

A photograph of the U.S. Capitol building in Washington, D.C., with its iconic dome and classical architecture. The building is reflected in a pool of water in the foreground. The image is split diagonally, with the top-left portion being white and the bottom-right portion being dark grey.

NAVIGATING REA'S AND CLAIMS

REQUESTS FOR EQUITABLE ADJUSTMENTS
(REA'S) AND CLAIMS

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With You Today



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Learning Objectives



- ▶ Understand the REA and Claim Process
- ▶ Discover best practices and industry specific guidance
- ▶ Examine pricing methodologies

Agenda for Today



Request for Equitable Adjustments



Introduction to Claims



Pricing Methodologies



Termination for Convenience

Request for Equitable Adjustment



Introduction to REA

At its core, any REA begins with the terms of the contract:

The government reserves rights to unilaterally take certain actions, and agrees that it will pay the contractor fair / equitable compensation and/or make other changes to terms and conditions to keep the contractor whole

- ▶ The government reserves rights via standard contract clauses (e.g.):
 - Changes - Fixed Price, FAR 52.243-1
 - Changes - Cost Reimbursement, FAR 52.243-2
 - Changes and Changed Conditions, FAR 52.243-5
 - Differing Site Conditions, FAR 52.236-2
 - Suspension of Work, FAR 52.242-14
 - Government Property, FAR 52.245-1
- ▶ The government action or order can be formal/written, and the order can be constructive
- ▶ Contractors generally must perform, subject to an REA and/or claim under the disputes clause

REA Entitlement Theories/Issues

SOME COMMON ENTITLEMENT THEORIES

- ▶ Formal change, but inability to reach agreement on value
- ▶ Differing site conditions
- ▶ Government caused delay
- ▶ Stop work orders

COMMON CONSTRUCTIVE CHANGES

- ▶ Contract misinterpretation by government
- ▶ Defective specifications
- ▶ Governmental interference/failure to cooperate
- ▶ Failure to disclose vital information (superior knowledge)
- ▶ Constructive acceleration

Notification



- ▶ Notification Obligations
 - Formal change: within 30 days of receipt of written change order (though may not be strictly construed, unless government is prejudiced)
 - Note the potential applicability of FAR 52.243-7
 - May shorten the notice period and increase the amount and type of information that must be submitted
- ▶ Best practices for dealing with orders from individuals other than the contracting officer
 - Look to the written notice criteria in FAR 52.243-4(b) & FAR 52.243-7
 - Ensure that the notice includes all the material facts with respect to the direction and seek written confirmation from the contracting officer as to how to proceed

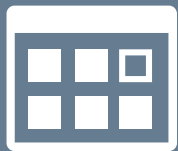
Contents of an REA

Approach REAs with the end game in mind but the goal is a negotiated settlement:



REA Outline

- ▶ Executive summary
- ▶ Factual background
- ▶ Grounds for entitlement
- ▶ Quantum/Relief requested (can be quite complicated)



Relief Requested

- ▶ Schedule (time to complete work)
- ▶ Contract price/fee adjustment
- ▶ REA preparation costs are generally recoverable/allowable as a matter of contract administration (internal company costs and legal fees)

