



The Cost Principle at 31.205-47 discusses the allowability of the costs associated with legal proceedings. Such costs include “administrative and clerical expenses; the costs of legal services, whether performed by in-house or private counsel; the costs of the services of accountants, consultants, or others retained by the contractor to assist it; costs of employees, officers, and directors; and any similar costs incurred before, during, and after commencement of a judicial or administrative proceeding which bears a direct relationship to the proceeding.”

The rules governing the allowability of the costs associated with legal proceedings are complex and we recommend you do not attempt to rely on common sense in making your determinations between allowable and unallowable costs. With that said, we would like to focus today on the costs of legal proceedings between a prime contractor and its subcontractors.

We have written fairly extensively on the topic of effective subcontractor management. We have also addressed several prime-subcontractor disputes on this site. Our most recent foray into the topic was [the article](#) on the litigation between CH2M Hill and DynCorp, where CH2M Hill (the subcontractor) was suing DynCorp (the prime contractor) for “its fair share of the profits” of the contract. In that article we noted that DynCorp had a “challenging” 2014, of which its litigation was but a small part.

Similarly, Orbital Sciences has had a “challenging” 2014, with the most obvious challenge being the recent failure of its Antares resupply mission to the International Space Station (ISS). As we understand it, the rocket failed mere seconds into its planned flight, crashing back to the ground and disintegrating into a fireball on its Wallops Island, Virginia, launch pad. Before the failure, Orbital had been planning to launch its Antares rocket again in April 2016. Now, not so much.

Meanwhile, Orbital's dispute with one of its subcontractors has gotten ugly.

On October 21, 2014, Orbital filed suit in the District Court of Eastern Virginia, alleging that Integrated Systems and Machinery (ISM) had failed to deliver contractually required hardware.

[One report](#) described the hardware being "held hostage" as—

new gimbals and cylinders for the hydraulic system used by the slow-moving, truck-like Transporter Erector vehicle that hauls Orbital's Antares cargo rocket and Cygnus space freighter out of their Wallops Island, Virginia, hangar and raises them vertical at their Mid-Atlantic Regional Spaceport launch pad over a kilometer away.

Orbital claims that ISM has refused to deliver the hardware because of "unresolved contractual matters," and further claims that it is ready to pay ISM upon delivery. According to [another article](#) —

The components Huber's firm has been withholding were ordered by Orbital in 2012 as part of a long-planned upgrade for the Transporter Erector Launcher that Orbital uses to haul Antares out to the pad and hold it upright for liftoff. But the mobile launch platform was among the equipment damaged Oct. 28 when Antares failed 15 seconds after liftoff and came crashing back down.

In other words, the explosion may have damaged the launch pad to such an extent that the "upgrade" may no longer be feasible. What's worse, the same article notes that Orbital is no longer planning its 2015 launch, and may not launch again at Wallops Island until 2016. That obviously puts a new spin on the value of the parts that ISM is allegedly holding hostage. Perhaps in recognition of his newly weakened bargaining position, the ISM President (Kevin Huber) offered to release "a partial shipment" to Orbital immediately. Orbital did not officially respond to the offer but ISM claimed that the offer had been "tentatively accepted" pending a formal agreement.

If Orbital has had a challenging year, so has ISM. ISM and Huber have been tangled in

## Prime-Subcontractor Litigation

Written by Nick Sanders

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litigation with Huber's former employer, Advanced Fluid Systems (AFS), which [filed suit](#) in 2013, alleging that Huber unlawfully transferred trade secrets regarding the Transporter Erector vehicle's hydraulic systems. AFS is suing for \$10 million in damages. Reportedly, AFS built the hydraulics under a 2009 contract from the Virginia Commercial Space Flight Authority. AFS alleged in its suit that Huber "gave technical information about the hydraulics systems to a Charlotte, N.C., company called Livingston & Haven in September 2012." The suit claimed that AFS found "evidence of the alleged data transfer on a corporate laptop collected from Huber after he left the company in 2012." The AFS complaint alleged that –

Huber, who was working full time for Advanced Fluid Systems at the time of the alleged transfer, subsequently conspired to steer servicing work for the Transporter Erector's hydraulics systems to Livingston & Haven, and to his own company, Integrated Systems and Machinery of New York ... Huber provided Orbital with bids for the work on behalf of both Advanced Fluid Systems and Livingston & Haven, substantially inflating the quote from Advanced Fluid Systems....

Orbital Sciences was named in the complaint, but was later dismissed as a defendant after it settled with AFS "out of court" in May, 2014. That leaves the litigation between current and former Orbital subcontractors, while the prime stays above the fray.

But Orbital is not *entirely* above the fray. Just to add another level of complexity, apparently the ownership of the Transporter Erector vehicle itself is in dispute. SpaceNews reported—

Ownership of the vehicle itself is the subject of a lawsuit Orbital filed in the Richmond, Va., Circuit Court in September against the Virginia Commercial Space Flight Authority.

Originally, the Virginia Commercial Space Flight Authority owned the vehicle. Orbital took ownership in 2010, when it bought the Transporter Erector and other ground-support equipment in a \$42 million deal to provide the state-run authority with cash to cover overruns incurred during construction of Antares' launchpad at the Mid-Atlantic Regional Spaceport — a corner of Wallops Flight Facility the state leased from NASA.

The state, Orbital said in its lawsuit, was supposed to buy back all of this equipment, which Orbital said could support launches of rockets besides Antares. In the case of the Transporter

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Erector, the state disagreed. The authority repurchased \$25.5 million worth of hardware from Orbital, but balked at paying \$16.5 million for the transporter and associated hardware, which the state claimed were specific to Antares, according to Orbital's complaint.

The Aerospace Corp., a government-financed think tank focused on military engineering projects, was brought in to mediate and, in 2012, ruled in Orbital's favor. Virginia nevertheless refused to take the transporter back, forcing orbital to sue, the company claims.

It is not clear which entity (if any) would claim ownership of the vehicle now – except perhaps to use as the basis of a multi-million dollar insurance claim.

To sum up, this situation is a quagmire of litigation. Accusations and allegations have been flying back and forth. Lawyers and litigators have been busy. Orbital Sciences is a party in some of the litigation. So is AFS. So is ISM. So is Huber. So is Livingston & Haven. And so is the Virginia Commercial Space Flight Authority. It's hard for us to guess at the amount of attorney fees that have been incurred, and which continue to be racked-up each day.

Meanwhile, the FAR Cost Principle establishes the allowability of such costs. 31.205-47(f)(5) states that the following costs are not allowable –

Costs of legal, accounting, and consultant services and directly associated costs incurred in connection with the defense or prosecution of lawsuits or appeals between contractors arising from either—

(i) An agreement or contract concerning a teaming arrangement, a joint venture, or similar arrangement of shared interest; or

(ii) Dual sourcing, coproduction, or similar programs, are unallowable, except when—

(A) Incurred as a result of compliance with specific terms and conditions of the contract or

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written instructions from the contracting officer, or

(B) When agreed to in writing by the contracting officer.

Based on the foregoing language, we believe that all costs incurred by all the various parties to the various lawsuits are unallowable. That's a lot of profit dollars.