A recent ASBCA decision (No. 58081, 2 December 2016) in the appeal of Kellogg Brown & Root Services, Inc. (KBR) of a contracting officer's final decision (COFD) disallowing $14.7 million in KBR's claimed subcontractor costs shows the pitfalls of issuing time and materials (T&M) subcontracts. It also shows how to defeat certain government arguments attacking claimed costs related to those T&M subcontracts.

KBR was issued a cost-plus-award-fee (CPAF) ID/IQ contract that "required KBR to provide the supervision, equipment, materials, labor, travel, and all means necessary to provide an immediate response for civilian construction contract capability in response to natural disasters or similar events." Under its contract, KBR responded to several huge natural disasters in the Southern United States, including Hurricane Katrina, Hurricane Ivan, Hurricane Rita, and other related efforts. As part of its efforts, KBR issued several T&M subcontracts.

We have written before that a prime contractor should think twice before issuing T&M subcontracts, because of all the administrative requirements that go into proper subcontractor management of that contract type. We recently wrote: "At this point, if a prime is going to be issuing a T&M subcontract, there had better be a compelling business reason. Because if there is no compelling business reason then it would seem to be a really bad idea." In this case, though, KBR seemed to have a compelling business reason for use of that subcontract type. The scope of work was simply too fluid to use a firm, fixed-price, type and the size (and maturity) of the subcontractors tended to preclude use of a pure cost-reimbursement type.

We don't like T&M subcontracts because DCAA likes to poke holes in them, particularly with respect to initial reasonableness of subcontract pricing and also with respect to whether the personnel performing the work properly fit into the labor categories in which they are being billed. In KBR's case, DCAA initiated Form 1 disallowances and made other audit findings (many of which were sustained by the contracting officer) that proved our point. The disallowances were so large and pervasive that, in June 2009, the Navy customer simply stopped paying all KBR invoices and making the required award fee determinations to which KBR was entitled under the contract.

DCAA questioned (and disallowed) KBR's subcontractor costs using the following rationales, many of which applied to the same subcontractor:

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Subcontractor markup applied to hourly labor rates and equipment, because that created a prohibited cost-plus-percentage-of-cost subcontract type.

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Subcontractor pricing was unreasonable.

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Unreasonable and/or unallowable costs built-into subcontractors' fixed hourly billing rates.

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Subcontractors billing lower-tier subcontractor costs as material (with markup) instead of labor, which would have been via fixed hourly rates (without markup).

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Unsupported third-tier subcontractor costs (certified payrolls were required to be submitted).

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Subcontractor billed labor hours that did not match the subcontractors' certified payroll records.

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Subcontractor invoice math errors related to labor adjustments (the contract work moved from Davis-Bacon Act applicable to nothing to Davis-Bacon Act applicable to Service Contract Act applicable).

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Subcontractor Other Direct Costs (ODCs) and associated markup, because reasons.

The ASBCA decision discusses those points and, in the main, refutes them. The vast majority of questioned (and disallowed) costs was found to have been properly billed by KBR. The decision did not discuss the fairness of simply not paying invoices for nearly eight years but, given the fact that the COFD was rejected in nearly all respects, we have to ask whether that reflected well on the Navy and its administrative team. The lesson here, for government folks, may be that ringing the alarm bell over a DCAA audit report is not always warranted. In fact, COs are required to be independent adjudicators of disputes between DCAA and contractors. (But we digress.)

The decision is worth going into because many of the points raised by DCAA (and sustained by the CO) in KBR's contract are points that are frequently raised. Thus, the decision gives us all some ammunition we can use to refute those points the next time they are raised. We are not going to cover all issues raised and decided in the decision; instead, we are going to focus on the ones that seem to us to be the most important.

1. A T&M subcontract with additional markups (on either side of the T&M equation) is an illegal cost-plus-percentage-of-cost (CPPC) subcontract . *No, it's not.* Citing to *Urban Data Systems* (699 F.2d 1147, Fed Circuit, 1983), Judge D'Alessandris, writing for the Board, found that "A contract is a cost-plus-a-percentage-of-cost contract when (1) payment is on a predetermined percentage rate; (2) the predetermined rate is applied to actual performance costs; (3) the contractor's entitlement is uncertain at the time of contracting; and (4) the contractor's entitlement increases directly with an increase in performance costs." He found that the additional markup applied by KBR's subcontractors to their T&M billings did not equate to a CPPC subcontract because the markups were not applied to actual costs; instead, they were applied to the fixed hourly billing rates. Thus, the second factor or prong of the four-part test was not satisfied. Even where a markup was applied to the reimbursable "M" side of the T&M contract, the contract was still not a CPPC type because it still had fixed hourly billing rates on the "T" side.
This is a critical finding and readers need to remember it.
Essentially, so long as any aspect of a subcontract is not billed at actual costs, it is very difficult to find that the subcontract is a CPPC type.

