

Government Contract Cost & Pricing: Recent Trends & Developments

Laura Semple, *Amentum*

Nicole Owren-Wiest, *Crowell & Moring*

Erin Rankin, *Crowell & Moring*

October 28, 2022

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Agenda

1. Cost & Pricing Trends
2. Contract Pricing & Truthful Cost or Pricing Data / TINA
3. Cost Allowability
4. Cost Accounting Standards

Cost & Pricing Trends

Cost & Pricing Trends

- What we're seeing:
 - Increased focus on post-award/defective pricing audits
 - Increased focus on CAS audits (e.g., 403, 410, 418, 420) & resulting noncompliance determinations
 - Increased focus on DFARS Business Systems Audits
 - Increased focus on compensation audits and DCAA demands for detailed data
- What about inflation?

DCAA: Reported Stats for 2021

Audit Type	Questioned / Exceptions Costs	CO Sustained Costs	CO Sustainment Rate
All Audits	\$8.44B	\$ 4.46 B	52.9%
Forward Pricing	\$ 5.41B	\$ 3.32B	61.3%
Incurred Cost	\$ 1.58B	\$ 488M	30.8%
Special Audits (Claims and Terminations)	\$ 1.39B	\$ 635M	46.6%
Other Audits (CAS, Business Systems, TINA)	\$ 49.6M	\$ 27.4M	55.3%

- Overall agency Return on Investment: \$5.20 returned for each \$1 spent on budget
- DCAA Net Savings 2020: \$3.5 Billion

Source – 2021 DCAA Annual Report to Congress, March 31, 2022

Contract Pricing & Truthful Cost or Pricing Data / TINA

Truthful Cost or Pricing Data / TINA

TINA Overview

- TINA requires “truth” in negotiation, i.e., the disclosure of all “cost or pricing data” so that both parties have access to the same information (level playing field)
- TINA requires certification that the contractor disclosed current, accurate, and complete cost or pricing data as of date of final price agreement
- TINA is a **disclosure** requirement: it does not require contractor to use the data, or to analyze available data, or to propose a lower price
- If data are “defective,” Gov’t contractually entitled to downward price adjustment (subject to defenses)
- Applies to individual pricing actions over the applicable threshold (\$2M) for non-commercial products/services when adequate competition not obtained
- Flows down to all tiers, unless exception applies

When Does TINA Apply?

TINA Coverage

- Applies to offerors/prospective contractors, prime contractors, all tiers of subcontractors, and contract modifications valued at **\$2M** or more, ***unless an exception applies***
 - Adequate price competition (i.e., two or more responsible offerors are independently competing for award)
 - Prices are set by law or regulation
 - Commercial products or commercial services are being acquired or modified
 - A waiver has been granted by the head of the contracting activity (this is rare)
 - Data that relates to an indirect offset under Foreign Military Sales contracts (this exception is implemented via DFARS 252.215-7014)
 - The exercise of an option at the price established at contract award
 - Proposals used solely for overrun funding or interim billing price adjustments

Cost or Pricing Data

Cost or Pricing Data

- “Cost or pricing data” defined in FAR 2.101
- **Facts** not judgments (facts are verifiable)
- As of date of price agreement
- Reasonably prudent buyer and seller would ***reasonably expect to affect price negotiations significantly***
- More than historical accounting data; not always easy call
- Must be “reasonably available” to the contractor:
 - Even if negotiators are unaware of data’s existence—best practice to conduct a “data sweep” of management and relevant functions
 - Urgency generally not an excuse
 - Organizational lag generally not an excuse

Enforcement of TINA

Risk of Non-Disclosure

- Government can reduce the contract price by the amount that the defective data increased the contract price, and they can recover interest for any amounts paid
 - Defective pricing clause will be applied under the *Christian* Doctrine, even if clause is not included in contract
 - Rebuttal presumption that defective data increased price
- Government can recover price adjustment from the prime for a subcontractor's defective cost or pricing data
- Penalty amounts equal to the increase (i.e., overpayment) may also be assessed for knowingly submitting defective cost or pricing data
- Can also result in civil and criminal liability
 - Frequently “defective pricing” is an underlying allegation of civil FCA claim
- Even if no liability, can create reputational risks

