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This is going to be an important article. Which means, of course, that few will read it and even fewer will heed it. So be it.

This is going to be a controversial article. Which means, of course, that most will disagree with it and even more will simply ignore it. So be it.

Newsflash: If you are a subcontractor, if you are supporting a prime contract and submitting vouchers/invoices to the prime contractor instead of directly to the U.S. Government, then you should not—indeed, you *must not*—let your cognizant ACO establish the billing rates you use to prepare those invoices.

The cognizant ACO has authority to establish provisional billing rates and final billing rates *only* for your prime contract billings, the invoices submitted directly to your US Government customers. Your cognizant ACO lacks authority to establish provisional billing rates and final billing rates for your subcontract invoices to your prime contractors.

To be clear, you can *agree* to give the ACO that authority. You can execute a subcontract with a prime contractor that links your provisional and final billing rates to what the ACO does for

the contractors over which s/he does have authority. You *can* do that, and many upon many subcontractors do so automatically, as a matter of routine. It's the common wisdom, the way things are normally done. So of course you can *choose* to do that.

But you'll be making a *big mistake* if you do so.

By way of background, try **this article** . In it we wrote:

… whenever the contractor knows that its provisional billing rates are varying, to a significant degree, from its currently anticipated final indirect rates for the year, it should request an appropriate adjustment. If the contracting officer declines to adjust the billing rates, then s/he needs to be able to justify why not—since the clause *mandates* that the provisional billing rates "shall be" the anticipated final rates. Bottom-line: while there may be some discretion with respect to notification, there is no discretion once notification has been made—the billing rates *must* be adjusted.

[Emphasis in original.]

For a little more nuance, consider reviewing this **other article** , in which we wrote—

So if the parties are complying with the requirements of the Allowable Cost and Payment Clause, then the difference between provisional and final billing rates should be *de minimis*.

That's the theory, anyway. We're quite certain that practice does not match theory in this area. The primary reason for the deviation between theory and practice is that many Contracting Officers apply decrement factors to contractor's proposed provisional billing rates in order to 'protect the Government's interests.' As a result of the desire to protect the Government's interests, contractors are only approved to bill at provisional rates that are lower than the estimated final billing rates. The size of the decrements seems to depend on the individual Contracting Officer; some contractors have rather small decrements and others have rather

larger decrements. The immediate impact is to reduce contractors' cash flows, which is annoying, no doubt. But since the provisional billing rates should be synced up to final billing rates over time, the cash flow impact primarily manifests during the current performance year and, accordingly, is perceived as a temporary phenomenon and not something to get overly worked-up about. …

The fact of the matter is that provisional billing rates should closely approximate final billing rates. Imposition of a large decrement factor on a contractor risks the government being unaware of a contract's true costs, and receiving a large 'surprise' when the final billing rates are negotiated. (We note for the record that too-low provisional billing rates do not relieve a contractor from having to comply with the Limitation of Cost/Limitation of Funds clause requirements.) Moreover, from the contractor's perspective, having provisional billing rates closely approximate final billing rates means that the settlement of final rates will not have a significant impact on cash flow.

Okay. You should be up to speed now. Provisional billing rates should always closely approximate expected final billing rates, and contractors should request adjustments to provisional billing rates when those rates start to differ significantly from estimated final billing rates. The parties have six years to negotiate final billing rates, and if the parties did the right thing during contract performance (as defined by complying with the requirements of the 52.216-7 Allowable Cost and Payment Clause) then the final invoices, calculated at the negotiated final billing rates, should be relatively small.

Note that all of our previous writings on the topic elided any discussion of what happens to subcontractors that want to adjust their provisional billing rates. The closest we've ever come to that discussion point can be found **over here** , where we wrote about a subcontractor to L-3 Communications that had submitted rate adjustment vouchers, that L-3 refused to pay until DCAA had conducted an audit and had determined the subcontractor's final billing rates. The subcontractor sued L-3 for a failure to pay its invoices (among other allegations) and won. We reported that suit and its outcome but we failed to draw any conclusions from it.