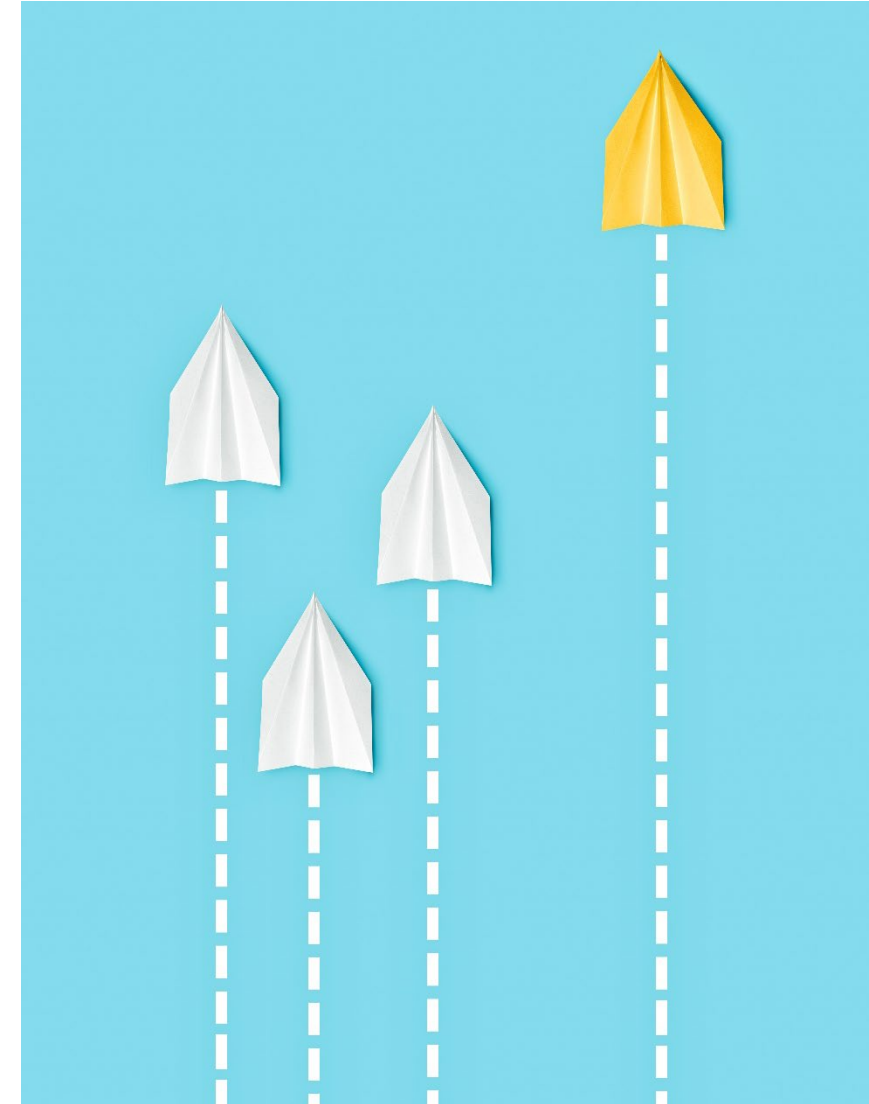
Allowability of REA Costs

- ▶ General rule: REA costs may be allowable
- ▶ REA costs: consultant costs and legal fees incurred in connection with negotiations relating to an REA should be allowable as contract administration costs, even if negotiations eventually fail
 - FAR 31.205-33, Professional and Consultant Service Costs
- ▶ Costs incurred in connection with the work performance of a contract or
- ▶ Costs incurred in connection with administration of a contract
- ▶ Generally allowable if also reasonable and otherwise allowable



Best Practices

- ▶ Be proactive and start early
- ▶ Cross-function cooperation and communication (legal + contracts + pricing)
- ▶ Identify potential changes and segregate increased costs immediately
 - Assign separate cost accounting number
 - Contract may require change order accounting
- ▶ Document estimates in sufficient detail; verify bases of estimate
- ▶ Delays: regularly update schedule to reflect changes as they occur
- ▶ Cost allowability: separate negotiations/contract administration costs from claim costs
- ▶ Manage/avoid broad release language (“known or unknown”) due to unintended consequences



Best Practices

- ▶ Scrub costs for unallowables
- ▶ Anticipate DCAA challenges to estimates
 - Relevance, causation, reliability of increased costs data
 - Unallowables
 - Labor hour reasonableness
 - Attorney, accountant, and consultant fees
 - Profit
 - Interest on claim



Importance of REA Pricing

- ▶ Done last and reviewed first
- ▶ Pricing drives the decision-making process
- ▶ Government often ignores entitlement and defends claim with attack on quantum
- ▶ Requires coordinated cross-functional team effort
- ▶ Contractor risks
 - False Claims, fraud
 - Defective pricing under TCPD/TINA
 - Disapproval of estimating system and possibly others



