Equity and Contract Disputes

Companies considering entering into a contractual relationship with the U.S. Government might think they are entering into a relationship based on mutual good will. They may think they are entering into a partnership with their government customers, a partnership based on the mutual goal of having work performed and a need met. Sadly, too often that is not the case.

Too often, government contractors are surprised to learn that somebody on the government side doesn't like them, or has an intent to harm them (usually financially). Too often, government contractors are surprised to learn that auditors may take credit for "questioning" costs that the contractor believes to be legitimate business expenses—perhaps years after the costs were incurred. Too often, contracting officers who are supposed to be independent, and who are supposed to resolve contractual disputes before they ripen into litigation, essentially rubber stamp those audit findings (for one reason or another) and dare the contractor to take them to court—knowing that the expense and time associated with litigation virtually guarantees that the biased decision will be accepted, and the money paid.

And far too often, when a contracting officer final decision is appealed in accordance with the contract's Disputes clause, the courts rule against the contractor on a procedural technicality—effectively jettisoning notions of equity in favor of administrative procedures.

Is that always the case? No, clearly not. But it happens sufficiently often that contractors entering the Federal government acquisition environment should be aware of the risk. They should be aware that they may become targets for overzealous auditors and poorly trained and/or biased contracting officers. They should be aware that the courts in which they will be forced to pursue litigation—should they wish to—may not be serving justice so much as administrative procedures.

Some Thoughts from Others

-

"*Equity's role within the courts 'is to prevent the law from adhering too rigidly to its own rules and principles when those rules and principles produce injustice'."* – Aristotle's *Ethics*, from Allan Beever's
Aristotle on Equity, Law, and Justice (Cambridge University Press, 2004)

-

"*When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." – Lynch v. United States*
, 22 U.S. at 579

-

Extortion – "The obtaining of property from another induced by wrongful use of actual or threatened force, violence, or fear, or *under the color of official right*." – Black's Law Dictionary 6th Ed.
(Emphasis added)

The Presumption of Good Faith

The current doctrine of the contract dispute appeal forums presumes government employees always act in good faith, a presumption that can only be overcome by "well nigh irrefragable proof" which, for obvious reasons, is nearly impossible to provide. Another legal practitioner wrote of this difficult hurdle, "[w]henever a contractor pleads a violation of good faith duties, DOJ [Department of Justice] argues that the allegation is essentially that the government acted in bad faith, which (they argue) requires ironclad proof of intentional misconduct targeted at the contractor, which is almost always impossible to demonstrate."[1]

The Contract Disputes Act (CDA) of 1978, codified at 41 U.S.C. 71, established the rules for pursuing claims against the Federal government. It is relatively prescriptive, as befits a limited waiver of sovereign immunity. Contractors must follow the rules exactly or risk having their claims dismissed by the courts. The CDA also provided remedies against fraudulent claims asserted by contractors. At 41 U.S.C. 7103(c)(2), the statute states:

(2) Liability of contractor.—If a contractor is unable to support any part of the contractor's claim and it is determined that the inability is attributable to a misrepresentation of fact or fraud by the contractor, then the contractor is liable to the Federal Government for an amount equal to the unsupported part of the claim plus all of the Federal Government's costs attributable to reviewing the unsupported part of the claim. Liability under this paragraph shall be determined within 6 years of the commission of the misrepresentation of fact or fraud.

Importantly, *no such provision exists with respect to claims first asserted by the Federal government* that require a contractor to appeal to an agency board or to the Court of Federal Claims. While the contractor's claim must be grounded in a good faith belief in its accuracy, any government claim is not subject to those same requirements.

What's good for the goose is emphatically not good for the gander.

Recent Board Decisions Viewed in Light of Equity

1.

Quimba Software

Quimba Software was a small, innovative, software development contractor that made the mistake of accepting a cost-reimbursement contract from the Department of Defense. Its treatment at the hands of the Court of Federal Claims (as affirmed by the Federal Circuit) is illustrative of how a company may run afoul of auditors, contracting officers and, ultimately, the courts.