What we should have said was, based on that case, *subcontractors don't have to wait for a DCAA audit and formal rate negotiation in order to submit adjustment vouchers to their prime contract customers.* Granted, that was only one case, and it was at the State level, thus its precedent-setting ability was somewhat in doubt to this non-attorney. But still, we missed that implication.

We rectify that omission today, citing to a recent U.S. Court of Federal Claims case to support our position. We refer to **U.S. Enrichment Corporation v U.S.A** . Now, before we get into our analysis of the decision, please remember that we are not attorneys and you should not rely on our legal analyses. If you want a legal analysis upon which you can rely, go hire yourself a good government contracts attorney.

All that being said, we look at the July 28, 2014 decision, in which Judge Firestone granted the Government's Partial Summary Motion to Dismiss, finding that the court lacked jurisdiction to hear the part of the case that involved USEC's subcontract costs. Judge Firestone's reasoning in granting the Government's Motion supports our position.

USEC filed a suit at the COFC, alleging that the Department of Energy (DOE) breached its contracts with USEC "when the government failed to reimburse certain indirect costs that USEC incurred as both a prime contractor and subcontractor while performing work at the United States Department of Energy's … gaseous-diffusion plants ('GDPs') in Portsmouth, Ohio and Paducah, Kentucky." USEC's suit was based on "DOE's purported failure to establish provisional and/or final indirect cost rates in a timely manner in connection with those prime and subcontracts, which allegedly resulted in USEC being under-compensated throughout performance." Roughly 10 percent of USEC's claimed $38 million in damages were related to its cost-reimbursement subcontracts with other prime contractors performing their own DOE contracts (also called "Captive work"). The Government argued that "the court lacks jurisdiction to entertain a suit brought directly by USEC in its capacity as a subcontractor."

Those subcontracts, as well as USEC's prime contracts with DOE, contained the Allowable Cost and Payment Clause (52.216-7). We have extensively discussed the requirements associated with that clause on this site. Indeed, the articles from which we quoted above go into some detail. Judge Firestone summarized many of those requirements in her decision.

With those requirements as context, Judge Firestone found that the dispute started with respect to USEC's FY 2003 indirect cost rates. The DOE granted one rate adjustment (in May 2004) but refused to grant another, despite USEC's June, 2004, request that it do so. And there the matter languished, for literally seven years, until 2011, when USEC finally submitted rate adjustment invoices for FY 2003 and DOE rejected them (we assume because they contained unapproved billing rates). DOE refused to let USEC adjust its FY 2004 billing rates. Eventually USEC took the DOE to court.

As noted, Judge Firestone granted the Government's Motion. She found that—

… USEC entered into separate agreements with prime contractors to provide Captive work, those agreements are controlling. To recover additional indirect costs, USEC must comply with the mechanisms set forth in those agreements and applicable regulations. See 48 C.F.R. § 52.216–7(d)(5) ('The completion invoice or voucher shall include settled subcontract amounts and rates. The prime contractor is responsible for settling subcontractor amounts and rates included in the completion invoice or voucher and providing status of subcontractor audits to the [C]ontracting [O]fficer upon request.')

Judge Firestone found that the DOE lacked privity with USEC in its capacity as a subcontractor. Accordingly, she could not hear that part of USEC's case. If USEC wanted to adjust its indirect cost rates so as to bill more (and collect more), then that matter was between it and its prime contractors. The DOE Contracting Officer was not a party to the matter, nor did s/he have authority to override the billing mechanisms found in USEC's subcontracts. If there was a dispute, then the two contracting parties would need to work it out. Importantly, Judge Firestone cited to the 52.216-7 language that expressly provided that the prime contractor, and not the U.S. Government, was "responsible for settling subcontractor amounts and rates." There was a regulatory basis for her position.

Therefore, it seems very clear to us that your billings to your prime contractors are a matter between you and them. The Government is not a party to your disputes nor does it have authority to set either the provisional billing rates or the final billing rates. Subcontractors need to push your prime contractors to the negotiating table and settle your final billing rates (with respect only to the individual subcontract under discussion), and you absolutely do not need to wait for DCAA or for your ACO.

Prime contractors, then can be good news for you. All those old prime contracts you can't close because you have subcontractors whose rates have not yet been finalized? Go ahead and negotiate your final billing rates and close 'em out.

Best get to it now.