General Pricing Considerations

- ▶ **Objective:** calculate the increased cost of the changed work
 - Contractor should be in the same profit or loss position as if no change occurred
- ▶ Generally broken out into four components:
 - Calculating costs directly attributed to added work
 - Calculating costs directly attributable to eliminated work
 - Calculating overhead and profit for costs attributable to changed work
 - Contract administration costs
- ▶ No presumption of reasonableness



General Pricing Considerations



- ▶ FAR 15.408, Table 15-2(III)(B), provides the format for change orders, modifications, and claims
- ▶ Seven components:
 - Cost elements (materials, services, direct labor, indirects, other costs)
 - Estimated costs of all work deleted
 - Cost of deleted work already performed
 - Estimate for cost of work added by the change
 - Net cost of change
 - Net cost to be deleted
 - References--documentation supporting specific cost elements

General Pricing Considerations



- ▶ FAR Part 31, Contract Cost Principles and Procedures, applies to modifications, but its application must result in an “equitable adjustment”
- ▶ FAR 31.201-2, allowability requirements:
 - Reasonableness
 - Allocability
 - CAS (if applicable), GAAP as appropriate
 - Terms of the contract
 - FAR Subpart 31.2 limitations

Introduction to Claims



Claims

- ▶ The Government's policy is to try to resolve all contractual issues in controversy by mutual agreement at the contracting officer's level.
- ▶ Per 52.233-1 Disputes:
 - Claim means a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to this contract.
 - Must be made in writing
 - Must be made within 6 years after the accrual of the claim
 - with exceptions when contractor fraud is involved

REFERENCE

- FAR 33.2 Disputes & Appeals
- FAR 52.233-1
- FAR 52.233-4
- 41 USC Ch 71 Contract Disputes

“Reasonable efforts should be made to resolve controversies prior to the submission of a claim. Agencies are encouraged to use ADR procedures to the maximum extent practicable.”

Claim Certification

- ▶ Contractors shall provide a certification when submitting any claim exceeding \$100,000.
- ▶ The certification shall provide for the following:
 - The claim is made in good faith;
 - The supporting data are accurate and complete to the best of the contractor's knowledge and belief;
 - The amount requested accurately reflects the contract adjustment for which the contractor believes the Federal Government is liable; and
 - The certifier is authorized to certify the claim on behalf of the contractor.

Issuance of a Decision

- ▶ The contracting officer's decision on a claim is final and conclusive, unless an appeal or other action is taken.

- ▶ Timing of CO Decisions
 - Submitted claims of \$100,000 or less: within 60 days from the CO's receipt of a written request from the contractor
 - Submitted claims of more than \$100,000: within 60 days of receipt of a submitted certified claim the CO shall -
 - Issue a decision; or
 - Notify the contractor of the time within which a decision will be issued.

- ▶ Any failure of the CO to issue a decision within the required time periods will be deemed a decision by the CO denying the claim.

Contractor's Right of Appeal

- ▶ A contractor may appeal the CO's final decision (COFD) to an agency board within 90 days from the date of receipt of a COFD.

- ▶ There are several Agency Boards of Contract Appeals
 - Armed Services Board;
 - Civilian Board;
 - The board of contract appeals of the Tennessee Valley Authority
 - The Postal Service Board

- ▶ Alternatively, a contractor may bring an Action De Novo in Federal Court
 - In lieu of appealing the COFD to an agency board, a contractor may bring an action directly on the claim in the United States Court of Federal Claims
 - Time for filing: within 12 months from the date of receipt of a COFD



Payment

- ▶ Interest on an amount found due a contractor on a claim shall be paid to the contractor for the period beginning with the date the contracting officer receives the contractor's claim until the date of payment of the claim.
- ▶ Interest accrues at the rates established by the Secretary of the Treasury and as applicable for each 6-month period.

Obligation to Continue Performance

Agencies are authorized to require a contractor to continue contract performance in accordance with the COFD pending a final resolution of any claim arising under, or relating to, the contract.



Suspected Fraudulent Claims

If the contractor is unable to support any part of the claim and there is evidence that the inability is attributable to misrepresentation of fact or to fraud on the part of the contractor, the CO shall refer the matter to the agency official responsible for investigating fraud.



