

The Allowability of Defense Base Act Insurance

Written by Nick Sanders

Friday, 13 February 2015 00:00



A couple of themes seem to recur in the annals of Apogee Consulting, Inc.'s blog. That's not really surprising, since we've been publishing the blog for more than 6 years now. It should be expected that certain topics pop up from time to time and thus allow us to look back on how they have evolved (or not) over time.

One recurring theme has been the Contracting Officer's Final Decision (COFD). The Contracts Dispute Act requires that there first be a COFD—*i.e.*, a decision from which to appeal to the courts. A COFD can be attacked on two grounds: either it was issued untimely, or it was not valid, because it was biased or otherwise lacked independence. We've written about the CDA's 6-year Statute of Limitations many times on this blog. At this point, we don't know if the 6-year Statute of Limitations is even enforceable any more, since Judge Dyk

[eviscerated](#)

previous case law in his Sikorsky ruling. We've also

[written](#)

about the required independence standard applied to the COFD before, though that second prong does not seem to be much addressed in the current decisions issued by the CDA fora.

Another theme that has shown itself from time to time is the use of questionable math in the "ROMs" issued by DCAA to Contracting Officers who need to issue a COFD with respect to a complex CAS-related matter. We have taken issue with DCAA's use of such tactics to support Contracting Officers and the resolution of CAS-related disputes. Candid conversations with DCAA auditors reveal the pressures to issue a calculation – *any calculation, no matter how flawed* – so that the CAFU

database can be updated to show progress on long-standing, thorny issues where it is thought that money can be recovered from contractors. The pressure on Contracting Officers to accept the DCAA ROMs and *to do something*

is

[similarly intense](#)

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– never mind the requirement to fairly and impartially weigh the facts and circumstances before issuing a Final Decision. In our view, the line between the DCMA Contract Recovery Initiative (as supported by DCAA) and outright asset forfeiture is uncomfortably blurred.

And yet another recurring theme is found in our series of discussions of [questionable](#) DCAA audit findings. Obviously, contractors are going to disagree with a certain percentage of DCAA audit findings. Indeed, DCAA auditors

must ignore any contractor disagreements

if they believe their audit findings are correct. (But note that DCAA auditors cannot simply ignore contractor rebuttals to draft findings; they must look at any additional evidence provided.

The preliminary audit findings

[must change](#)

if the evidence indicates the original conclusion was wrong.) Notwithstanding the natural tendency between auditor and auditee to disagree, problems arise when DCAA auditors question costs without a solid basis, and when the Contracting Officer “rubber stamps” those findings when issuing a COFD. In certain extreme cases, contractors have been known to

file suit

against DCAA, accusing the auditors of professional malpractice. The DoD OIG asserted that as many as 81 percent of all DCAA audits contained GAGAS noncompliances, so should we be surprised if the majority of contractors think that too many DCAA audit findings are flagrantly wrong?

And our final recurring theme for this article is the Federal contractor known simply as KBR (formerly Kellogg Brown & Root) (formerly a subsidiary of Halliburton). A keyword search on this site returns 35 individual blog articles in which KBR is mentioned in some way or another. We write so often about KBR because the company is involved in a myriad number of issues. Without meaning to disparage KBR, we think that one can obtain a fairly decent idea of the current slate of Federal contract compliance issues by following the allegations, counter-allegations, disputes, and litigation involving KBR. For example, recently, KBR became the first contractor in a great long while to [file suit](#) against DCAA, alleging professional malpractice, regarding auditor disallowances of Private Security Contractor (PSC) costs the company paid to protect its employees when the local United States military forces proved unable (or unwilling) to do so. KBR is apparently at the forefront of the war being waged between Defense Department auditors and defense contractors.

Which brings us to a recent ASBCA decision on a Motion for Summary Judgment issued by Judge O’Sullivan in the matter of *Kellogg Brown & Root Services v. United States* ([ASBCA](#)

[No. 59557](#)

, January 22, 2015).

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As is the case with so much of the litigation involving KBR, this dispute started with the LOGCAP contract, in which KBR provided logistics support to the United States Army in various far-flung and dangerous places including Iraq. This particular issue involved the requirement that KBR provide “Defense Base Act” insurance for its staff working on the LOGCAP Task Orders. Not only did KBR cover its own employees through DBA insurance, but it also covered the employees of its subcontractors. Judge O’Sullivan found that “Through 2005, KBR had provided insurance coverage to 94,405 subcontractor employees who were Third Country Nationals and 81,239 subcontractor employees who were Host Country Nationals.” That’s a *lot* of insurance coverage.

The way KBR obtained insurance coverage worked like this: “subcontractors provide[d] KBR with estimated payroll for each subcontract enrolled into the program. A separate DBA policy [was] issued for each subcontract under the master policy.” Importantly, KBR paid the premiums on behalf of its subcontractors. That eliminated any pyramiding of indirect costs and/or profit, and created economies of scale that might tend to lower the insurance premiums. Judge O’Sullivan noted: “The subcontractors [did] not reimburse KBR for the premiums and [did] not include DBA insurance costs in their billings.”

