

## Proposal Preparation Costs for Change Orders and Claims

Written by Nick Sanders

Thursday, 27 September 2012 00:00

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Astute readers may have noticed that we've recently spent significant verbiage discussing the Contracting Officer Final Decision and how the CoFD factors in to making claims against the Government, and they may have wondered why. We have nothing to say, and can neither confirm nor deny. (\*\* *Whistles innocently* \*\*)

Here's more of the same.

Recently, the Court of Appeals, Federal Circuit, issued [an opinion](#) in the matter of *Tip Top Construction v. Donahoe, Postmaster General*

. The opinion discussed a number of issues that are of interest and relevance, including whether change order proposal preparation costs should be treated as direct or indirect costs, whether a contract clause can create mutual agreement between the contracting parties regarding the allowability of proposal preparation costs, whether the cost of outside consultants and attorneys can be recovered in the price of a change order, and how such costs should be supported.

Here's the story as we understand it—keeping in mind that we are not attorneys and you should obtain legal advice from competent counsel if you are dealing with these issues.

Tip Top Construction received an ID/IQ type contract from the U.S. Postal Service, in which work to be performed would be issued via Work Order. The process of issuing a Work Order

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included: (1) a Joint Scope Meeting, (2) preparation of a Detailed Scope of Work, (3) submission of a firm fixed-price proposal in response to the Detailed Scope of Work, (4) acceptance of the proposed price, and (5) issuance of the Work Order at the accepted price. The contract contained a clause that prohibited recovery of proposal preparation costs, stating “The contractor shall not recover any costs arising out of or related to the development of the work order including but not limited to the costs to review the Detailed Scope of Work or prepare a Price Proposal Package . . . .” In addition, the contract contained a Changes clause worded very much like the same FAR contract clause (52.243-1).

Pursuant to the foregoing, the USPS issued a Work Order (valued at \$229.7K) to Tip Top to replace the air conditioning system at the Main Post Office on an island in the Virgin Islands. During performance, an issue arose regarding the type of refrigerant to be used in the replacement system. Ultimately, the USPS directed Tip Top to use the refrigerant type it wanted (with an associated change in the type of equipment) and to submit a proposal for the additional cost of the changed work. The value of Tip Top’s change order proposal was \$28,838. The USPS directed Tip Top to proceed with the changed work, “for a price to be determined later but not to exceed \$28,838.43.”

For the next nine months, “Tip Top and the Postal Service discussed pricing of the changed work.” That is to say, the parties spent nine months and an unknown number of hours discussing less than \$30,000. And yet, after nine months, there was no agreement and nobody got fired. It’s a wonderful world, right? Now we understand why the USPS is losing so much money.

According to the Appellate decision—

The critical issue in the negotiations was whether Tip Top was entitled to recover the costs it incurred in preparing the \$28,838.43 estimate that Mr. Diaz [Tip Top’s outside consultant] submitted to Mr. Morales [the USPS Construction Manager] on October 18, 2009.

During that nine month period, the USPS Contracting Officer sought guidance from his superiors on the sticking point, asking, “If one of our JOC Contractor firms hires a firm to do their cost estimating for proposals and modifications is the cost . . . considered an overhead charge or does it become a direct or indirect billable cost?” The answer received was that “The cost is an overhead charge and not a billable cost.”

By this time, Tip Top had retained outside counsel to assist in negotiations and its bills were

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mounting. Finally, at the end of nine months, it submitted a claim under the Contract Disputes Act for \$34,553.77. As the Court noted, the claim was comprised of—

... (i) Tip Top's subcontractor's price for the change (in the amount of \$18,757.43, plus 10% profit, 4% insurance, and 4% gross receipts tax, for a subtotal of \$22,133.77); (ii) \$9,655 for 'Preparation Costs & Extended Overhead'; and (iii) \$2,745 for 'Legal Fees.'

So now we have to modify our previous statement. We can see that the parties spent nine months and an unknown number labor hours discussing *less than \$10,000*. And there was no agreement and nobody got fired. And now there was a formal claim, to boot. And the price of your postage was just increased, and now you understand why.

