Pool over base equals rate.

It's really that simple.

It's just math.

Elementary school division, to be precise.

You take your indirect cost pool and you divide it by the amount of dollars in the allocation base, and you get an indirect rate. Then you multiply the amount of allocation base charged to your contract by the indirect rate, and you get the amount of indirect costs allocated to your contract.

Nothing could be easier.

But some people over at the Department of Energy have a problem with that math.

We're talking about the appeal of CH2M-WG Idaho, LLC (CWI), before the Civilian Board of Contract Appeals (CBCA), as documented in **a decision** published by the CBCA in September, 2017. By way of background, CWI was awarded a $2.5 billion contract by DOE (known as the Idaho Cleanup Project). The parties disagreed on how much incentive fee CWI had earned and CWI appealed the contracting officer's final decision. CWI was seeking $27.4 million in lost incentive fees plus $6.0 million in lost "safe units"—which were essentially incentive compensation paid to CWI employees. (There was another matter but that's the topic for another article.) In sum, CWI was looking for the CBCA to award it roughly $33.4 million plus interest.

And the CBCA obliged.

The case was postured as a matter of contract interpretation—and it was—but what it really was was an argument over math. DOE officials didn't like how the math allowed CWI to earn "extra" incentive fee and so they tried to reform the contract by unilaterally changing how the incentive fee was to be calculated. The changed the incentive fee formula after the fact; *i.e.*, after CWI had already performed the work and the contract was essentially complete.

It was clear that DOE's attempt to reform the contract after the fact bothered the CBCA. As it should have.

But let's talk about the math.

When DOE issued the RFP for the Idaho Cleanup Project, it told bidders what to bid on—and, critically, what not to bid on. As Judge Sheridan, writing for the Board, noted, "The work set forth in the SOW was referred to as the 'target work.' The selected contractor would be paid its costs to perform the target work, including indirect costs such as G&A costs, as well as an incentive fee, provided certain cost measures were met." The scoped work became known as "B.4 work." In addition, the RFP also discussed "potential non-target work" that might be awarded to the winning contractor. That additional work became known as "B.5 work." The contract's target cost and associated incentive fee was based solely—*by DOE direction*—on the B.4 work. Any B.5 work would be awarded separately, and would be performed on a CPFF basis.

Thus, the contract was bifurcated. There was contractually scoped, estimated, work to be performed on a CPIF basis and there was non-scoped, non-estimated, work that would be performed on a CPFF basis, to the extent it was awarded at all.

All that being said, almost immediately after contract award, DOE began discussing with CWI the award and administration of B.5 work. An early project baseline reflected that the B.5 work might be valued at $51 million in direct costs, plus an additional $39.3 in G&A expenses that would be allocated to that non-target work. According to the CBCA decision, at that time “CWI informed DOE that because it maintained only a single G&A pool it was reallocating $39,288,999 of G&A out of the target work into the non-target work to cover the B.5 non-target work G&A costs.”

Because that’s how the math worked.

If you have a single G&A pool that covers two types of work (in this case B.4 and B.5 work), you have to calculate the G&A expense rate based on the *total amount of work actually incurred*, not just the work the parties initially estimated. Further, as both types of work incur costs, the G&A expense pool must be allocated to the costs in both categories.

It’s not a manual thing. It’s not (necessarily) an adjusting journal entry or some type of accounting jiggery-pokery done by bean-counters wearing green eyeshades.

It’s just math.

It’s the difference between estimated billing rates and actual billing rates. Estimated billing rates are what you expect; actual billing rates are what you end up with. (See the contract clause 52.216-7, Allowable Cost and Payment, for more details.)

As the contract progressed, CWI would provide DOE with an annual estimate of B.5 non-target work and used that estimate to develop estimated billing rates. From Judge Sheridan—

CWI applied agreed upon forward pricing rates for purposes of estimating its G&A expenses. The rates used were compliant with the regulatory requirements of the CAS, incorporated into the contract, and consistent with CWI's established and disclosed accounting practices. [The B.5] work was ordered and priced on a CPFF basis, based on full application of G&A costs to that work.

As the contract progressed, it became obvious that the B.5 non-target work was "was exceeding what DOE initially anticipated." Which is interesting, right? That statement implies that DOE knew there would be some amount of non-target work awarded at the time of the RFP, but directed the offerors not to bid that work into their pricing. The result of that initial direction was to inflate the offeror's proposed prices, since they were bidding on lower-than-expected costs.

The rationale for that initial direction was not ever provided to the Board, to our knowledge.

Finally, more than two years into contract performance, DOE woke up and realized that allocation of G&A from B.4 target work to B.5 non-target work meant that CWI's costs for the B.4 work—which was subject to the incentive fee provision—was going to be lower than the parties had initially agreed upon. Consequently, CWI was going to receive an incentive fee that was larger than DOE considered to be fair.

