and Construction, Inc.* "[C]ourts and boards have accepted several formulae for computing home office overhead allowable during a period of suspension. As appellant has acknowledged, none of these is entirely equitable. One of the commonly accepted methods is the Eichleay formula. However, its use is also strongly opposed by many because it does have deficiencies and inaccuracies."

<sup>18</sup>. *Capital Electric Company*, GSBCA No.s 5316 and 5317, 83-2 BCA 16548.

<sup>19</sup>. *Capital Electric Company v United States*, 729 F.2d 743 (Fed. Cir 1984)

<sup>20</sup>. *Stephenson Associates, Inc.*, "As concerns liability, we have based our holding for appellant on Capital Electric, and Capital Electric says that the Eichleay formula is a proper method of calculating extended overhead. We choose to stay with Eichleay."

<sup>21</sup>. *Berley Industries, Inc. v City of New York*, 385 N.E.2d 281 (1978), "The case before us readily reveals how the mechanical imposition of a formula akin to the one advanced by the plaintiff can all too easily bring a harsh daily penalty when only compensatory damages are warranted or even when the doctrine of *damnum absque injuria* is in order. For all practical purposes, it would completely ignore the safeguards against overreaching and arbitrariness to which the law of evidence has long been committed. As Justice (now Presiding Justice) Murphy pointed out in his dissent below. ' . . . I can only conclude that the mathematical computations under the 'Eichleay formula' produce a figure with, at best, a chance relationship to actual damages, and at worst, no relationship at all.'" *See also Capital Electric Company*, GSBCA 5316 & 5317, 83-2 BCA ¶16548, "The daily rate concept of recovery of extended overhead that Eichleay represents comports with neither the

pervasive principles nor the broad operating principles that encompass generally accepted accounting principles. It neither associates cause with effect nor allocates costs that cannot be so associated to a specific accounting period or periods. It does not assign indirect costs to as an appropriate cost objective during the period in which those indirect costs were incurred. [Three] American Institute of Certified Public Accountants, Accounting Principles Board, Professional Standards, Accounting Secs. 1026.21, 1026.23, 1027.10-S-6A(1) (1978). The concept is but a species of *damnum absque injuria* as suggested by the New York Court of Appeals in *Berley*, and that has led to its limitation and ultimate rejection in many forums. *See also* Anderson, David G., Recovery of Indirect Costs Pricing of Equitable Adjustments Terminations for Convenience, 1989 American Bar Association, p108. "The Eichleay formula is based upon a number of presumptions, the correctness of which determine the formula's accuracy and usefulness. These presumptions are: (1) a proportional relationship exists between contract billings and fixed indirect costs; (2) the indirect cost pool includes only fixed costs; (3) the contractor does not perform any substituted work or value during the delay; (4) the contractor was otherwise working at full capacity during the delay period of contract performance; (5) the effect of a delay on a contractor is the same regardless of when the delay occurs; and (6) the period of contract performance is as an acceptable base period for accumulating fixed indirect costs."

<sup>22</sup>. *Eichleay Corp.*, "There is no exact method to determine the amount of such expenses to be allocated to any particular contract or part of a contract. It has been held a number of times that it is not necessary to prove a specific amount, but only to determine a fair allocation



for the purpose of compensating a contractor for delay by the Government.”

<sup>23</sup>. *Eichleay Corp.*, “The method to be used in future cases will depend upon the record made in those cases.”

<sup>24</sup>. *Capital Electric I*, “Extended overhead is calculated by, and is synonymous with, a daily rate method. [Unabsorbed] overhead is calculated by determining an allocation rate differential.”

<sup>25</sup>. *Capital Electric I*, “As far as this panel is concerned, we do not believe these precedents should be overruled. They are of such long standing and have been followed in so many decisions of the various boards of contract appeals that such action should more properly be taken by Congress.”