REA and Claims Pricing Methodologies



Pricing Methodologies

ACTUAL COST METHOD

- ▶ Actual cost data is the preferred method for proving costs
- ▶ Requires early recognition and establishment of separate job cost codes
- ▶ Best evidence available under the circumstances
- ▶ Key point: establish connection to government conduct
- ▶ Cumulative impact of multiple changes
- ▶ FAR 52.243-6, Change Order Accounting
 - Permits CO to order the accumulation of actual costs
 - Contractor must indicate in its proposal which proposed costs are actual and which are estimates

Pricing Methodologies

ESTIMATED COST METHOD

- ▶ REAs often require some type of estimates
 - Cost of deleted work
 - Actuals are unavailable for added work
 - Lack of segregation
 - Future impacts
- ▶ Good faith estimates are preferred when actual costs are not available
- ▶ Support: detailed substantiating data or reasonably verifiable cost experience
- ▶ Methods include:
 - Buildup through studies, use of subject matter experts (SMEs)
 - Analogy/actual cost of single event
 - Parametric/cost estimating relationship
 - Engineering build-up

Pricing Methodologies

TOTAL COST METHOD

- ▶ Difference between the bid cost/price and actual cost
- ▶ Disfavored; assumes entire cost overrun is government's fault
 - Fails to identify specific extra costs caused by changes, differing site conditions, or delays
- ▶ Four factors the contractor must show:
 - Impracticality of proving actual costs
 - Contractor's bid was realistic
 - Reasonableness of its actual costs
 - Lack of responsibility for added costs



Pricing Methodologies

MODIFIED TOTAL COST METHOD

- ▶ Contractor may adjust the total cost method to account for other factors
- ▶ Two elements of the total cost method computation are adjusted:
 - Original costs in the contract price
 - Total costs of performance
- ▶ Goal of adjustments: eliminate amounts for which the government is not responsible
- ▶ May occur in situations where the bid was not realistic or there were other causes for the extra costs



