In the previous article (**Part 1 of 2**) we went into some detail regarding differences between commercial item contracts and non-commercial contracts, focusing on how a prime contractor would deal with subcontract changes. We asserted that, generally, subcontract changes for non-commercial subcontracts would be valued on the basis of any additional costs incurred (though of course a change might lead to reduced subcontractor costs). We further asserted that, generally, subcontract changes for commercial subcontracts would be (or could be) valued on the basis of prices rather than costs.

We asserted that when a prime contractor has awarded a commercial subcontract, and then seeks to enter into a supplementary agreement with the subcontractor to make a change to that subcontract, then the value of the associated equitable adjustment may be based on price, and the subcontractor's costs in performing that changed work are irrelevant if that is the case.

In this article we want to discuss two ASBCA cases that hopefully support those assertions.

The first case is yet another ASBCA appeal of a contracting officer's final determination regarding Kellogg Brown & Root's (KBR) LOGCAP III contract. If you were ever looking for a contract that generated litigation, this would be it. One of the reasons for that, of course, is KBR was supporting U.S. combat operations in Southwest Asia. Regardless of the amount of planning done, combat is (shall we say?) messy and tends to disrupt the best of plans. As a Prussian wrote 150 years ago, "No battle plan survives contact with the enemy." The same truism could be said of contracting. No combat support contract, no matter how well written, survives contact with the battlefield.

Anyway, in **this appeal** , KBR sought reimbursement for the costs of settling two requests for equitable adjustment (REAs) by a subcontractor that was providing accommodations to house military personnel at bases in Iraq, including Camp Anaconda. KBR issued an $81 million FFP subcontract to First Kuwaiti Co. of Kuwait (FKTC) to construct 2,252 prefab trailers and transport them to a staging area bordering Iraq, from where FKTC would then transport them to Camp Anaconda. When they got to the Camp, FKTC would unload them and set them up for troop housing. At least, that was the plan. But the plan didn't survive for very long.

As Judge Melnick (for the Board) wrote—

Main Supply Route (MSR) Tampa was the critical road for transporting supplies into Iraq from Kuwait. … Because there was a war on, MSR Tampa was extremely dangerous. Insurgent attacks began in the spring of 2003 and people were shot and killed. Among those who frequently lost their lives were KBR affiliated personnel. Its vehicles were attacked at least as early as July 2003. KBR was aware of and concerned about convoy force protection prior to the issuance of TO 59. In June 2003, the military imposed movement restrictions, requiring military control and escorts into Iraq of all assets, including contractors. The military required the escorts to reduce disruptions that would otherwise arise from attacks upon unescorted elements.

(Internal citations omitted.)

Long story short, the trucks carrying the trailers backed up at the border. FKTC had to incur additional costs to store the trailers until they could be transported. In addition, the Camp wasn't fully prepared to receive the trailers, and thus FKTC incurred additional costs during the unloading and preparation phases of its work. FKTC submitted a request for equitable adjustment (REA) to KBR for "double handling." Judge Melnick didn't think very much of the subcontractor REA, characterizing it as "cryptic," and noting that FKTC never disclosed its additional costs to KBR—it provided "rates and prices," but never costs. KBR added $23.831 million to FKTC's FFP subcontract to cover the "double handling." In addition, FKTC submitted a second REA for "delays" and "idle truck time" at the border. Again, FKTC did not base its proposed REA on additional actual costs; it proposed a flat rate of $500 per delay day. Again, KBR negotiated the rates without addressing actual costs incurred, and added an additional $24.923 million to the FFP subcontract to compensate KFTC for the delays.

DCAA disapproved the payments because they lacked cost data to support them. DCAA disapproved $51.27 million in subcontractor costs, indirect costs, and award fee. The ACO allowed $3.78 million but disallowed the remaining $47.49 million. KBR appealed.

Another long story short, Judge Melnick found that the REA costs paid by KBR were unreasonable, pursuant to the requirements of 31.201-3. Because they were unreasonable, they were not allowable. Among other failures noted by the Judge, he wrote extensively about KBR's acceptance of KFTC's rates and factors instead of actual costs incurred. He wrote "Thus, an equitable adjustment is not based upon market prices, but reasonable incurred costs. … An equitable adjustment's use of actual cost data ensures that it does not produce a windfall." In addition, Judge Melnick wrote—