The 2015 Gibson Dunn Year-End Government Contracts Litigation Update[2] discussed the Quimba situation thusly:

Quimba Software, Inc. entered into a cost-plus-fixed-fee contract with the Air Force. Co-owner Robert Dourandish signed the contract in his capacity as one of the company's officers. After the completion of contract performance, the Air Force disputed the allowability of certain costs, and the contracting officer issued a final decision seeking the recovery of approximately $92,000 from the contractor.

Quimba Software challenged the Government's claim in a lawsuit initiated in the Court of Federal Claims. Dourandish separately filed suit against the Air Force in the same venue in his individual capacity, alleging breach of contract and interference with his constitutional right to seek federal contracts. The Court of Federal Claims dismissed the Dourandish action for lack of subject matter jurisdiction. The Federal Circuit affirmed the dismissal on the basis that Dourandish, as an owner of Quimba Software, was not a party to the contract between the company and the Air Force. Therefore, the court had no jurisdiction under the Tucker Act to adjudicate his suit.

Meanwhile, at the ASBCA, Quimba's appeal of the contracting officer final decision was dismissed as being moot.[3] Quoting from the decision—

Following discovery in this appeal, the ACO rescinded the demand for repayment, and released the government claim. The government moves to dismiss the appeal as moot. Quimba opposes, arguing chiefly that the issue of government bad faith remains. …

Quimba's main argument is that, while the final audit report was issued in 2008, the government waited until December 2013, after expiration of the Contract Disputes Act statute of limitations, 41 U.S.C. § 7103(a)(4)(A), to issue the final decision. Quimba tells us that, '[i]n issuing the [final decision] after the expiration of [the statute of limitations], the Government deliberately, and with premeditation, is forcing frivolous and baseless litigation on Quimba since ... Quimba had no choice but to litigate - or accept an unjust determination'. Quimba adds that it is entitled to discovery to support its allegations of government bad faith.

The Board declined to permit Quimba to pursue discovery that it asserted would have supported

its bad faith argument, writing “While Quimba stresses that *Combat Support* ‘includes an exception for Bad Faith behavior’, there is no prima facie showing, and no evidence of such conduct, here. We again follow ‘the presumption, unrebutted here, that contracting officials act in good faith.’

But Quimba persevered. After six long years of battle, another judge at the Court of Federal Claims found that the government’s position, as established by contracting officer final decision and (revised) counter-claim for an additional $50,000, was erroneous. The Court found for Quimba on a Motion for Summary Judgment, writing that “This Court finds that the deferred compensation costs are deductible under section 404 of the IRC and its accompanying regulations, and therefore, allowable under FAR 31.205-6(b)(2)(i).”

The Court did not discuss the auditors’ role or contracting officer’s role in this debacle. As is almost always the case, the government actors were presumed to have acted in good faith. The quality of the government’s initial finding (and subsequent modification of that original finding during litigation to add another $50,000) was accepted as being made in good faith, despite Quimba’s assertion that discovery might prove otherwise.

Quimba’s eventual victory was small consolation to the firm’s founders. The company had declared bankruptcy long before.

At least Raytheon—one of the largest defense contractors in the world—had the resources to litigate without filing bankruptcy.

1.

Raytheon

A recent ASBCA decision[4] involved more than 100 pages of findings of fact and related decisions covering multiple areas of cost allowability and allocability. The short summary is that government auditors identified many questioned costs and those audit findings were sustained by several contracting officers—and Raytheon appealed.

The various contracting officers' final decisions seemed to virtually rubber-stamp questionable DCAA audit findings. And by "questionable" we mean: the audit procedures appeared to represent significant departures from GAGAS requirements. They seemed to lack much (if any) pretense of objectivity. Instead, they seemed to be speculative—we could say fictitious—findings intended to provide the contracting officer with ammunition to extract from Raytheon as much cash as possible. (As we will quote below, at points the auditors' testimony literally stated that.) Some of the audit findings were described by the Board as being speculations without supporting evidence; I would assert that was a charitable characterization.