Defective Pricing Claims

Elements of a Government Claim for Defective Pricing

Government has burden to prove 5 elements (*Alloy Surfaces Co.*, ASBCA No. 59625, 20-1 BCA ¶ 37,574):

1. The information at issue is ***cost or pricing data***
2. The data was ***reasonably available*** to the contractor
3. The data was either not disclosed or not meaningfully disclosed
4. The Government relied on the defective data to its detriment
5. Causation (presumption that defective data causes increased contract price, but rebuttable)

Statute of Limitations for Defective Pricing Claims

AAI Corp., d/b/a Textron Sys., Unmanned Sys., ASBCA No. 61195, et al. (Mar. 23, 2022)

- Textron entered into an \$87M contract for unmanned aircraft vehicle systems with the Army
- Nearly 11 years after Textron submitted cost or pricing data, the CO issued a final decision that the Govt was entitled to price adjustment of more than \$7M due to alleged defective pricing
- ASBCA held that one part of the Govt’s claim—alleged defective pricing of ground control shelters—was untimely under the CDA’s 6-year statute of limitations
 - Textron’s 2006 bid gave the Army adequate notice for a claim, but the COFD was not issued until 2017
 - “Claim accrual is not suspended simply because the government failed to appreciate the significance of what the contractor furnished”
- ASBCA rejected the Govt’s assertion that the alleged defective pricing was “inherently unknowable” because only “simple long division” was required to uncover the claim
- Other parts of the Govt’s claim, relating to labor costs and subcontractor COPD relating to delivery of a sensor suite payload, were allowed to proceed

Cost Allowability

Cost Allowability

FAR Part 31 Overview

- A set of complex rules applicable to direct & indirect costs in:
 - Cost-reimbursement contracts
 - Time & materials contracts (the reimbursable material portion)
 - Pricing/negotiating indirect cost rates
 - Pricing changes and other contract modifications
 - Price redeterminations under price-redetermination contracts
 - Fixed-price contracts when cost analysis is performed (e.g., when certified cost or pricing data are required)
- Does not apply to contracts/subcontracts for commercial products/services

Cost Allowability

FAR Part 31 Overview

- Provides guidance for allocating costs directly and/or indirectly to cost objectives
- Requires credits, rebates, allowances or other income relating to any allowable cost received by or accruing to the contractor to be credited to the Government via a cash refund or cost adjustment
- Requires unallowable costs (and directly associated costs) to be identified and excluded from any billing, claim, or proposal applicable to a Government contract/subcontract
- Oversight and enforcement through pre- and post-award audits
- Penalties for charging expressly unallowable costs (double damages) or agreed-to-be unallowable costs (treble damages)

Cost Allowability

Elements of Cost Allowability

- Reasonableness
 - What is reasonable depends upon a variety of considerations and circumstances, including - (1) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance; (2) Generally accepted sound business practices, arm's length bargaining, and Federal and State laws and regulations; (3) The contractor's responsibilities to the Government, other customers, the owners of the business, employees, and the public at large; and (4) Any significant deviations from the contractor's established practices
- CAS or GAAP compliant (as applicable)
- Allocable (assignable/chargeable to one or more cost objectives on the basis of relative benefits received or equitable relationship)
- Terms of the contract
- FAR Part 31 Cost Principles
- Adequately supported by documentation / other evidence

Cost Allowability

Cost types receiving most auditor scrutiny

- Executive compensation (Especially in incurred cost audits at small to medium-sized contractors because the compensation for top executives at large companies is usually limited by the statutory cap on executive compensation. Privately held companies could be perceived as disguising profit distribution as compensation.)
- Bonuses/incentive compensation
- Consultant fees
- Legal costs
- Travel costs
- Gray areas

Costs for Certain Legal Proceedings: Beyond the Cost Principle

FAR 31.204(d)

- “Section 31.205 does not cover every element of cost. Failure to include any item of cost does not imply that it is either allowable or unallowable. The determination of allowability shall be based on the principles and standards in this subpart and the treatment of similar or related selected items.”

***Geran v. Tecom, Inc.*, 566 F.3d 1037 (Fed. Cir. 2009)**

- Because an allowable cost must comply with the “[t]erms of the contract,” costs associated with a judgment in a Title VII case alleging sexual harassment would be unallowable under FAR 52.222-26, which prohibits sex discrimination.
- Therefore, “settlement costs are also unallowable unless the contractor can establish that the plaintiff in the discrimination suit ‘had very little likelihood of success on the merits.’”

