Over in California's 2nd District Court of the State Court of Appeal, the Parsons-Dillingham joint venture was recently handed a significant victory in its long-running False Claims Act battle with the Los Angeles County Metropolitan Transit Authority (MTA). In a couple of unpublished opinions, the finding of the Superior Court that the joint venture was liable under the FCA for billing unallowable indirect costs was reversed, and the defendants were awarded attorney fees. Since at one point the joint venture was on the hook for perhaps as much as $93 million, this is indeed a significant victory.

The Parsons-Dillingham joint venture was awarded its "original contract" for Red Line construction in 1984, but the contract was amended in 1991 to add "segment two" to the project. The Court referred to the post-1991 contract as "the Amended Contract," since the 1991 amendment added additional contract language that affected cost recovery. (In 1993 another amendment added "segment three" to the project, but that did not seem to affect the parties' rights.)

Suits were filed against the joint venture in 1996 and 1997, based on post-1991 billings, but it was not until 2014 that the Superior Court found liability—"approximately $30 million for improperly billed general and administrative costs (G&A) and overhead charges, $25 million for unauthorized subcontractor overhead charges and $38 million in prejudgment interest." It took another four years for that finding to be reversed. In summary, we are talking about some 22 years of litigation.

Judge Perlus, writing for the Court, summarized the cost recovery requirements thusly—

Pursuant to Article CP-3.A. of the amended contract Parsons was entitled to its 'Recoverable Costs,' defined as, '(i) allowable direct labor costs ('Direct Labor,' as defined below), (ii) associated allowable Indirect Costs (also referred to herein as 'Overhead' or 'Overhead Costs') in an amount stated as a percentage (the 'Overage Rate') of the appropriate component of Direct Labor, (iii) costs of subcontracts, and (iv) other direct charges ('ODCs') necessarily and reasonably required in the performance of this Contract. . . .' The provision defining Recoverable Costs continues, '[N]o costs or expenses incurred by [Parsons] as a result of [Parsons's] failure to comply with terms and conditions of this Contract shall constitute Recoverable Costs.' It also states, 'All Recoverable Costs must be reasonably incurred by [Parsons] exclusively in connection with the performance of the Services subsequent to the date of this Contract. Except where explicitly stated to the contrary in this Contract, Chapter 1, Subpart 31.2 of the FARs [(Federal Acquisition Regulations)] shall be used to determine whether a given cost item is an element of Recoverable Cost.'

(Internal footnote omitted.)

The original dispute alleged that Parsons had failed to adjust its provisional billing rates to actual rates, and that it had billed MTA for unallowable costs. The MTA unilaterally established final billing rates, and Parsons filed a cross-complaint, alleging (among other things) breach of contract.

In analyzing the contract language, the Superior Court found that there was an "exclusivity clause"—i.e., that only costs that were exclusively incurred by Parsons in performance of the project were recoverable in MTA billings. Looking at the FAR definitions of indirect cost, general & administrative expense, allocability and allowabilty, the Superior Court concluded that overhead and G&A expenses were allocable to the project but had been made unallowable by the "exclusivity clause" language. The Appellate Court disagreed, writing—

The key language of the so-called exclusivity provision—'reasonably incurred . . . exclusively in connection with the performance of the Services subsequent to the date of this Contract'—properly (and literally) read, is not a disallowance of reasonably allocated indirect costs, including G&A, incurred in performing the amended contract, but a temporal limitation, requiring Parsons to charge direct costs and allocate indirect costs incurred before the May 1, 1991 effective date of the amended contract to the base contract in effect since 1984.That is, only those expenses for work done after April 30, 1991 on MOS-1 and MOS-2—direct labor, associated allowable indirect costs, subcontract costs and other direct charges—were recoverable under the terms and conditions of the new amended contract. No indirect cost pool to be allocated to the amended contract could include elements, including G&A, that predated May 1, 1991. … although G&A is recognized as a recoverable cost under the FAR and was billed by Parsons and paid by MTA under the base contract without dispute, nothing in the amended contract explicitly disallowed continued recovery of this major cost item as the amended contract required if FAR subpart 31.2 was not to be followed to determine recoverable costs and as the parties did, for example, for facilities costs, a far less significant item. Whatever else may be said about the 'exclusivity clause,' it does not explicitly prohibit the recovery of G&A.

There was more to the dispute, and much more to the Appellate Court's opinion. But that's not the point of this article. The point is: state and local contracts can be risky. Some of those contracts are funded with Federal dollars; many reference FAR cost allowability requirements. Contractors that bucket such contracts into lower risk categories, because they are not prime contracts directly with a Federal agency or because they are not subcontracts issued under a Federal prime contract, are making a mistake. State and local contracts carry risks, and some of those risks are substantial.

We are reminded of the 2012 SAIC settlement with respect to allegations made about corrupt decisions on SAIC's "City Time" project—a project with the City of New York. The company's Statement of Responsibility, made as part of its settlement agreement with the Department of Justice, stated "Those responsible for directly managing the project failed to enforce the company's procurement policies in ways that allowed the irregular [subcontract] relationship to continue." As a result of the project's failure to comply with company policies, the company was required to pay more than $500 million.

We are fairly confident in saying, six years later, that the SAIC management team at the time wished it had classified its New York City project as high risk and applied the appropriate level of scrutiny. $500 million can pay for a heckuva lot of scrutiny.

In addition to regulatory risks, some state and local contracts can be inartfully drafted, as individuals who lack Federal government acquisition experience attempt to mimic the contract language used by Federal government acquisition professionals. (Example: Using the acronym "FARs" when the correct term is "FAR".) Just because the contract language references or invokes Federal regulations does not mean that the language will be interpreted in the same way as a Federal Court would, should a dispute arise.

All in all—and as we've written before—it's important to accurately assess your contract risks so that you can manage them. Focusing solely on Federal contracts and subcontracts, and ignoring contracts with state and local governments, will likely lead to some problems. In extreme cases, you can be looking at more than 20 years of litigation.