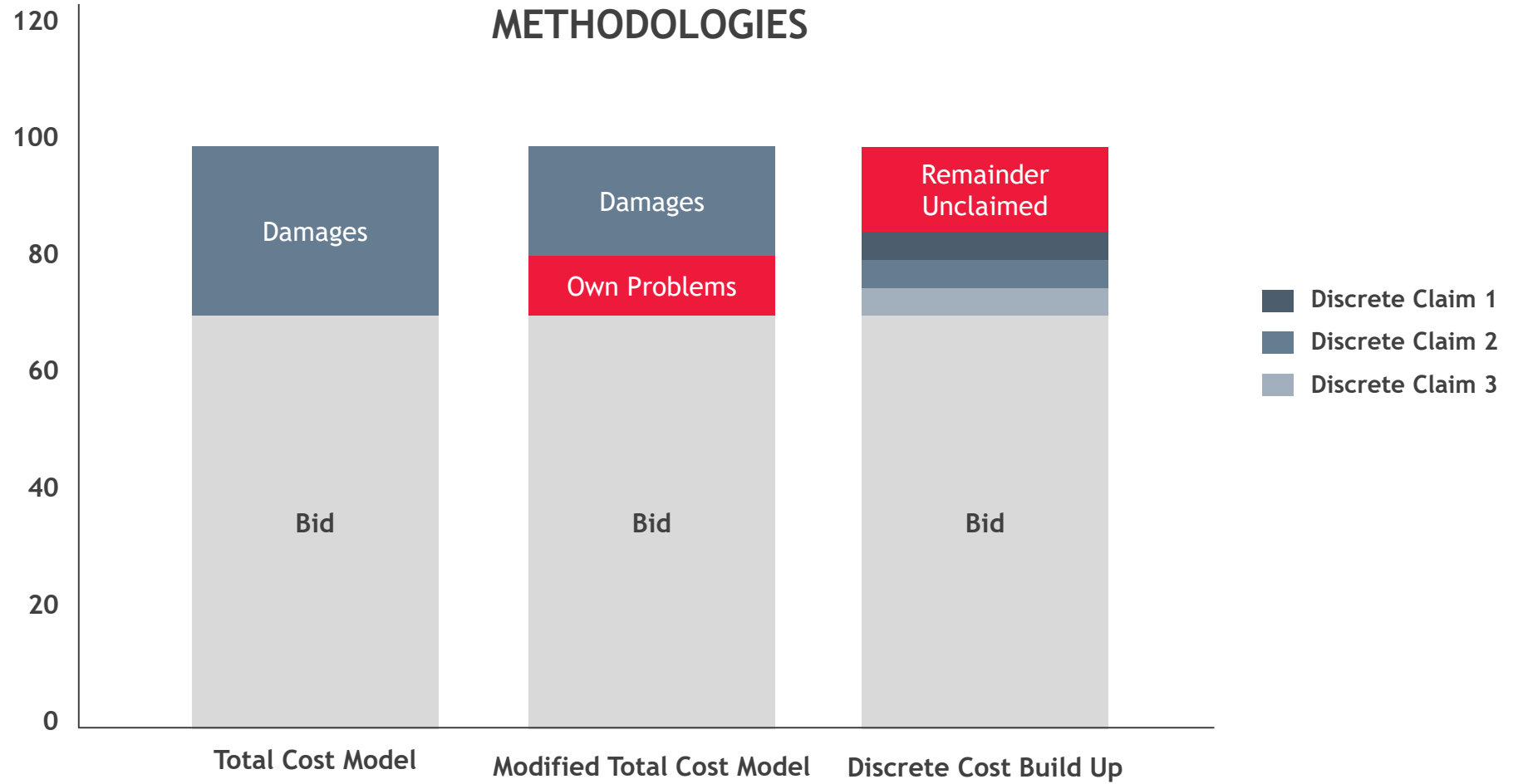
Pricing Methodologies

DISCRETE COST OF BUILD

- ▶ Provides for direct quantification of any increased costs
- ▶ Ties increased costs to contract changes (i.e., claim elements)
- ▶ Most precise method; generally preferred
- ▶ Often used for termination settlement proposals



Pricing Methodologies



Audit Process

- ▶ Audits should be expected on substantial claims and terminations
- ▶ REAs are often audited prior to negotiations
- ▶ Post-completion audits typically occur prior to close-out on contracts with multiple, major change orders
- ▶ Expect the auditor to find something - be prepared
- ▶ Proper documentation to support the claimed costs are key
 - Review supporting documentation prior to the audit and identify any potential gaps - leave no surprises for your company to the audit itself
 - Organize the support documentation and make available to the auditor
 - Make sure your company is leading the narrative of the audit



Best Practices for Claim Package

- ▶ Well-supported claims can achieve quicker and more favorable settlements.
- ▶ Provide a narrative that tells your story and justifies each claim element
- ▶ Include all records to substantiate claim elements. For example:
 - Accounting/Job cost records
 - Timekeeping or Equipment Usage records
 - Narrative
- ▶ Keep claim and support materials in digestible pieces/easy to understand
- ▶ Claim elements should be credible to avoid additional scrutiny and slow the process
- ▶ Submissions should be easy to understand
- ▶ Remember preparation costs may be directly recoverable depending on the vehicle
- ▶ May consider separating your claim in two where you know CO agrees with only certain pieces

Common Pitfalls

- ▶ Inadequate documentation
- ▶ Inadequate flow-down of pass-through rights allowing prime to similarly terminate subcontractors
- ▶ Inadequate contract administration
- ▶ Inadequate cost controls
- ▶ Inadequate proposal coverage
- ▶ Inadequate planning
- ▶ Inadequate communication
- ▶ Failure to timely react
 - Changes - constructive and directed
 - Provide notice of contract/budget overrun
 - Government caused delay, impacts
 - Communicate
 - Troubleshoot
- ▶ Special tooling, fixtures, equipment
 - Inadequate planning, price analysis
 - Sunk costs may be at risk

Common Pitfalls II

- ▶ Flawed contractor assumptions
 - Understand your cost and pricing model
 - Disproportionate cost incurrence relative to unit pricing
- ▶ Base period - cost of performance
 - Items acquired in year 1, for use in later years
 - Costs incurred in year 1, to be recovered in later years
- ▶ “What if” analysis
 - Contract terminated before year 1, costs have been recovered?
 - When does contract become profitable?
- ▶ What is your exposure, your business risk, for disproportionate cost incurrence relative to sales?



