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## *Decisions*

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### **ASBCA Rejects Cost Claims That Are Not Allocable Or Supported By The Record**

*States Roofing Corp., ASBCA 55504, 2010 WL 337648 (Jan. 19, 2010)*

The Armed Services Board of Contract Appeals denied a contractor's claims for legal and accounting costs because they were either not reasonable and allocable or were not supported by the record. The ASBCA partially sustained the claim for labor costs.

Navy contractor States Roofing Corp. sought legal, accounting and in-house labor costs it allegedly incurred preparing its cost proposals. It asserted that the expenses were recoverable contract administration costs. See *Bill Strong Enters., Inc. v. Shannon*, 49 F.3d 1541 (Fed. Cir. 1995), overruled in part on other grounds, *Reflectone, Inc. v. Dalton*, 60 F.3d 1572, 1579 (Fed. Cir. 1995) (en banc). The Navy countered that the costs were not allowable because they were incurred in connection with the preparation and prosecution of States Roofing's claim. See Federal Acquisition Regulation 31.205-47.

**Background**—In August 2000, the Navy awarded States Roofing a contract for repairs and related work on roof cells at the Naval Operating Base, Norfolk, Va. The contract included FAR clauses 52.214-26, Audit and Records—Sealed Bidding, 52.233-1, Disputes, and 52.243-4, Changes. The ASBCA found that during contract performance, the Government issued unilateral contract modifications for which States Roofing submitted the requested cost proposals. None of the modifications were definitized by Nov. 6, 2001, the date of beneficial occupancy.

Through a Dec. 12, 2000 request for equitable adjustment (REA), States Roofing sought payment for installing parapet wall flashing. The Navy's Dec. 1, 2001 letter advised States Roofing that it found no merit in the REA, but stated that the rejection was not a contracting officer's final decision. States Roofing president Hugh DeLauney, legal counsel Neil Lowenstein, and accountant Susan Moser met with the Navy Dec. 12, 2001, to discuss the unsettled contract changes, including States Roofing's calculation of indirect cost rates. Moser summarized the background and status of States Roofing's indirect cost calculation by letter to the CO.

Twice in early 2002, DeLauney and Aubrey Etheridge, States Roofing's quality control manager, met with Navy representatives and negotiated a settlement of 24 of the pending changes, subject to a Defense Contract Audit Agency audit of States Roofing's indirect cost rates. Etheridge gave the Navy a list of the settled items, with the notation that the settled items did not include delay, disruption or time extensions.

There were subsequent settlement meetings in February and March 2002. Following the meetings, the Navy requested—and States Roofing provided—additional documentation. After further communications, States Roofing in June 2002 submitted a cost proposal in the revised amount of \$44,848 for its proposal preparation costs, including 600 labor hours for \$16,290, \$2,280 in legal fees for Dec. 6, 2001–April 30, 2002, and \$5,455 for accounting fees for June 1, 2001–Jan. 29, 2002. States Roofing did not explain the basis for the prorated allocations of the legal and accounting fees, the ASBCA said.

The Navy continued working to definitize the outstanding unilateral contract modifications and the REA items. On April 7, 2003, it sent States Roofing a modification definitizing earlier modifications and paying States Roofing for REA items for which entitlement had been found. Instead of signing the modification, States Roofing converted 67 of its 117 cost proposals, including the \$44,848 claim as item 66, into a certified Contract Disputes

Act claim, which the CO received April 21, 2003. The CO issued final decisions on States Roofing’s CDA claim in September 2004. Item 66 was among the claims she denied.

**DCAA Audit**—DCAA questioned the legal and accounting fees because it could not verify the prorated allocation amounts and because the costs were already included as general and administrative (G&A) overhead costs. States Roofing acknowledged that it typically includes legal and accounting fees as G&A expenses, and the audit found no evidence that the costs were separated from G&A costs.

DCAA also questioned some labor costs because States Roofing would recover the costs twice if the same costs were allowed as claim preparation costs and as labor costs for the period after Nov. 6, 2001, the beneficial occupancy date. DCAA found that States Roofing simply reallocated the post-beneficial occupancy labor costs to its proposal preparation claim, and could not verify that work was performed on the dates claimed.

