As consultants to a diverse group of government contractors, we frequently find ourselves in the position of having to explain requirements associated with various solicitation provisions and contract clauses. Our readers know, of course, that there is a host of provisions and clauses with which to comply, each with individual requirements. Some of them are fairly well known and most everybody has a fair idea of their basic compliance requirements; but others are less well understood and tend to fall towards the bottom of the compliance checklist.

The Limitation of Cost (LoC) and Limitation of Funds (LoF) clauses are two of the latter set. They're insidious little clauses, because they seem so straight-forward and yet shift risk in subtle and far-reaching ways. A **write-up** of the clauses from the law firm of Watkins Meegan is entitled, "Two FAR Clauses that Are Sometimes Overlooked," and, indeed, the clauses are often overlooked or ignored.

Let's be clear: Contractors ignore the LoC/LoF clause requirements at their own peril.

The two clauses go together because they basically have the same set of requirements. The LoF clause (52.230-21) pertains to cost-type contracts that are incrementally funded, and the LoC clause (52.230-20) pertains to cost-type contracts that have been fully funded. Essentially, the clauses act to limit contractors' ability to seek reimbursement for otherwise allowable costs they've incurred on their cost-type contracts.

It seems counter-intuitive that contractors would be limited in the amount of costs they could recover from their government customers. After all, doesn't the fact that the contract is a "cost-type" mean that all allowable costs will be reimbursed? It's the fixed-price contract types that have ceilings on contractor costs. Cost-type contracts are supposed to be low risk because they don't have any such ceilings. The contractor incurs costs and, if they're allowable, then the government reimburses them. How can cost-type contracts have cost limits?

We've heard that position being espoused many times over the years, and it's wrong. The LoC/LoF clauses are what make that position wrong. The two clauses establish limits on recoverable costs incurred on cost-type contracts. It's more than that, actually. The clauses require advance notification of expenditures *before* they reach certain prescribed limits. If the contractor fails to comply—and comply *exa* *ctly* —with the clause requirements, then the government has the right to refuse to pay allowable costs incurred for the contract if they exceed the specified ceiling. By failing to comply with the LoC/LoF clause requirements, the contractor has essentially converted its cost-type contract into a firm, fixed-price contract. That's *really* not a good thing.

We've noted it in this blog when contractors run afoul of the clause requirements. For example, in **this story** we wrote about a hapless contractor that "had failed to comply with the administrative requirements of the Limitation of Cost clause and thus no increase to the contract value would be forthcoming," but we've never really focused on the matter. We remedy that oversight today.

We're going to assume that you, the reader, are going to mosey over to a FAR site and check out the exact wording of the clauses. We're going to assume that you are going to actually *read your contracts* and make sure you understand what your contract clauses require of you. Thus, we are not going to recapitulate the standard FAR clause language here. It's your responsibility to figure out what you need to do, not ours.

Unless you want to hire us. In which case, let us know how we can assist you!

Instead of reciting the clause language, we are going to focus on a recent decision over at the Armed Service Board of Contract Appeals (ASBCA) in which Boeing **l earned the hard way** about the requirements associated with the LoF clause. Note: this is *Boeing* we're talking about—one of the largest defense contractors in the USA. So if Boeing hasn't figured out the clause requirements with respect to all of its defense programs, you may rest assured that the answer is far from obvious. Here is an opportunity to learn along with Boeing, and for a very small fraction of the company's cost.

Let us set the stage for you.

Boeing had a cost-plus-award-fee (CPAF) engineering services contract, awarded by the US Air Force. The contract was a Task Order type, meaning that the government would issue orders for certain amounts of services from time to time. Crucially, the contract was “incrementally funded”—meaning that the government would dole out certain amounts of funding from time to time. The contract period of performance encompassed one base year and nine (9) option years.

One Task (Contract Mod 112) was an engineering assignment for Boeing to design, develop, fabricate, install, test and FAA certify a Global Air Traffic Management System for 3 KC-10 aircraft. (That Task was called "the KC-10 GATM assignment".) The specified total estimated cost-plus-award-fee for the assignment was $79,250,000. The specified completion date for the assignment was 30 April 2003. Contract Mod 112 also increased the obligated (allotted) funds in the contract Schedule to a total amount of $133,123,763.97.

The thing about cost-type contracts is that they don’t always go as planned. If the parties could foresee every eventuality, they likely would not use a cost-type contract format. The KC-10 GATM assignment did not seem to go as planned. On 7 January 2002, bilateral Mod 179 increased the total estimated cost-plus-award-fee of the KC-10 GATM assignment to $97,477,602.00 and extended the period of performance to 31 March 2004. On 11 August 2003, Boeing reported to the government that the GATM assignment would not be completed until 31 March 2005 (a two-year delay) and that it was willing to enter into "a Cost Share Arrangement” so as to complete the Task.

A month later (10 September 2003), Boeing and the government “agreed in principle” that the KC-10 GATM assignment would be continued on a cost-reimbursable basis "upon agreement of a new EAC [estimate at completion] and schedule between Boeing and the Government". On 24 September 2003, Boeing provided the government with a schedule showing completion of the assignment on 30 September 2005 (note another six month delay) and an estimated cost at completion of $154.7 million (a cost-growth of roughly $57 million against the original budget of $97.5 million).