Question: What other “breaches” of contract clauses might be implicated by *Tecom*?

***Bechtel Nat'l, Inc. v. United States*, 929 F.3d 1375 (Fed. Cir. 2019)**

- Affirmed *Tecom* rule that costs associated with discrimination suits are “only allowable if [the contractor could] show that the former employees had very little likelihood of success.”
- Did not address the broader issue of other contract clauses.

Cost Reasonableness: Burden of Proof

Northrop Grumman Corp., ASBCA No. 62165 (Aug. 4, 2021)

- Certain NGC pension plan participants earned compensation during their working years in excess of the compensation cap set forth in FAR 31.205-6(p)
- To calculate pension amounts, NGC included as a compensation factor amounts in excess of the applicable FAR 31.205-6(p) limitation in a given year, as part of participants' earned salary and bonus
- In Sept. 2019, the CACO issued a COFD disallowing the portion of the benefit related to the compensation in excess of the FAR 31.205-6(p) cap as a directly-associated cost
- In Dec. 2020, after NGC appealed the COFD at the ASBCA, DCMA argued for the first time that the pension cost was also unallowable because it was unreasonable under FAR 31.201-3, which states:
 - “If ***an initial review of the facts results in a challenge of a specific cost by the contracting officer*** or the contracting officer's representative, ***the burden of proof shall be upon the contractor*** to establish that such cost is reasonable.”
- No ruling on the merits (yet), but the ASBCA allowed DCMA's reasonableness challenge to proceed because the reasonableness challenge was not materially different, factually or legally, from the claim asserted in the COFD

Cost Accounting Standards

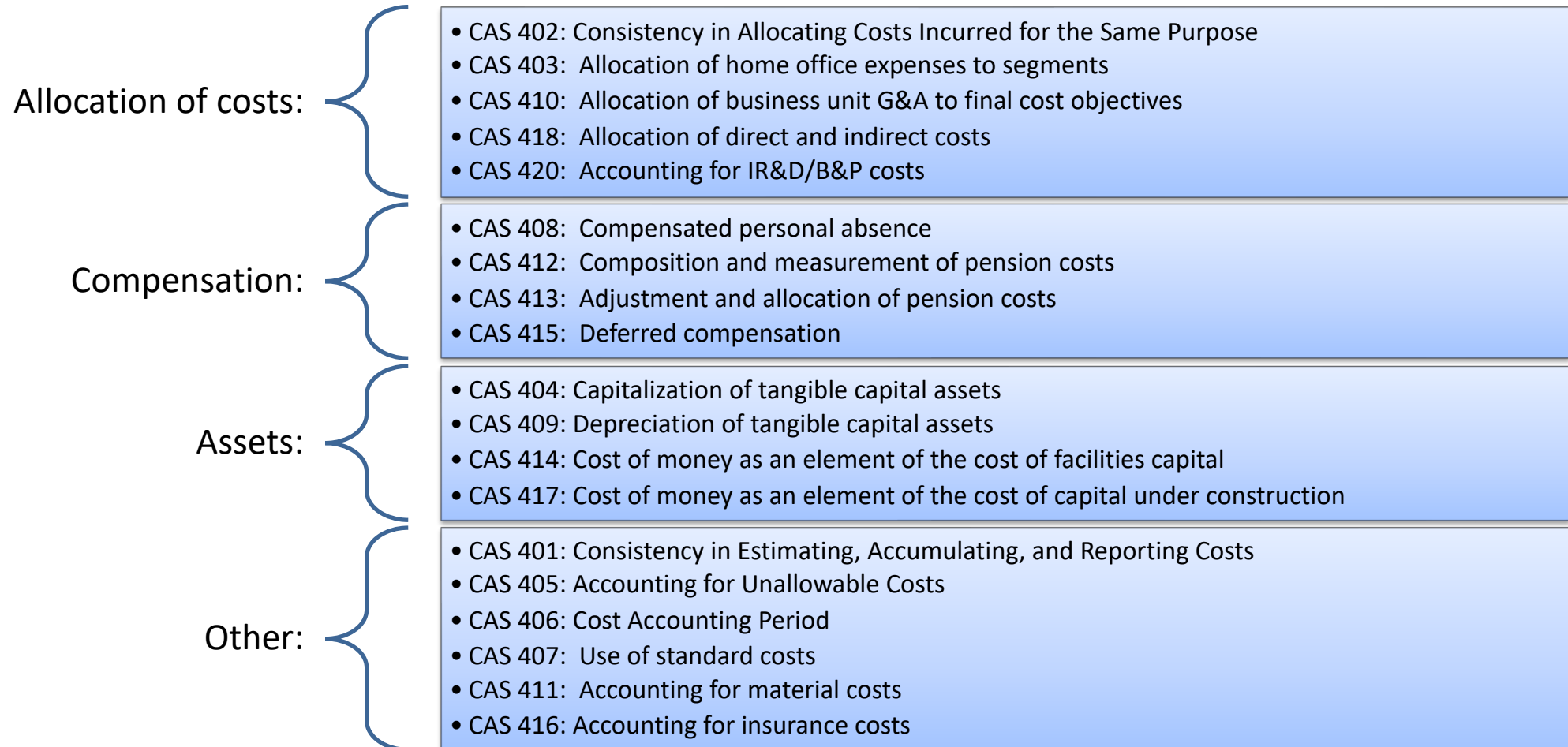
What are the Cost Accounting Standards?