DeLauney intended to reduce the total number of States Roofing’s hours claimed by five percent to reflect other work being performed, but Moser’s revised claim did not include this adjustment. Considering DeLauney’s testimony, Moser adjusted the revised claim during the hearing to reflect a five-percent reduction in States Roofing’s in-house labor hours, reducing the total to 574.3 hours for \$13,571.

**ASBCA Analysis**—States Roofing personnel, including its counsel and accountant, met many times with the Navy from December 2001–June 2002, to resolve the outstanding unilateral contract modifications and States Roofing’s REA cost proposals. States Roofing provided the Navy with additional information as requested, the Board found.

Under *Bill Strong*, costs incurred for the “genuine purpose of materially furthering the negotiation process” should be viewed as contract administration costs because the underlying policy of resolving disputes by negotiation benefits the Government. Thus, the claimed legal and accounting fees and in-house labor costs should be classified as contract administration costs, the ASBCA added.

*Bill Strong* held that contract administration costs are “presumptively allowable if they are also reasonable and allocable.” Here, the Board found that “not all the claimed costs are recoverable either because they are not reasonable and allocable or are not supported by the record.” According to the

ASBCA, (a) States Roofing “did not explain the basis for its prorated allocations” for legal and accounting fees, (b) “there appear to be errors associated with the allocations,” (c) the fees typically are included as G&A expenses and recovered in a home office overhead rate, and (d) States Roofing acknowledged that the requested fees should have been but were not transferred from its G&A pool to the contract as direct costs. Thus, awarding the requested fees would amount to a double recovery, the ASBCA said.

States Roofing’s claim of legal and accounting costs as direct costs “is not consistent with its established practice of treating these costs as indirect costs,” the ASBCA concluded.

**Labor Costs**—States Roofing submitted 117 cost proposals to the Navy. But the Board found the evidence insufficient to find entitlement to all of the in-house labor costs claimed:

Indeed, even DeLauney recognized that not all of the time listed on the summary time schedule for these employees was devoted to cost proposal activities. But, he reduced the claimed amount by only five percent, explaining broadly that the reduction was meant to reflect other, unidentified, work being performed during that time period.

The Navy argued that States Roofing did not prove that all of the claimed costs were attributable to the preparation of its proposals or that the five-percent reduction was accurate and reasonable. However, the record contained sufficient evidence to award States Roofing some of the costs under *Bill Strong*. The Board concluded that States Roofing was entitled to recover \$5,000 as the reasonable and allowable costs of in-house labor for proposal preparation and contract administration.

◆ **Practitioner’s Comment**—The Board’s decision in *States Roofing* is an important reminder of the potential pitfalls contractors face when seeking to recover legal and accounting and in-house labor costs incurred in the preparation and negotiation of an REA.

As an initial matter, *States Roofing* reaffirms that under *Bill Strong*, legal and accounting and in-house labor costs incurred for the “genuine purpose of materially furthering the negotiation process” are contract administration costs, and are therefore “presumptively allowable if they are also reasonable and allocable.” 49 F.3d 1549–50. As illustrated in *States Roofing*, the Board examines the “objective

reason why the contractor incurred the cost[s]” to determine whether they are contract administration costs or are incidental to the prosecution of a claim. *Id.* at 1550.

Here, despite the CO’s letter advising States Roofing that the CO found no merit in the REA and several rounds of negotiations and exchanges of supporting documentation, the Board found that States Roofing and the Navy were at all relevant times engaged in a collaborative effort to resolve the contractor’s outstanding cost proposals. The Board viewed the parties’ willingness to continue to meet and share information as evidence that the costs should be classified as contract administration costs.