Termination for Convenience



Termination for Convenience

- ▶ A unilateral right to terminate a prime contract, in whole or in part, when it is in the Government's interest
- ▶ Prime contractor has no such right
- ▶ Allows government to cut short the life of the contract, for a multitude of reasons, avoiding spending money on future performance



Authority

- ▶ FAR Part 49 Termination of Contracts
- ▶ FAR 52.249 Termination contract clauses
- ▶ Supplemental regulatory requirements
 - DFARS Part 249 and 252.249
 - Other agency supplements

Notice of Termination

- ▶ The Termination Contracting Officer (TCO) must provide written notice to contractor as required under FAR 49.102
 - Defines scope of termination
 - In whole or in part
 - Effective date
 - Special instructions
 - Contractor steps to mitigate labor impact
 - Contains other important information



Termination Team

GOVERNMENT

- ▶ Agency contracting personnel
 - Administrative Contracting Officer (ACO)
 - Contracting Officers Technical Representative (COTR)
 - TCO
- ▶ Agency supporting personnel
 - DCAA, DCMA, Subject Matter Expert's

CONTRACTOR

- ▶ Contractor personnel
 - Project manager and program personnel
 - Accounting team
 - Legal team
- ▶ Third party
 - Accounting experts
 - External legal advisors

Duties of the Contracting Officer

- ▶ Directing the action required of the prime contractor
- ▶ Examining the settlement proposal of the prime contractor
 - And that of subcontractors, as appropriate
- ▶ Promptly negotiate settlement and enter into a settlement agreement
 - To expedite settlement, the TCO may request specially qualified personnel to assist, advise, review, recommend
- ▶ Promptly settle the settlement proposal by determination for the elements that cannot be agreed on, if unable to negotiate a complete settlement.
- ▶ Hold a conference with the contractor to develop a definite program for effecting the settlement.
 - Principal subcontractors may be requested to attend.