2. When the government asserts that subcontractor pricing is unreasonable, the burden of proof is on the contractor to prove it is reasonable . *Well, not exactly.* Citing to another KBR decision at the Federal Circuit level, Judge D'Alessandris quoted ""the standard for assessing reasonableness is flexible, allowing [the Board] to consider many fact-intensive and context-specific factors.'" Thus, even though the burden of proof was on KBR, its arguments as to why the pricing was reasonable were persuasive. For example, with respect to one subcontractor (Environment Chemical Corporation), DCAA alleged that KBR awarded the

subcontract to the highest of three bidders without justification and that KBR did not solicit bids from qualified competitors that had lower rates. In the COFD, the CO determined that ECC's labor rates were reasonable compared to its competitors but still questioned some of the claimed labor costs. According to the decision, "KBR … presented direct evidence that ECC' s bid of $68 per hour was the best value because the other two offerors did not submit fully burdened labor rates as requested by KBR, and also because the rates, when adjusted for the additional overhead items disclosed in the bids by the other offerors, were higher than ECC's rate or close to the ECC rate with other overhead items still not accounted for." Thus, the rates were found to be reasonable. Period.

3. The government can question unallowable and/or unreasonable costs within the fixed hourly billing rate . *No, they can't.* Back to ECC. The COFD asserted (based on the DCAA audit findings) that ECC's fixed hourly billing rates contained unallowable and/or unallocable and unreasonable costs, including such items as an allocation of unallowable/unallocable "management airfare" and lodging costs that were already reflected in the hourly billing rates. Judge D'Alessandris disposed of those assertions, finding that the FAR cost principles did not apply to the fixed-price hourly billing rates. He wrote "FAR 31.205 pertains to the allowability of selected costs for cost-type contracts. FAR 3l.204(b)(1) provides that costs in that FAR part are allowable for cost-reimbursement, fixed-price incentive, and price redeterminable contracts. As ECC had a fixed-price, time-and-materials contract, these cost allowability provisions are inapplicable and we find for KBR with regard to the $0.15 per hour management airfare issue. … ECC submitted a fixed-price fully burdened bid, and the final decision does not question the fixed hourly rate. *How ECC internally apportions that hourly rate is irrelevant to the Navy, as the Navy is reimbursing at a fixed hourly rate of $68 per hour* ." (Emphasis added.)

4. Math errors in the reconciliations supporting subcontractor invoices, without further support, indicate unallowable costs . *Wrong again*. One subcontractor had to repropose its hourly billing rates as its efforts flipped in and out of Davis-Bacon Act and Service Contract Act coverage. There were other contract changes going on as well. KBR kept a spreadsheet of all the changes and, according to DCAA, it was rife with math errors. The COFD cited to DCAA's audit finding without any further support. The decision states "On cross-examination, the DCAA auditor … testified that he had not attempted to seek more information from KBR regarding the calculations in the spreadsheet. He also conceded that if the explanations [provided by KBR about the changes] were correct, then there were no math errors in the spreadsheet. [He] further testified that if the rates used the in the spreadsheet were appropriate, there would be no basis for questioning BE&K's costs." (Internal citation omitted.)

5. Failure to submit certified payrolls to support invoices results in unallowable subcontractor costs . *Nope.* That's not correct either. KBR paid 75% of a subcontractor's invoice but

withheld 25% percent because the subcontractor failed to submit certified payrolls to establish compliance with Davis-Bacon Act requirements. Naturally, the COFD asserted that the 75% paid was unallowable because it was unreasonable for KBR to have paid the subcontractor anything at all. For its part KBR asserted that "it was unreasonable for the Navy to disallow the FSS invoice amount in its entirety, especially because KBR had already reduced the invoiced amount by 25%." Key to KBR's argument was that the work had been actually performed. Judge D'Alessandris wrote "The DCAA audit and the final decision denied payment based solely upon the failure to provide the certified payroll information, and the disallowance was not based on any finding that the payroll information provided, although not in the correct format, was inaccurate. Under these circumstances, we hold that the Navy improperly denied any payment of the invoice; however, there is a quantum issue to determine the appropriate amount of withholding. Here the contracting officer denied 100% of the amount invoiced, which already reflected a 25% discount from FSS' invoice. Pursuant to the Board's holding in *Acme,*
the withholding must be a 'reasonable' amount. The reasonable amount is a quantum issue to be remanded to the parties."

This decision is complex, with more than 250 separate findings of fact. We have attempted to summarize the aspects of the decision that we found potentially impactful to our readers. There were other aspects that we could have discussed but then this article would have approached the 56 page length of the decision! For those seeking more insight, we suggest you read the entire decision, once the ASBCA website returns to functionality.

Hat Tip to ERMan for sending us the decision via email. Much appreciated!