Honestly, we cannot give better advice than “read your contract.”

Read it before you ask questions. Read it before you get into an argument with your customer.

Read the contract.

You want to know when title passes to your customer so that you can claim revenue?

You want to know whether you can justifiably invoice for pre-contract or post-Period of Performance costs?

You want to know whether a cost can be justifiably claimed in an invoice?

The answer to all those questions—*and more*—starts with reading the contract.

What does it say?

You would be amazed at the number of people who don’t read their contracts. You might be similarly surprised at the number of people who think a consultant can give good advice without first knowing what the contract says.

Everything starts with the contract—and many things end with the contract as well.

As a good example of what we’re talking about, let’s look at a **recent decision** at the U.S.

Court of Federal Claims, written by Judge Horn. Normally we wouldn't discuss the decision, because it involves a dispute between the State of California and the Department of Interior (DOI). The DOI awarded the California State Controller's Office (SCO) a cooperative agreement but then refused to reimburse the SCO for $296.5K in invoiced costs allegedly incurred pursuant to that agreement, because the costs were not allowable under the terms of the agreement.

California sued the DOI, claiming breach of contract. As Judge Horn wrote—

Part 6.4 of the Agreement governed 'Payment of Reimbursable Costs.' Under Part 6.4(B), the DOI was responsible for reimbursing the SCO 'for approved costs incurred under this Agreement in accordance with 43 CFR 12(A) Administrative and Audit Requirements and Cost Principles for Assistance Programs.' At the time the parties entered into the Agreement in September 2010, 43 C.F.R. Subpart 12(A) prescribed the administrative requirements and cost principles for grants and cooperative agreements entered into by the DOI. … The regulation at 43 C.F.R. § 12.2 (2010) indicated that a cooperative agreement with a state is subject to several Office of Management and Budget (OMB) Circulars, including OMB Circular A-87, which established principles and standards for determining costs incurred under grants, cost-reimbursement contracts, and other agreements with state, local, and Indian tribal governments. … Additionally, Part 8 of the Agreement, titled 'Standard Award Terms and Conditions,' stated that '[a]wards are based on the application submitted to, and as approved by DOI, and are subject to the terms and conditions incorporated either directly or by reference in the following: . . . 43 C.F.R. 12(A) . . . 43 C.F.R. 12(C). . . '

In addition—

The Agreement at Part 6.5(C) stated, "[f]ringe benefits shall be allowed in accordance with the State's established accounting system." Pursuant to Part 6.5(D) of the Agreement, "[o]verhead rates shall be allowed in accordance with the State's established audited accounting system." Part 7.1(D), however, required that the SCO "maintain complete cost records for the Agreement period in accordance with the Generally Accepted Accounting Principles (GAAP). Such records shall be in sufficient detail to clearly demonstrate the total actual costs associated with the project . . . ."

Using methodology that had been documented in the California State Administrative Manual (SAM) for more than 30 years, California calculated a single hourly rate for each of its

employees working on the cooperative agreement. That single hourly rate “merged an employee’s salary, fringe benefits, and indirect costs” together.

Some unnamed DOI entity issued an “Attestation Report” that asserted that California’s methodology led to an overstatement of incurred costs. The State of California disagreed, stating that DOI “has no contractual authority to dictate California’s polices and accounting practices and control. The Department of Interior cannot require the State to develop a costly separate accounting of its federal royalty program.”

In other words, the State of California was simply using its accounting system—the same accounting system that it had in place for 30 years. The DOI contract that imposed cost allowability principles and standards could not require California to change its accounting system.

(Sound familiar? This is exactly what is required of any business that wants to accept a cost-reimbursement government contract.)

From what we can tell, the problem was, fundamentally, the way the CA SCO calculated the quantity of direct labor hours. If the parties could have agreed on that issue, they may well have been able to resolve the application of indirect rates to the resulting direct labor dollars. However, the DOI asserted that “that every hour billed after reaching the ‘actual working hours’ of 144 causes an overstatement of costs.” The problem seemed to be that some of the “excess” hours were how California recovered some of its employee fringe benefit costs. (It’s complicated because California also applied a separate fringe benefits percentage.)

Before the Court of Federal Claims, both parties filed Motions for Summary Judgment, asserting that there was no genuine dispute as to any material fact and the prevailing party would be entitled to judgment as a matter of law. In this case, the parties differed with respect to their interpretations of the contract language. In essence, they were asking the Court to interpret the contract for them.

As Judge Horn wrote—

In its motion for summary judgment, defendant [DOI] argues that OMB Circular A-87 applies to the Agreement because Part 6.4 and Part 8 of the Agreement expressly incorporated by reference 43 C.F.R. Subpart 12(A), which incorporated by reference OMB Circular A-87. … plaintiff [CA SCO], in its cross-motion for summary judgment, simply asserts … that it was entitled to calculate fringe benefits and indirect costs in accordance with California's State Administrative Manual, and that the DOI incorrectly 'required California to use OMB's method of accounting for costs.' In its filings, the plaintiff concludes that it is 'entitled to summary judgment under the specific language of § 6.5.C of the Agreement,' which plaintiff believes is 'clear, unambiguous and dispositive.'

Thus, Judge Horn needed to decide which of the parties' interpretation was correct. In issuing the Court's decision, Judge Horn quoted from many precedents. We're going to quote some of those, as follows:

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"Contract interpretation starts with the language of the contract."

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"The starting point for any contract interpretation is the plain language of the agreement."

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"In contract interpretation, the plain and unambiguous meaning of a written agreement controls."

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"Terms must be given their plain meaning if the language of the contract is clear and unambiguous."

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“In addition, we must interpret the contract in a manner that gives meaning to all of its provisions and makes sense. Further, business contracts must be construed with business sense, as they naturally would be understood by intelligent men of affairs.”

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“A reasonable interpretation must assure that no contract provision is made inconsistent, superfluous, or redundant.”

Judge Horn concluded that the contract language was not ambiguous. She wrote—

The plaintiff [CA SCO] should have calculated its fringe benefits and indirect costs in accordance with 43 C.F.R. Subpart 12(A), including the OMB Circular A-87, and, permissibly, California’s State Administrative Manual. Part 6.4(B) of the Agreement provided that the DOI would reimburse the SCO in accordance with 43 C.F.R. Subpart 12(A) … and Part 8 … also indicated that the Agreement was subject to the provisions of 43 C.F.R. Subpart 12(A). Thus, the Agreement unambiguously incorporated 43 C.F.R. Subpart 12(A) into the Agreement by making several explicit references to ‘43 CFR 12(A).’ … With the exception of the regulations specifically pertaining to fringe benefits and overhead rates, the administrative regulations and cost principles prescribed in OMB Circular A-87, however, still applied to the SCO’s requests for reimbursement, even if the SCO chose to bill utilizing California’s State Administrative Manual. … When the SCO opted to use the accounting system contained in California’s State Administrative Manual, the DOI was required to reimburse the SCO for its costs, only if those costs met the requirements for reimbursement contained in both California’s State Administrative Manual and OMB Circular A-87.

In other words, the State of California should have read its contract.