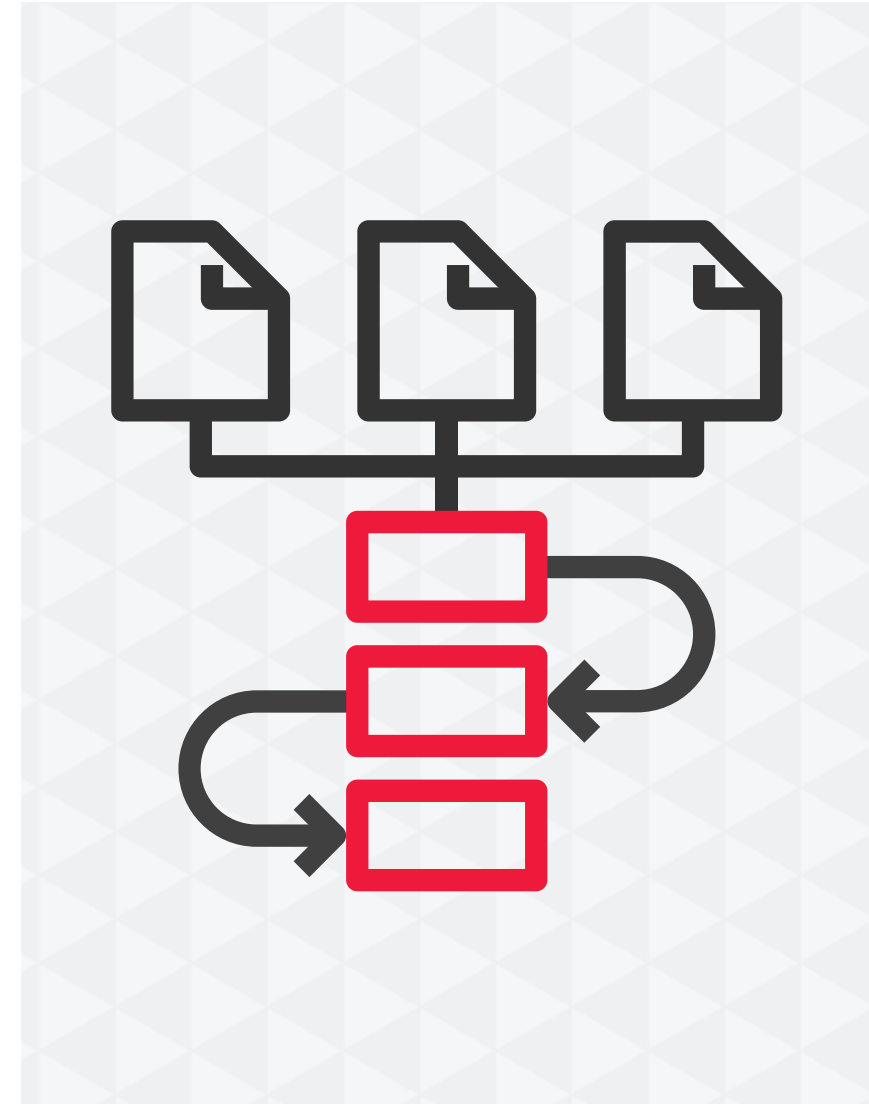


Duties of the Contractor

- ▶ Stop work, immediately
- ▶ Issue termination notices and immediately advise the TCO of any special circumstances precluding the stoppage of work;
- ▶ If partial termination, perform the continued portion of the contract and submit promptly any REA for the continued portion
- ▶ Protect and preserve property in the contractor's possession, and as directed by the TCO, deliver the property to the Government
- ▶ Promptly notify the TCO in writing of any legal proceedings growing out of any subcontract or other commitment related to the terminated portion of the contract
- ▶ Settle outstanding liabilities and proposals arising out of termination of subcontracts, obtaining any approvals or ratifications required by the TCO
- ▶ Promptly submit settlement proposal
- ▶ Dispose of termination inventory, as directed or authorized by the TCO
- ▶ Develop plan for conducting due diligence
 - Assign primary responsibilities to key stakeholders
 - Initial assessment, valuation
 - Perform preliminary contract review to quantify amount invoiced and paid to date

Subcontract Flowdown

- ▶ Prime contractor SHOULD flowdown T4C rights to:
 - Subcontractors, vendors, suppliers, consultants
 - Without flowdown, prime contractor assumes breach of contract risk for subcontractors
- ▶ Example:
 - After receiving a termination for convenience notification from the government, contractor may terminate for convenience this subcontract, in whole or in part but only to the degree specified in the government's termination notice.
 - The parties agree that any subcontractor termination claims shall be governed by and resolved under FAR Part 49 and any related termination clauses included in the prime contract, as may be modified elsewhere in this subcontract.