For example, an auditor changed her findings from questioning a portion of Raytheon's government relations costs to questioning 100% of such costs. When questioned under oath, "[the auditor] based her ultimate conclusion that all of cost center 90206's costs should be disallowed on the fact that she did not find documentation 'either way' on whether the costs were allowable or not, or claimed or not."

In another example, Raytheon provided evidence to its contracting officer in support of the allowability of claimed patent costs; however, the contracting officer declined to review that information because of concerns about the looming statute of limitations. In other words, the contracting officer was more concerned about protecting the government's litigation position than getting to the right decision.

In another example, when explaining to the Board how DCAA developed its questioned cost position on premium airfares, the auditor stated "Because we were just trying to determine -- when we were doing the audit, we were just trying to determine a reasonable amount. We understand these are negotiations, so we were just trying to give the government some kind of platform to, kind of, base where they should start at."

In other words, the auditors viewed their role as providing government negotiators (and litigators) with "some kind of platform" on which to base a position. This is classic gamesmanship. Had the roles been reversed, and had Raytheon presented its claims based on such tactics, we would not be surprised to learn that it would be facing legal consequences. The Board of Appeals did not address the apparent lack of good faith in the government's positions.

Raytheon faced a choice, as all government contractors face in similar situations: they can try to

negotiate a lower amount (i.e., engage in horse-trading) or they can appeal. Appeals are expensive and can take years. At a minimum, Raytheon was required to pay its attorneys quite a bit of money (all unallowable) in order to prevail. At least Raytheon is a multi-billion-dollar entity with deep pockets—unlike Quimba Software.

1.

L3 Technologies

In March the ASBCA dismissed L3's appeal of several contracting officer final decisions that sought more than $11 million in various questioned direct and indirect costs.[5] While recognizing that L3 "has been to the Board quite often in recent years as a consequence of COFDs stemming from incurred cost audits" and that "none of these appeals has led to a decision on the merits" (because the contracting officer rescinded the COFDs during the litigation)—the Board continued to permit the government to engage in behavior that (from the view of a layperson) seems quite evocative of the term "extortion."

The dissenting opinion discussed the cycle of what might be characterized as extortive behavior, noting that—

In its opposition to DCMA's motion to dismiss, L3 summarizes similar audit disputes between L3 and DCAA/DCMA from 2006 through 2018.These disputes all followed a similar path: DCAA conducts Audits challenging costs, DCMA issues COFDs implementing the DCAA Audits and demanding repayment of the challenged costs, L3 appeals the COFDs to the Board and DCMA either withdraws the COFDs or the parties settle for a nuisance amount resulting in dismissal of the appeals with prejudice. The disputes involved in this decision followed a similar path but remain unresolved. There are several similar appeals that have been stayed pending resolution of the appeals in ASBCA Nos. 61811, 61813 and 61814.

The dissenting opinion was on the right course, but it fell short because it did not take the final leap to the right conclusion. L3 Technologies' appeal should have been heard in order to serve the principle of equity. The Board should have explored whether the DCAA and DCMA behaviors of repeating a wrongdoing until L3 gave up—essentially a war of attrition if not rising to the level of extortion—constituted bad faith.

The three examples above serve as warnings to companies considering entering the government contracting environment. Be advised: you are not partnering with your government customers. There is a chance that you may find yourself in the crosshairs of an auditor or a contracting officer. And if you take your case to the courts expecting justice, don't be surprised if you lose on a technicality.

[1] *A Twice-Told Tale: The Strangely Repeated Story of "Bad Faith" in Government Contracts* , Fredrick W. Claybrook, Jr., The National Quarterly Review of the United States Court of Appeals for the Federal Circuit (2014).

[2] https://www.gibsondunn.com/2015-year-end-government-contracts-litigation-update/

[3] ASBCA No. 59197, 5/13/2019. Citations omitted from all quotes.

[4] Raytheon Company and Raytheon Missile Systems, ASBCA Nos. 59435, 59436, 59437, 59438, 60056, 60057, 60058, 60059, 60060, 60061 (Feb. 2021). *Motion for Reconsideration denied.*

[5] L3 Technologies, ASBCA Nos. 61811, 61813, 61814, March 2, 2021. Internal citations omitted from quotes.