As you might suspect, the Air Force customer was not thrilled with the state of affairs. Indeed, although the customer provided some additional funding, it was not as much as Boeing forecasted it would need. On 15 October 2003, Modification 220 increased the total estimated cost-plus-award-fee for the KC-10 GATM assignment to “only” $107,309,826 and extended its performance time to 31 March 2005. A couple of more Mods increased the available funding to $121,603,858—still significantly below the amount Boeing had told the Air Force it would need. Apparently, that was as much funding as the Air Force was willing to provide to Boeing.

After roughly three months of negotiation, on 10 March 2004, the Contracting Officer issued a Stop-Work Order to Boeing. A couple of weeks later, he issued a Termination for Convenience Notice, terminating the KC-10 GATM assignment.

(Familiarity with the T4C process is going to be assumed. If you feel as if you need some background reading, try **this piece** .)

In response to the T4C Notice, Boeing terminated its subcontract with Honeywell. A few months later, Honeywell submitted its Termination Settlement Proposal (TSP) and asked Boeing for $22,100,059. Boeing looked at that request and then notified its Termination Contracting Officer (TCO) that it would need as much as $154 million to pay off various supplier claims and settle its own situation. (Funny how that amount was really, really, close to the $154.7 million it had told it customer it would need to finish the assignment.) The TCO replied to Boeing's notification as follows—

It is rare that the TCO requests additional funds to be added to the terminated cost type contracts. There are, at times, the PCO may have reason(s) to add additional funds to the terminated cost type contracts. However, the Government, usually, will stand by the 'Limitation of Funds' clause. Per your funding status, we only have $4,719,870.15 remaining in the contract.

Apparently in denial over its financial situation, Boeing came back with another request for more funds, to which the TCO replied—

I have discussed with you before in that this contract is a cost type contract, and the 'Limitation of Funds' clause does apply; therefore, no additional funds will be requested. The amount remaining in the contract is it. As discussed earlier, if for some reason the PCO wants to obligate more funds to the contract, he can do so.

Boeing continued to act as if it were ignorant of its precarious financial position, going so far as to submit a "Settlement ROM Proposal" in which it asked for $37.1 million in additional funds. The government did not deign to reply to that request.

Meanwhile, Boeing and Honeywell settled for $10.8 million (roughly 50 cents on the dollar). The Honeywell settlement figure was included in Boeing's certified TSP, which was audited by DCAA. DCAA "questioned all but $182,185 of the $10.8 million settlement," and the TCO refused to approve it. On 3 August 2010, the TCO issued a final decision denying ratification of all but $280,294 of the $10,800,000 Honeywell settlement agreement. The final decision was based "primarily on cost allowance [allowability?] and cost allocation grounds, but also invoked the LoF clause as a bar to recovery of any amount that would exceed the funds allotted to the KC-10 GATM assignment."

Boeing appealed that TCO final decision to the ASBCA.

Judge Freeman first found that the LoF clause applied to the total contract funding and not to the funding of individual Task Orders. This is an important finding because it contradicts other decisions in which each Task Order was found to be a separate contract. (See, for example, **this article**.) However, Judge Freeman reasoned that the government intended the LoF clause to apply to the entire contract as a whole because there was another contract clause (H-841) that also covered funding allocated to individual Task assignments, and he need to interpret the contract has a whole, giving meaning to all clauses. Readers interested in that aspect of the decision are invited to go read it (page 8).

However, the rest of the decision did not go Boeing's way.

Judge Freeman found that the Government never promised to increase contract funds to the level sought by Boeing. Importantly, the Judge found that there had been no agreement on the EAC or the performance schedule. Furthermore, the Judge didn't agree with Boeing's argument that, by terminating the contract when it was in an overrun condition, the Government waived the LoF requirements. He wrote—

Boeing had notice that the government considered the LOF clause to be applicable to the termination settlements eight months before it concluded the Honeywell settlement agreement. Boeing also knew, or is chargeable with knowing, the terms of the LOF clause, the amount of the allotted funding in the contract and the amount of its incurred costs in performing the contract. Subparagraphs (f) and (h) of the LOF clause expressly provided that Boeing was not obligated to incur, and the government was not obligated to reimburse, any costs of performing the contract, including termination activities, that would exceed the allotted funding in the contract. *If Boeing did incur termination costs in excess of the allotted funding, it was a volunteer and did so for its own account.*

In other words, Boeing should have included potential subcontract termination liability in its “incurred” costs when reporting pursuant to its LoF clause requirements. When that calculated number approached the funding amount provided by its USAF customer, it should have stopped work. Because Boeing exhausted the funding before subcontractor termination settlement liability was incurred, it was not able to have its subcontractor settlements reimbursed, even though it had received a Termination for Convenience.

This is a great lesson on how the two little understood clauses (Limitation of Cost and Limitation of Funds) turn out to be critically important when a contractor wants the government customer to fund an overrun on a cost-type contract.

Do not ignore the Loc/LoF clause requirements.