The key aspect of the DBA insurance program was that the premiums were based on estimated payrolls, not actual payrolls. The premiums were set based on the subcontractor estimates and did not change unless the estimated payrolls changed. KBR evaluated estimated subcontractor payrolls on a quarterly basis, and adjusted them for new Task Orders, change orders to Task Orders, and/or completed or terminated Task Orders (among other circumstances). But the one thing that KBR did not do was to adjust the DBA insurance premiums to reflect actual subcontractor payrolls if they should happen to differ from estimated payrolls. One reason given by KBR for the lack of true-up was a lack of visibility into the actual payrolls of its subcontractors. Another reason might have been that there was no need to adjust for actual payrolls – *because premiums were established based on estimated payrolls and actual payrolls had no impact on premiums*. Regardless, KBR was quite open with its DCAA auditors that it did not “true-up” DBA insurance premiums to account for any differences between estimated and actual subcontractor payrolls.

DCAA had a problem with that.

DCAA issued an audit report asserting that KBR’s method resulted in unallowable costs. The audit report stated—

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KBRSI asserts it does not have visibility of the subcontractors' actual payroll records. However, based on KBRSI's subcontractor DBA insurance policy, the insurance company had the rights [sic] to verify the subcontractors' remuneration. KBRSI was unable to confirm the insurance company (AIG) or insurance broker (Aon) verified the subcontractors' remuneration.

The contractor is in noncompliance with FAR 31.201-2(d) -Determining Allowability which states:

'A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a claimed cost that is inadequately supported.'

In addition, the contractor is in noncompliance with (i) FAR 31.205-19(d)(l) because it did not measure, assign, and allocate costs in accordance with 48 CFR 9904.416, and (ii) CAS 416-40(b) because it did not allocate insurance costs to cost objectives based on the beneficial or causal relationship between the insurance costs and the benefiting or causing cost objectives.

To determine how much of KBR's DBA insurance premiums were unallowable, DCAA examined—

... one of KBR's subcontract Master Agreements and compar[ed] the 'estimated DBA premium' per the Master Agreement (a premium amount calculated by multiplying the labor hours invoiced under the Agreement for the period October 2006 to September 2007 by the Iraq/Kuwait premium rate) to the DBA premium amounts invoiced by the insurer and paid by KBR.

DCAA used that analysis to question 43 percent of KBR's claimed FY 2007 DBA insurance premiums – some \$33.9 million. In addition, DCAA issued a ROM to the Contracting Officer asserting that KBR's alleged practice of immediately expensing DBA insurance premiums was

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noncompliant with CAS 416 and resulted in a cost impact to the Government of \$34.4 million. All in all, KBR was on the hook for roughly \$68 million plus interest. Plus attorney fees.

One problem KBR faced in its litigation to fight the government's asset forfeiture (or perhaps "claim" if you prefer) is that it wanted the government to file a claim for the funds at the ASBCA so it could fight the claim. The government didn't want to file a claim. The upshot of that particular dispute was that Judge O'Sullivan directed the government to file a claim.

In her decision, she noted that the government should file its claim first because of the paucity of information in the COFD. She wrote—

In this case, the government has asserted that \$33.9 million in subcontractor DBA insurance premium costs incurred by KBR in performing the LOGCAP contract are unallowable, yet it has not articulated a basis for its claim. The Board has examined the ACO's decision which does not explain the rationale for finding these costs unallowable. The final decision includes the summary sentence: 'The cost billed was not based on actual subcontractor labor incurred during FY 2007' but does not explain why that fact, in the contracting officer's opinion, renders the costs unallowable. It is important to note the costs billed were KBR's actual incurred premium costs, as confirmed by the DCAA audit.

The final decision also states that it references and relies on the DCAA audit report and KBR's response to that report. The Board has examined the audit report, which states that it is disallowing the costs based on KBR's failure to 'true up' its subcontractor DBA insurance costs based on actual subcontractor payroll, and that this failure to 'true-up' is a noncompliance with FAR 31.201-2(d), which requires contractors to maintain records sufficient to demonstrate that claimed costs have been incurred, are allocable to the contract, and comply with applicable cost principles.

However, the audit report does not explain what significance, if any, actual subcontractor labor costs (even if such information were available to KBR) would have to the issue of the allowability of KBR's subcontractor DBA insurance costs, which were based on estimated subcontractor payroll and not subject to adjustment based on actual subcontractor payroll.

Now you see how the themes we mentioned at the beginning of this article weave together in

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this particular decision. Once again, KBR is forced to litigate a silly DCAA finding that was clearly rubber-stamped by the cognizant Administrative Contracting Officer who either did not understand the issues or chose not to understand the issues. As a result of the silly audit finding, a COFD was issued that failed to articulate the rationale for the government's attempt to take nearly \$34 million from KBR.

And this particular decision does not even address the DCAA "ROM" related to the alleged CAS 416 noncompliance.

Obviously the matter will be litigated on the merits, but from where we sit in our non-attorney couches, it seems to be very much a foregone conclusion. The DBA insurance premiums were based on estimated payrolls and actual payrolls were simply irrelevant to the matter. It's a no-brainer, in our view. If KBR needed another cause of action related to DCAA professional malpractice, they may well have found it here.