<sup>26</sup>. *Capital Electric II*, “In this case, compensable delay was stipulated before the board. Moreover, Capital introduced un rebutted evidence that it could not have taken on any large construction jobs during the various delay periods due to the uncertainty of the delays and (except after the original contract period, when a major portion of the project had been completed and accepted) due to the limitation of its bonding capacity. Thus, Capital has not actually used an ipso facto approach. Indeed as stated in *Eichleay*, 61-1 BCA p.2894 at 15,117: ‘The mere showing of these facts is sufficient to transfer to the Government the burden of going forward with proof that Appellant suffered no loss or should have suffered not loss.’ Amicus American Subcontractors Association states: ‘When the evidence adequately proves the existence of damages owing to a delay in work on the project, the extent of those damages need not be quantified to a mathematical certainty,’ citing *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 51 S.Ct 248, 75 L.Ed.2d 544 (1931)”

<sup>27</sup>. *Capital Electric II*, “The slight difference between damages calculated according to the *Eichleay* formula (\$150.99 daily contract rate) and the ‘close variation’ (board’s words) of the *Eichleay* formula (\$155.81 daily contract rate) used by Poole and Kent appears to be appropriate to its circumstances, as do the variations used by Poole and Kent’s subcontractors, Firepak, United States Metal, and Johns-Manville.”

<sup>28</sup>. *IPS Group, Inc.*, ASBCA 33182, 88-3 BCA ¶1142 (1988), “The *Eichleay* formula is the generally accepted method for computing the recovery of extended home office overhead due to Government responsible delay. *Capital Electric Company v. United States*, 729 F.2d 743 (Fed. Cir. 1984).” *See also Ricway, Inc.*, ASBCA 29983, 86-2 BCA ¶18841, “This Board has consistently recognized the use of the *Eichleay* formula as an appropriate method to approximate the amount of delay damages attributable to the unabsorbed overhead resulting from suspension of work by the Government. Failure to apply it has been strongly rejected by the Court of Appeals for the Federal Circuit in *Capital Electric. Co. V. United States*, 729 F.2d 743 (Fed. Cir. 1984).”

<sup>29</sup>. *G.S. & L. Mechanical and Construction, Inc.*, “Those who would argue against the application of the *Eichleay* formula must do more than has been done; they must present a viable and more accurate alternative. It is not for a court or board to devise some method on its own, but rather to have a well-thought-out position presented to it through appropriate argument in an appropriate case.

The situation is analogous to defending against a quantum claim. It is not enough for the Government to attempt to prove that a contractor’s method of computation is inaccurate and then proceed no further, for this leaves only the opponent’s approach in the record. Rather, Government counsel (for a contractor’s counsel in the event of a Government claim) must also prove that some other method of computing an amount due is more appropriate, and present the resulting computations of the tribunal’s consideration. Put bluntly, it is for a party who alleges unreasonableness of an approach to granting relief, not the tribunal, to devise and present an acceptable method of granting the relief sought.”

<sup>30</sup>. *Essex Electro Engineers, Inc.*, ASBCA 21066, 79-2 BCA 14035, “The auditor may prefer the exclusive use of the Allegheny method of computing unabsorbed overhead for manufacturing facilities rather than the *Eichleay* method but this preference also is immaterial to the allowance of this element of the claim.”

<sup>31</sup>. *Harvey-Wells Electronics, Inc.*, ASBCA 6507, 67-2 BCA 6603, “The record does not support appellant’s contention that a space allocation method should be used to arrive at an increased overhead allowance.”

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**BOARDS OF CONTRACT APPEALS BAR ASSOCIATION**

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# **Application for Membership**

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I am applying for associate membership

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**SECTION III**

Date: \_\_\_\_\_ Signature: \_\_\_\_\_

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**FORWARD THIS APPLICATION WITH A CHECK FOR \$25.00 PAYABLE TO THE BCA BAR ASSOCIATION TO THE TREASURER AT THE FOLLOWING ADDRESS:**

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2100 Pennsylvania Ave, NW  
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