… FKTC was required by its subcontract with KBR to support equitable adjustments with detailed cost breakdowns in conformance with FAR Part 31 and the DoD FAR Supplement. It was also required to maintain books and records reflecting its subcontract performance and make them available to KBR for cost-reimbursement purposes. Indeed, FKTC knew its truck lease costs but declined to disclose them. FKTC also maintained records of when trucks carrying trailers crossed the border, and records of the number of trucks waiting at the border on specific dates. It simply strains credulity that it did not record how much it actually paid its drivers while they waited at the border or how long trucks actually waited, especially given that it would ultimately seek millions of dollars in additional compensation for these events. It is highly unlikely that a company could grow to the size and sophistication of FKTC without tracking its costs. Significantly, KBR has not contended that it asked for such records at the time the REAs were submitted, or knew that they did not exist. It was not reasonable for KBR to simply assume they did not exist. It was not reasonable for FKTC to consider their absence acceptable, especially in light of FKTC's record-keeping responsibilities contained in the subcontract.

(Internal citations omitted.)

KBR tried to argue that its subcontract with FKTC was a commercial subcontract. (See? We got to that point eventually.) KBR argued that, because the subcontract was for a commercial item, “it was legally barred from basing [the REA] upon actual costs." Judge Melnick was not persuaded.

He wrote that “KBR's subcontract with FKTC does not contain the FAR's commercial items changes clause. Its changes clause permits unilateral changes and requires REAs to be supported with costs conforming to FAR Part 31.” Because the FKTC subcontract lacked the appropriate changes clause language, KBR could not claim should be treated as a commercial subcontract.

The appeal(s) were denied. KBR is out $47.49 million, unless it is successful on appeal.

The second case we want to discuss went a different way. Indeed, KBR cited to that decision in its arguments. The second case is an appeal of United Launch Services. The appeal has a long pedigree, going back to a first summary judgment decision in 2013 (ASBCA No. 56850) and then another (much more relevant) decision in June, 2016, followed by a very recent notice of final settlement in the contractor's favor.

Summarizing all that litigation history into a blog article is tricky, and we already wrote too much about KBR. What you need to know is that the USAF awarded Boeing a fixed-price commercial item contract for Integrated Launch Services (ILS). The fixed price was based on a certain number of launches of certain missions, with each mission having a certain payload weight. The payload weight determined the launch vehicle used by Boeing. Importantly, the contract contained a commercial changes clause and did not contain any of the other changes clauses we wrote about in Part 1.

You really ought to read the **2016 decision** . The interplay between Boeing and the USAF is fascinating. During the interplay, ULA was formed and became a subcontractor to Boeing, pending contract novation. Long story short, Judge Wilson found for ULA, stating that the subcontract had been changed by the USAF and Boeing/ULA was entitled to be compensated for the change. Judge Wilson reached back to the 2013 decision to discuss how to quantify and support an REA in a commercial subcontract. He wrote—

Although the term 'equitable adjustment' has been considered a term of art, that conclusion arises from its use in non-commercial items contracts where the government has a right to direct a unilateral change. In that context, the term is generally limited to requiring those 'corrective measures utilized to keep a contractor whole when the Government modifies a contract.' However, this customary understanding of the term need not be followed in the event of a significant change in context. The Changes clause in this commercial items contract dictates that it can only be changed with the agreement of the parties. It requires the parties to negotiate an equitable adjustment in the event they agree upon a change causing an increase or decrease in contract costs, performance time, or that otherwise affects any other contract provision, but it does not define the limitations of the equitable adjustment. The government cites no authority defining the term in this context. Appellant has produced evidence that the parties negotiated equitable adjustments under this contract based upon changed market conditions, and not merely upon changed costs, showing the term was intended to permit such action.

(Internal citations omitted.)

Accordingly, Judge Wilson found that cost information was not relevant to valuing an REA for a change to a commercial subcontract, at least in this instance. The subcontract contained prices for certain launches, and the change could be quantified using contract pricing, without regard to costs incurred. More than two years later (November, 2018), a brief decision announced that the parties had agreed to award ULA $240 million for the changed launch requirements.

But that's not quite the end of the story. Going back to Judge Melnick's decision in KBR, footnote 7 discusses, and distinguishes the 2016 ULA decision. Judge Melnick wrote "Nothing in *United Launch Services* dictates that the equitable adjustment of an allegedly commercial subcontract must ignore costs and rely only upon a price analysis." We agree that the ULA decision did not state that costs must be ignored when available; but in that particular case of REA valuation costs *were* ignored and the ASBCA accepted the methodology used. In any case, it is unclear whether the comment in a footnote is precedent-setting, or simply *dicta*. But what do we know? We're not attorneys.

So that's the story on pricing subcontract changes. It's been a long road; we trust it was worth the trip.