Overview

- Nineteen standards, some or all may apply to certain contracts depending on contract type, dollar thresholds, and applicability of exemptions (full or modified coverage)
- Govern how costs:
 - Are measured (how much),
 - Are assigned (to which cost accounting period), and
 - Are allocated to final cost objectives (how you distinguish direct from indirect costs, and the basis used for allocating indirect costs)
- Sometimes require submission of current Disclosure Statement that describes (compliant) cost accounting practices
- Requires the contractor to consistently follow their disclosed (or established) cost accounting practices

What are the Cost Accounting Standards?

The 19 Standards, 48 C.F.R. 9904



When Do the CAS Apply?

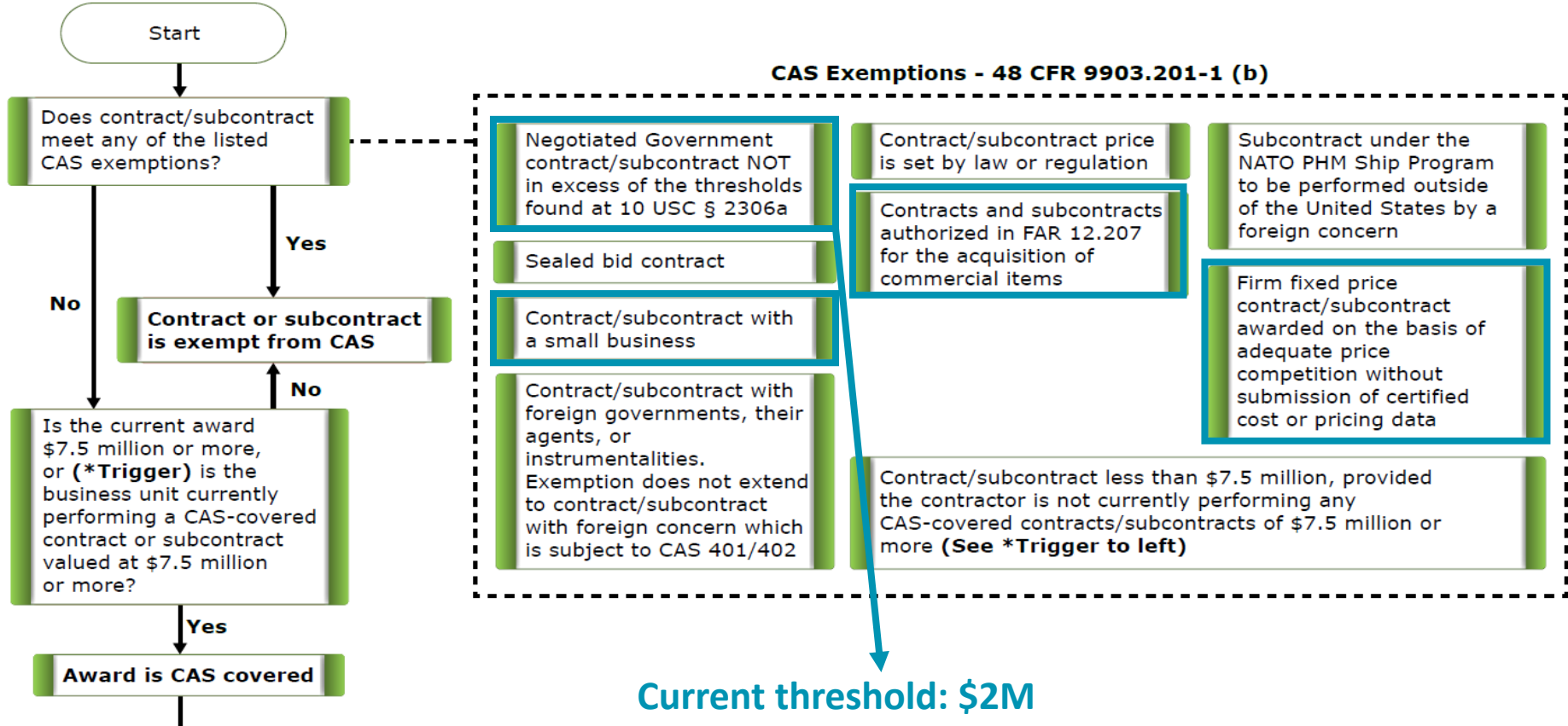
Determining CAS Coverage