The USPS Contracting Officer issued a Final Decision, granting an equitable adjustment in the amount of \$22,133.77, but denied the remainder of the claim, on the grounds that (1) recovery of proposal preparation costs was prohibited by the contract clause, and (2) it was unreasonable for Tip Top to spend \$6,705 to prepare a change order valued at \$22,100. On appeal to the Postal Service Board of Contract Appeals (PSBCA), Tip Top was granted an additional \$2,565 for costs it paid to its outside consultant (Mr. Diaz) for the period ending October 15, 2009 (which is the date on which the USPS accepted Tip Top's proposal "for a price to be determined later ....")

Notably, the PSBCA ruled that the contract clause in question did not bar recovery of change order proposal preparation fees. As the Court of Appeals (Federal Circuit) wrote—

The Postal Service had urged that the provision in Contract Clause B.309 barred recovery of the costs Tip Top sought. The Board rejected this argument. The Board stated that Clause B.309 did not apply to Tip Top's claim because the clause only barred recovery of contractor costs incurred in reviewing a Detailed Scope of Work. This, the Board stated, was 'a process exclusive to award of the original work order.' ... The Board continued that it was the changes clause of the contract that governed Tip Top's claim for an equitable adjustment resulting from the Postal Service's change order. The Board ruled that Tip Top had met the requirements for recovery under this clause as far as the \$2,565 in costs relating to Mr. Diaz's work prior to October 15, 2009 were concerned. The Board stated that the costs were compensable because they represented 'an increase in [Tip Top's] direct cost of performance due to the change.'

Thus, the PSBCA clearly ruled that the costs of preparing the change order proposal were allowable direct costs pursuant to the contract's Changes clause. However, the PSBCA did not grant Tip Top the remainder of its claim, which consisted of "Mr. Diaz's fees and overhead costs after October 15, 2009 until he left the job in March of 2010 [and] legal fees ... for work

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done during the period April 21 through June 8, 2010.” The PSBCA denied Tip Top recovery of these costs because—

... the negotiations between Tip Top and the Postal Service after October 15, 2009, relating to recovery of Tip Top’s estimating costs, which resulted in work by Mr. Diaz and outside counsel, ‘had nothing to do with performance of the changed work or genuine contract administration and were solely directed at trying to convince the contracting officer to accept [Tip Top’s] figure for the change and maximizing [Tip Top’s] monetary recovery.’ ... The Board concluded: ‘[O]nce the substitute equipment was approved, nothing remained to be negotiated except the price. There is no evidence that the parties’ negotiations addressed an extended delivery schedule or any other changes to contract performance requirements.’

...

The Board also found that Tip Top had not adequately documented Mr. Diaz’s charges, stating, ‘As the consultant likely was working on other project matters, it was incumbent upon [Tip Top] to identify hours, if any, spent on the equipment change issue, and it has not done so.’

Tip Top appealed the PSBCA decision to the Court of Appeals (Federal Circuit), who had this to say—

The question is whether costs arising from negotiations relating to the price of the changed work are recoverable in this case because they constituted part of the increased costs arising from the change directed by the Postal Service. ... In short, both the PSBCA and the government take the position that reasonable contract administration costs arising in the setting of a change order are recoverable. We do not disagree. It seems to us proper that if a change order requires a contractor to incur contract administration costs, those costs are recoverable to the extent they are reasonable. Thus, the dispute depends on whether the costs are classified as general contract administration costs or claim preparation costs. ...

In our view, both the costs of Mr. Diaz’s work between October 15, 2009, and March 8, 2010, and counsel’s fees through June 8, 2010, were incurred ‘for the genuine purpose of materially furthering the negotiation process.’ [Citing *Bill Strong*, 49 F.3d at 1550.] ... Only on June 18, 2010, did negotiations finally end when Tip Top submitted its claim under the CDA. Simply because the negotiations related to the price of the change does not serve to remove the associated costs from the realm of negotiation and genuine contract administration costs. Consideration of price is a legitimate part of the change order process. In holding otherwise, the Board, we believe, erred.

The Appellate Court also found that there was sufficient evidence that the costs being claimed by Tip Top were incurred for the purposes stated. Tip Top was entitled to the additional \$9,835 it had sought, plus interest on its claim pursuant to the CDA.

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So, readers, it took an Appellate Court to decide a quantum of less than \$10,000—a quantum that should have been quickly negotiated and settled by the USPS Contracting Officer. Instead, the \$10,000 remained a matter of dispute for nine months, and was a matter of litigation for more than two years. And to our knowledge, nobody got fired.

And the Postal Service is losing money by the bucketful while cutting back service and raising the price of postage. And now you understand why.