Starting in November, 2007, DOE and CWI personnel engaged in discussions about DOE's concerns. The parties' positions were succinctly explained in an internal DOE letter, which stated—

Consistent with its disclosure statement, CWI applies G&A to all work including B.5 at the same provisional rate. As a result, the base upon which CWI's G&A is applied is increased, the G&A rate [is] lowered and the ICP Target portion of the G&A cost is reduced. The reduced Target share of the G&A cost benefits CWI under the CPIF Contract terms improving its variance. CWI contends that this benefit is inherent in the contract structure and no adjustment is necessary. DOE believes CWI is being unfairly rewarded under the G&A structure and is proposing a reduction in the final ICP Target fee earnings to account for the fee attributable to the B.5 G&A application above that included in the LCB.

DOE's position evolved to the point where it was not allowing CWI to propose G&A expense on

the B.5 non-target work it wanted CWI to perform, unless CWI could show (to DOE's satisfaction) that the additional non-target work was causing CWI to incur additional G&A expenses. (Which is *crazy* since, by definition, G&A expenses are not attributable to any specific final cost objective. But that's where DOE's denial of the math took it.) In addition, DOE refused to negotiate fixed fee associated with the estimated G&A expenses that would be allocated to that work. The decision quotes an internal 2011 DOE email as saying—

We tried to work this issue out a couple of years ago and ran into a stalemate. The decision at the time was this would be one of the final contract negotiation items that resulted in it being tabled. ... In my opinion, their draft proposal is miles away from what the government position should be on this . . . . I would recommend that CWI needs to demonstration [*sic*] why the increase in B.5 work caused a linear increase in indirect costs consistent with their indirect cost % of total cost.

The entire issue was "deferred"—which in our view is a shorthand way of saying the parties couldn't resolve it and were hoping they would all retire before it became a show-stopper. In other words, they declined to do the jobs that the taxpayers were paying them to do, because the jobs involved math and were otherwise too hard for them. What makes things worse, from our point of view, is that the drivers of the controversy seemed to be the DOE Finance folks, who didn't possess a certificate of appointment (warrant) as Contracting Officers, but who seemed to think their objections should be listened to by the people who did possess contractual authority. And the Contracting Officers, who were charged with resolving issues of controversy arising under their contract before they turned into messy—and expensive!—litigation, did nothing in the face of the concerns expressed by the DOE Finance folks.

For years.

Our rather forceful opinion above was echoed, albeit with more restraint, by the Board. Judge Sheridan wrote—

Throughout contract performance, various DOE offices responsible for analyzing the G&A allocation issue (DOE-ID, DOE budget, and DOE finance) seemed to be consistently revisiting the issue but unable to reach any DOE consensus about what to do about it. Instead of timely negotiating a solution to the G&A allocation issue, DOE-ID decided to defer the issue until the end of performance.

Nobody did anything for years, even though they all knew that the issue was out there. The can was kicked down the street in the vain hope that it might be resolved through magic, or through osmosis, or through any means other than rolling-up shirtsleeves and dealing with it. The situation went on for years and the people whose job it was to resolve it … didn't.

Yet nobody was demoted for incompetence or dereliction of duty, to our knowledge.

Just like nobody was demoted or otherwise censured for trying to rewrite Cost Accounting Standard 410 because they didn't like the result.

Meanwhile, in 2009 the American Reinvestment and Recovery Act (ARRA) added more than $400 million in additional funding to the Idaho Cleanup Project. Of that amount, $118 million was added to B.4 target work and $287 was added to B.5 non-target work. Obviously the additional ARRA work just made the bad situation worse, from DOE's viewpoint, because now there was *a lot* of CWI G&A being allocated to the B.5 non-target work.

Yet the G&A allocation issue was left unresolved and allowed to fester.

While all this was happening, DOE's position continued to evolve. In 2012, DOE told CWI that they weren't disputing the allocation of G&A expense (probably because there was no way for them to do so) but, instead, they were disputing the interpretation of the incentive fee contract clause that would allow CWI to share in the cost-savings associated with a reduced allocation of G&A to the B.4 target work. The DOE Contracting Officer told CWI that "DOE will not pay cost incentive fee for simple cost allocation actions when no cost savings occurred."

Sure. And the earth is flat and the moon landings were faked and chemtrails are real things. In other words, DOE was denying reality. DOE was denying that the math, combined with the contract structure and contract terms that it had initially insisted on, resulted in CWI getting more profit than DOE felt it should be entitled to receive.