- Applies to **contracts, not contractors** (implemented by FAR Part 30 & FAR Ch. 99)
- Flowdown from CAS-covered prime contracts, but exemption may apply at subcontract level
 - FAR 52.230-2, Cost Accounting Standards
 - FAR 52.230-3, Disclosure and Consistency of Cost Accounting Practices
 - FAR 52.230-6, Administration of Cost Accounting Standards
- No clear rules for indefinite delivery/quantity contracts, “hybrid” contracts (e.g., multiple CLINs of different contracts types)
 - Clarify/assert applicable exemption(s) during proposal phase
- CAS coverage determined at time of contract award, and maintains that status throughout life of contract (regardless of any modifications that may put it over an applicable threshold)

When Do the CAS Apply?

Determining CAS Coverage: key exemptions are highlighted in blue

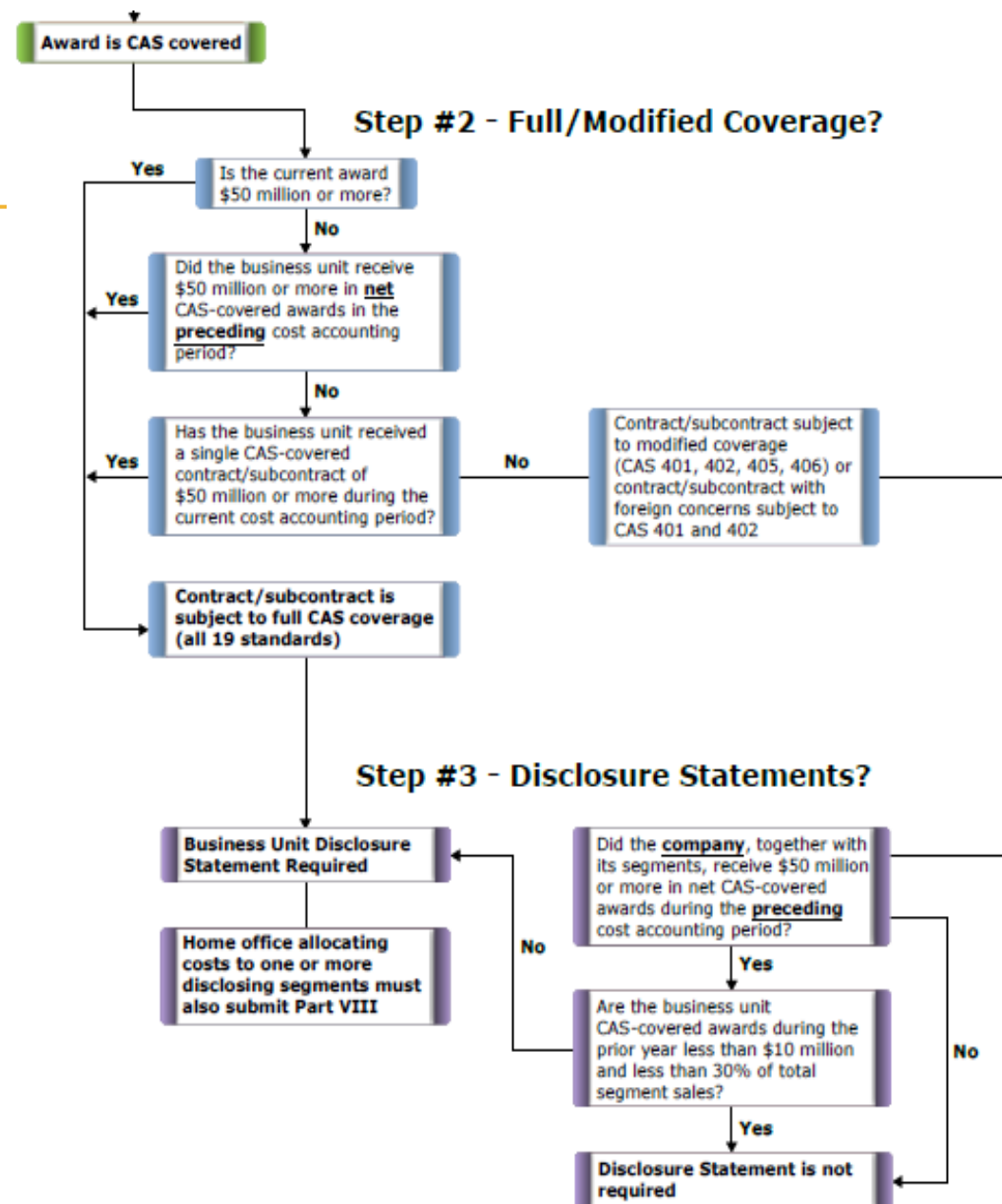
Step #1 - Does CAS Apply?