*States Roofing* also demonstrates that the Government will resist the recovery of such costs, even if relatively minor amounts are at issue. For example, the Navy argued in *States Roofing* that the use of the word “claim” by counsel to describe his Feb. 11, 2002 discussions with the Government established that the negotiations had reached an impasse. Although the Board rejected this contention because “there were significant further discussions and submissions of information” after that date, contractors and counsel should nonetheless be cautious in describing their negotiation efforts in documents such as e-mails, time descriptions and invoices. See, e.g., *Chem-Care Co.*, ASBCA 53614, 06-2 BCA ¶ 33427 (rejecting contractor’s claim for legal fees where counsel’s invoices used the term “claim” to describe the work he had completed). The Board also rejected the Navy’s argument that the accounting fees incurred in connection with DCAA’s audit were not recoverable because States Roofing should have anticipated incurring such costs under the audit clause, FAR 52.214-26. The Board explained that the audit clause “only relates to the contracting officer’s right to examine and audit a contractor’s records and has no application to the recovery of allowable contract administration costs under *Bill Strong*.”

Perhaps most importantly, *States Roofing* reinforces the lesson that even though a contractor’s legal and accounting and in-house labor costs can be allowable under *Bill Strong*, they are not recoverable unless they are also reasonable, allocable and supported by the record.

In *States Roofing*, the Board denied recovery of legal and accounting fees for several reasons, including the contractor’s failure to adequately explain the basis for its “prorated allocation” of costs, errors in its

calculations and its failure to allocate claimed costs consistent with its normal accounting practices. In addition, the Board granted only partial recovery of the in-house labor costs because the contractor provided “insufficient evidence” to support entitlement to all of the claimed costs. In that regard, *States Roofing* illustrates that contractors must adequately explain both the basis for the amount of their claimed costs, and their methodology for allocating the costs to the contract administration effort. This decision also underscores the fact that a contractor’s ability to do so largely depends on the records it keeps during contract administration.

As in *States Roofing*, many contractors likely will find it difficult to isolate retrospectively, and therefore prove, the amount of their allowable contract administration costs in the absence of contemporaneous records that can be used to support a claim. Therefore, best practices dictate that contractors should maintain a system to segregate, track and document legal and accounting and in-house labor costs that are incurred during the preparation and negotiation of cost proposals to the Government. Such a system could be as simple as adopting a policy requiring employees, outside counsel and accountants to provide more precise time descriptions and keep more detailed records of their work so that contract administration costs can be identified at a later date. Although the sophistication and complexity of a contractor’s system will invariably depend on the breadth and nature of the work, *States Roofing* makes clear that contractors who rely solely on after-the-fact attempts to explain the basis and allocation of their contract administration costs run the risk that they will not be able to prove entitlement in the event of a dispute.

Finally, *States Roofing* demonstrates the paramount importance of complying with the well-settled rule that “[c]osts incurred for the same purpose in like circumstances” must be classified consistently as either direct or indirect costs, but not as both. See *Def. Supply Sys., Inc.*, ASBCA 54494, 05-2 BCA ¶ 33031 at 163707-08, *aff’d*, 188 Fed. Appx. 995 (Fed. Cir. 2006); see also FAR 31.202(a). Here, the contractor claimed its legal and accounting fees as direct costs, even though it typically included these costs in its G&A expenses and recovered them in its home office overhead rate. Not surprisingly, the Board denied recovery, in part, because the contractor’s claim violated the requirement to treat like costs consistently. Moreover, the Board held that permitting recovery

of such costs would amount to a double recovery because the contractor failed to properly transfer the requested fees from its G&A pool to the contract as direct costs. Had States Roofing removed these legal and accounting costs from its indirect cost pool for direct charging, it might have been able to recover them as long as similar costs incurred for the same purpose were also removed from the G&A pool. See, e.g., *Granite-Groves (JV)*, ENGBCA 5674, 93-1 BCA ¶ 25475 (FAR does not prohibit practice of transferring costs from an indirect cost pool to a direct charge for an REA provided other similar costs incurred for the same purpose are treated consistently).

Although the majority of the contractor's claim in *States Roofing* was denied, the decision is nonetheless an important reminder that even though a contractor's legal and accounting and in-house labor costs can be allowable contract administration costs under *Bill Strong*, they are not recoverable unless they are also reasonable, allocable and supported by the record.



***This PRACTITIONER'S COMMENT was written for THE GOVERNMENT CONTRACTOR by Elizabeth A. Ferrell, a partner, and Alejandro L. Sarria, an associate, in the Government Contracts Practice Group of McKenna Long & Aldridge LLP in Washington, D.C.***