The contract was physically completed on September 30, 2012—and the G&A allocation issues had still not been resolved. Finally—

On July 2, 2013, CO Mitchell-Williams submitted a proposed bilateral modification to CWI, which included a downward adjustment to CWI's target cost and target fee for target work based on the G&A costs allocated to B.5 non-target work. DOE proposed to reduce CWI's target costs by $85,229,025 and target fee by $6,272,856 based on the G&A costs allocated to B.5 non-target work. Citing the contract's Changes clause (FAR 52.243-2) and the Incentive Fee clause (FAR 52.216-10) as authority for its proposed adjustment, DOE warned that it 'would issue a unilateral modification, followed by a final fee determination' if CWI failed to agree to the bilateral adjustment. DOE also sought to reduce CWI's target cost and target fee based on certain fringe costs allocated to B.5 non-target work. CWI responded to DOE's letter on July 8, 2013, disagreeing with DOE's position and refusing to execute the proposed modification.

DOE issued the unilateral mod and CWI submitted a claim in March, 2014. The DOE CO issued a final decision in May, 2014, and CWI appealed to the CBCA.

In deciding the issue for CWI, Judge Sheridan and the Board made some key statements. Among them—

First, that the contract's Changes clause did not give DOE the right to unilaterally change the contract to reduce target cost and fee. The Changes clause does not give the government "an unfettered right to change any and every clause in the contract." Specifically, the Board found that the Changes clause does not give the government the right to change the contract's payment terms. Judge Sheridan wrote—

The Changes clause applicable to this contract does not provide DOE the right to unilaterally change the contract to adjust payments between the target and non-target work as a means of correcting the B.5 G&A allocation issue. DOE may issue unilateral changes only for the contract's description of services to be performed, time of performance (i.e., hours of the day, days of the week, etc.), and place of performance of the services.

Second, that the contract's Incentive fee clause did not give DOE the right to unilaterally adjust

target costs and fee, absent a modification that added or deleted contract work. Judge Sheridan wrote—

A plain reading of the clause allows a contracting officer to adjust the target cost and target fee when work under the contract is increased or decreased by modification. The Incentive Fee clause we are interpreting here does not allow a contracting officer to *unilaterally* move costs from one category of work (non-target work) to another (target work) to affect what DOE views as an inequity resulting from CWI's allocation of G&A from target work to non-target work. Furthermore, the contract's Incentive Fee clause, upon which DOE relies, does not apply to the non-target work from which DOE seeks to shift costs.

…The target cost and target fee specified in the schedule were established entirely independently from and without consideration of the B.5 non-target work, at DOE direction and by DOE design. The FAR 52.216-10 clause permits adjustments to the target cost and target fee 'specified in the Schedule' and, accordingly, does not permit adjustments for either the addition or deletion of B.5 non-target work that was never included in the schedule's target cost and target fee per the parties' agreement. DOE's decision to order, or not to order, non-target work did not change CWI's existing obligations associated with the separate and distinct target work and cannot serve as a basis to unilaterally reprice the target work.

(Emphasis in original.)

Third, that DOE waited too long "at its own peril" to address the issue, "both because it was not an issue DOE was contractually allowed to address unilaterally, and because, by the time DOE decided to address the issue, CWI's position on an equitable adjustment for the G&A allocation issue had changed." Judge Sheridan added—

It appears from the record that DOE-ID hoped the issue would simply resolve itself, but other DOE entities persisted in revisiting the G&A allocation issue. The record is devoid of any consistent DOE analysis on the issue, and it seems that DOE-ID was content in deferring until the very end of the contract the decision of whether and how a contract adjustment might be calculated. When ultimately the final fee determination and modification 260 were issued, CWI disagreed on the adjustment and took a hard line, arguing that DOE was not entitled to the unilateral adjustment under the terms of the contract. DOE, while presenting equitable arguments, has provided no compelling legal basis to support its unilateral actions.

Judgment for CWI, at least on the first two issues. We'll discuss the third issue in another article.

Finally, we are reminded of the CAS Board's Restatement of Objectives, Policies and Concepts. (That's a document from the prehistoric days before the internet that you basically cannot locate anymore—which is a pity.) In that document, the CAS Board reiterated its view that it considered a Cost Accounting Standard to be fair when it showed neither bias nor prejudice to either contracting party. The CAS Board went on to say that "in any given case, the results of contract pricing may ultimately be regarded as fair or unfair by either or both parties to the contract because, on a case-by-case basis, fairness is viewed from the personal vantage point of the particular party."

Obviously, DOE felt the application of CAS 410 resulted in an unfair incentive fee calculation for CWI. But the application of CAS 410 to DOE's contract with CWI was not something within the control of either party. Further, once CAS 410 defined the G&A expense pool and the chosen allocation base, then the rest was math.

Just math.