When Do the CAS Apply?

Determining Full or Modified CAS Coverage

- Full CAS coverage applies if:
 - Contract value is \$50M or more, or
 - Contract value exceeds \$7.5M and business unit received \$50M or more in net CAS-covered awards in preceding cost accounting period
- Disclosure statements are sometimes required under modified CAS coverage
 - Contract is subject to Modified CAS and company (together with its segments) received \$50M or more in net CAS-covered awards in preceding cost accounting period (unless the segment CAS-covered awards in the prior period are less than \$10M and less than 30% of total segment sales)



Changes in Cost Accounting Practices

Changing from One Compliant Practice to Another

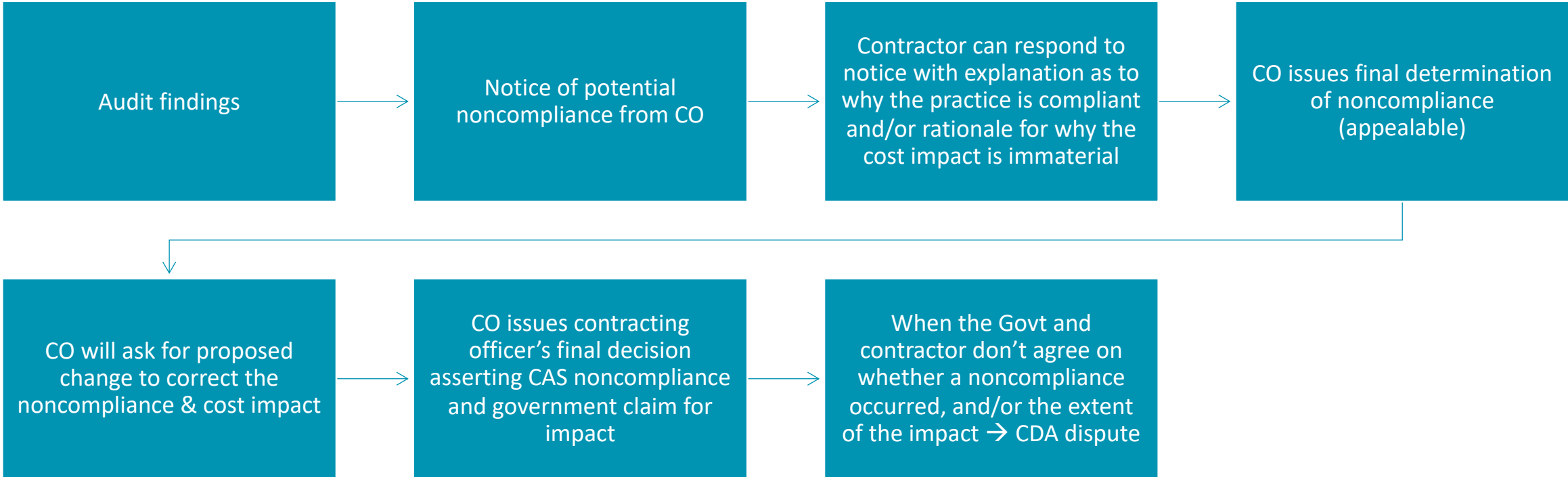
- Threshold question: is it a **change to a cost accounting practice**, or an organizational or administrative change?
- When the contractor makes a business decision to change from one compliant practice to another compliant practice, that is generally considered a “unilateral change”
- Contractor changes to practices may require contract price adjustments, but only to the extent they favor the Government
- Steps in the process to change cost accounting practice:



