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An old legal adage says that “bad cases make bad law”. By this we take it that bad rulings make hard compliance. A recent ASBCA ruling on a motion for reconsideration in the **appeal of SRI International** (ASBCA No. 56353, issued October 5, 2011) is a good exemplar of what we mean.

SRI International’s original appeal to the Board under the Contract Disputes Act concerned the allowability of Letter of Credit (LOC) fees over a two-year period. The Board **found** that the costs were allowable. As the Board decided—

When the government disallows costs on the basis of a FAR cost principle, the burden is on the government to prove that the costs are unallowable. … In disallowing SRI's LOC costs … the government relies solely on FAR 31.205-20. In pertinent part, this cost principle disallows ‘costs of financing...capital.’ ’Capital’ is defined to mean ‘net worth plus long-term liabilities.’ … SRI has treated all of the $25 million worth of bond debt… as a part of its ‘Current liabilities.’ ... Thus, even though the … Bonds have a maturity date of 2028, from an accounting standpoint, SRI's financing of its renovation project has actually been, and is, raising capital in the short-term, not long-term.

The government has not challenged as inappropriate SRI's treatment of the full amount of its long-term bond debt as a part of its ‘Current liabilities.’ It has not explained why FAR 31.205-20 disallowing the cost of financing—which specifically defines capital as ‘long-term liabilities’—is applicable in view of that treatment. We conclude that FAR 31.205-20 is inapplicable to disallow the fees SRI paid for the LOC required to secure its long-term bond debt in the short-term (one year).

So that would be the end of the matter, with the Board finding that SRI’s Letter of Credit fees to be an allowable indirect expense, but for the government’s motion for reconsideration.

In its motion, the government did not challenge the Board’s ruling that SRI’s LOC costs were allowable; instead, the government asked the Board “to clarify the portion of the decision that could be interpreted as making a lump sum monetary award plus interest.”

In its original ruling, the Board stated, “…this appeal is sustained in the amount of $609,621 with interest pursuant to 41 U.S.C. § 611 running from the putative receipt date of 21 September 2007.” The Board’s direction contradicted an agreement struck between SRI and the government while the decision was pending. That agreement called for the following –

The parties agree that the overhead rates established by this Agreement include disputed costs. In order to expedite the settlement of these rates and factors, these costs have been provisionally allowed. If ASBCA concurs with the Contracting Officer's Final Decision (COFD) finding the costs unallowable, the Contractor agrees to make separate payment to the Government of the amount of G&A expenses overpaid by the Government, plus interest, under the contracts subject to this Agreement by reason of the cited noncompliance. If the contractor prevails in the aforementioned ASBCA case, it is agreed that no adjustments to the rates established by the Final Overhead Agreement for SRI International's FY 2005 shall be made.

The government's concern was that the Board's direction "could be interpreted as awarding SRI 'a lump sum payment … with interest …' as opposed to allowing SRI to 'recover the LOC costs as part of the final overhead rate settlement process …'." According to the Board, the government contended that, "the exact amount SRI will recover under all the affected contracts may not necessarily be $609,621" and, as a result, SRI might "recover more money than it is entitled to recover under the affected contracts."

For its part, SRI told the Board that it agreed that it was not entitled to a lump-sum payment with respect to the previously disallowed LOC fees. However, SRI contended that it was entitled to a lump-sum payment for interest as computed by the Contract Disputes Act.

The Board explained that—

To be clear, what our decision holds is that the LOC costs SRI incurred in FYs 05 and 06 are allowable indirect costs, and SRI is therefore entitled to include the LOC costs in its indirect G&A cost pool for those years. This, however, is not the end of the process. As envisioned in the Allowable Cost and Payment clause and FAR 42.705-1, the allowable LOC costs for FYs 05 and 06 still have to be allocated to the affected contracts and be scrutinized against the terms of those contracts before the actual amount of allowable LOC costs under each affected contract may be determined. Thus, the final indirect cost rate establishment process must run its course.

The Board quoted its decision in ATK Launch Systems and the Court of Federal Claims' 2007 decision in ATK Thiokol v. US, stating—

The consequence of an award of monetary damages in this case is only that the award will be included in the G&A pool applicable to the affected contracts. … To the extent that the court's award implicates cost ceilings, incentive provisions or other clauses of particular contracts, the DACO, not the court, will make any necessary interim adjustments. … Ultimately, a final indirect

cost rate and the final amount due under each contract will be established by the DACO, reconciling any payments that have been paid out on an interim basis, including any damages awarded by the court.

The Board rejected the government's argument that CDA interest cannot be awarded in this case because "until such time as SRI submits its completion vouchers for FY 2005 and FY 2006, the Government's contractual obligation to make final payments for the allowable indirect costs does not arise." Instead, the Board decided that "the amount found due is the total amount of LOC costs … and paid pursuant to FAR 52.216-7(h) as a consequence of our decision." Moreover, "the CDA interest on the FYs 05 and 06 LOC costs due SRI will be computed from [the date SRI filed its CDA claim] and run until paid under each affected contract…."

The Board's ruling makes good legal sense. It is also ridiculous.

Under the Board's logic, SRI is entitled to interest on its CDA claim, but that interest needs to be computed as follows:

1.

Determine how much LOC costs for FYs 2005 and 2006 were allocated to individual contracts.

2.

Determine which contracts can recover those costs. For example, firm fixed-price contracts do not permit recovery of any increased contractor costs.

3.

For contracts that do permit cost recovery, determine how much can be recovered, contract by contract. For example, if recovery of the additional costs puts the price above the amount of funding available, then the contractor cannot recover.

4.

For contracts that permit recovery, prepare and submit final vouchers.

5.

Determine the date on which the government pays the final vouchers.

6.

CDA interest is the amount determined to be recoverable in Step 3, applied to the period between the date the claim was submitted and the date the final voucher was paid.

The Board's decision is impractical and, hopefully, the parties will figure out a way around it.

First of all, the very definition of G&A assumes that there is no individual beneficial or causal relationship between an element of the G&A expense pool and an individual final cost objective (contract). See FAR 31.201-4(c). It is literally impossible, from a government contract cost accounting viewpoint, to determine how much of the LOC costs (as individual cost items) would be allocated to any particular contract. If such a relationship could be determined, then the LOC costs should not have been included in SRI's G&A expense pool.

Second, to have to calculate interest due on a contract-by-contract basis is infeasible and borders on the absurd. SRI will have to wait until its FY 2006 indirect costs are audited and negotiated. As we all know, that could take years. Then it will have to submit final completion invoices and determine when the government pays those vouchers. Then it will have to submit another request for payment (to the DOD Judgment Fund, we assume) and wait for that payment to be made.

Such an approach, we believe, eviscerates the intent of the Contract Disputes Act. Instead of acknowledging the time value of funds lost through an erroneous Contracting Officer's Final Decision, the methodology outlined above might actually end up costing SRI more to implement than it obtains in CDA interest payments.

It seems to us that a much more workable solution would have been to allow SRI to include the LOC costs in its G&A expense pool but have the government issue a lump-sum payment for CDA interest, based on the ratio of cost input in the cost-reimbursement (and perhaps T&M) contract types to the total G&A allocation base, times an agreed-upon duration. Have the government cut SRI a single check for interest only, and let that be the end of it.

The ASBCA did a good job with respect to the determination of cost allowability. But it did a poor job with respect to understanding how government contract administration works. This decision, if followed literally, will result in a burdensome and expensive solution to what was an easily negotiated solution.

As we said in the beginning, "bad cases make bad law". And bad rulings make hard compliance.