Noncompliance Determinations

What Now?

- Failure to comply with applicable CAS or failure to follow disclosed practices consistently may entitle the Government to contract price adjustments, plus compound interest
- The typical process:



It's Good To Be King: Offsetting Cost Impact Claims

The Boeing Co. v. United States, No. 17-1969C (Fed. Cl. Sept. 21, 2022) [appeal filed Sept. 30, 2022]

- Longstanding dispute in which Boeing argued that Government's application of FAR 30.606 was a breach of contract and an illegal exaction because the FAR directly contradicts the plain language of the CAS statute:

CAS Statute, 41 U.S.C. § 1503(b)

- For a contract price adjustment resulting from cost accounting changes, “[t]he Federal Government may not recover costs **greater than the aggregate increased cost** to the Federal Government.”

CAS Administration, FAR 30.606(a)(3)(ii)

- “In resolving the cost impact, the CFAO...Shall not combine the cost impacts of any of the following **unless all of the cost impacts are increased costs to Government**: (A) One or more unilateral changes; (B) One or more noncompliances; (C) Unilateral changes and noncompliances.”

- Per COFC, Boeing's claims, although “couch[ed] in terms of breach and money damages,” in fact challenged the validity of FAR 30.606, and did not seek contractual relief [NB: even though Boeing's COFC action is an appeal of a government claim and an appeal of its own CDA claim on a deemed denial basis]
- Per COFC, Boeing's claims must be brought under the APA (over which COFC lacks jurisdiction) instead of the CDA
- COFC distinguished cases where Fed. Cir. has allowed challenges to regulations, made in the context of a CDA claim, stating that in those cases, the “regulatory interpretation issue was **narrow**, applied only to a **single contract** between plaintiff and defendant, and **did not apply prospectively** to future actions”

CAS 413 Pension Adjustments & Statute of Limitations

- The purpose of a CAS 413 adjustment is for the Govt and the contractor to “settle-up and pay their fair shares ***to ensure that the pension plans at issue are fully-funded to meet the promises made to the employee-participants*** covered by the pension plans.” *Northrop Grumman Corp.* ASBCA No. 61775 (Oct. 7, 2020) (quoting *Raytheon Co. v. United States*, 105 Fed. Cl. 236, 270 (2012)).
- We are seeing increased CAS 413 activity, due to continued uptick in M&A and pension freezes
- Court of Federal Claims recently held that the CDA’s six-year statute of limitations begins to accrue on the ***date of the CAS 413 triggering event***. *Textron Aviation Defense LLC v. United States*, No. 20-1903C (Fed. Cl. Aug. 12, 2022)
 - ASBCA has not addressed this question

Questions?



Laura Semple
Assistant General Counsel
Amentum
Laura.Semple@amentum.com
703.579.6305



Nicole Owren-Wiest
Partner
Crowell & Moring LLP
nowrenwiest@crowell.com
202.624.2863



Erin Rankin
Counsel
Crowell & Moring LLP
erankin@crowell.com
202.624.2590

[crowell.com](https://www.crowell.com)

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