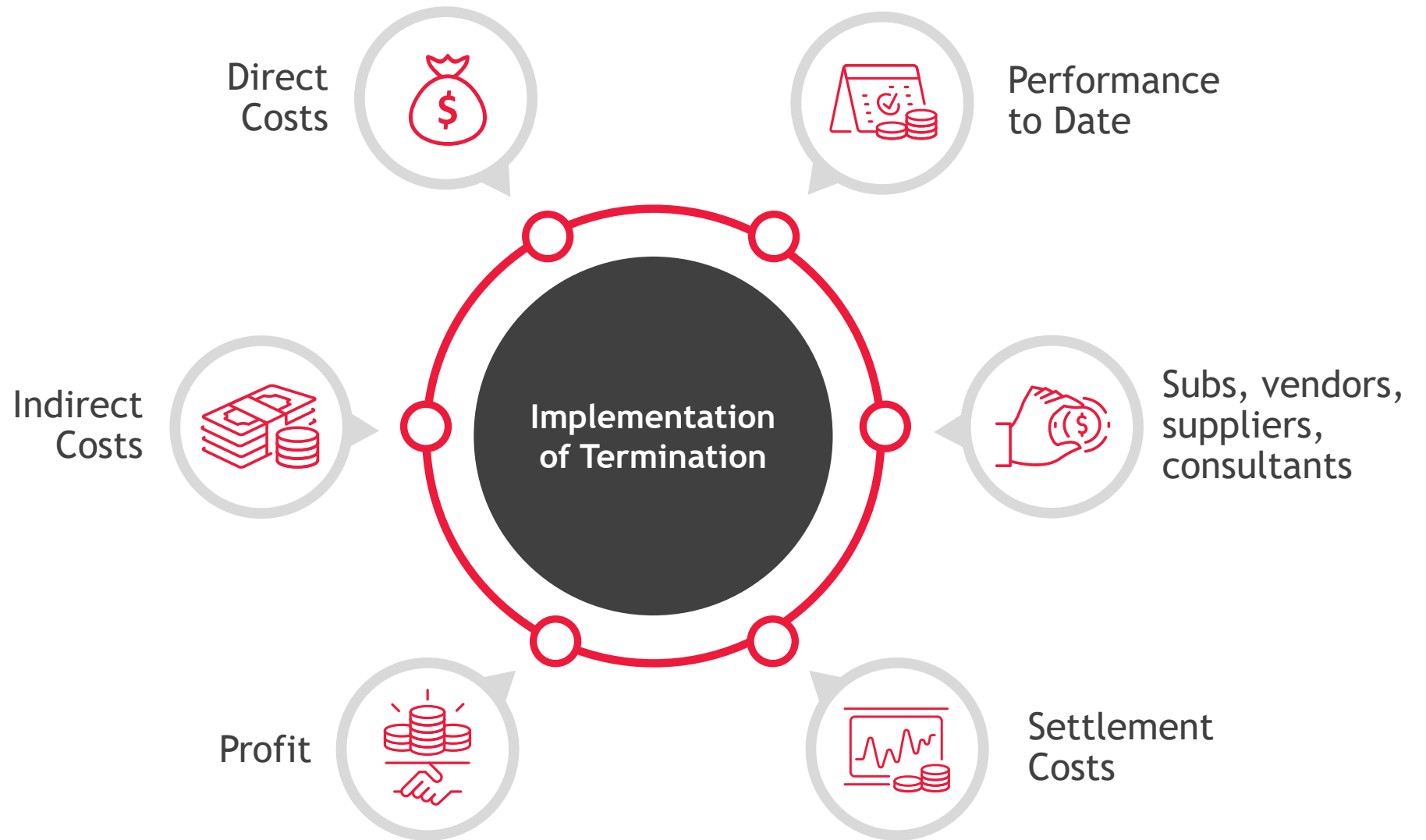
Subcontractor Termination Claims

- ▶ Are supposed to be presented to TCO within six months
- ▶ Can be extended
- ▶ Should be audited by prime contractor to validate:
 - Allocability, reasonableness, allowability of costs
 - Direct and indirect costs
 - Existence and condition of inventory and WIP items
 - Compliance with contract requirements
 - All WIP to be physically inspected for conformity
 - Need for loss adjustment
- ▶ Should use the same FAR forms



Contractor Goal

MAXIMIZE COST RECOVERY



Proposal (RFP Response) Preparations

- ▶ Plan ahead
- ▶ Review and understand solicitation provisions
- ▶ Will proposal be incorporated into contract?
 - If so, assumptions, end notes will/should become part of the contract terms and conditions - binding effect
- ▶ Will proposal merely be a reference document?
 - If so, proposal is informational, not necessarily binding
- ▶ Will selected parts but not all of proposal be incorporated, such as pricing schedule?
 - Arguably the whole proposal should be binding because pricing is per se tied to the performance described elsewhere
 - Debatable question

IN YOUR PROPOSAL, CONSIDER INCLUDING:

End notes calling out important cost considerations, such as: If a contract is terminated for convenience in whole or in part before completion of option year two, contractor shall be entitled to recover as a termination cost, the full measure of fixed costs incurred before effective date of termination.

KEY ASSUMPTIONS, SUCH AS:

We assume agency will purchase X units over Y years.

Solicitation Requirements & Clauses

- ▶ FAR Standard Contract Format
 - ▶ Section C - Technical Specs, SOW, Deliverables
 - ▶ Section H - Special Clauses
 - ▶ Section I - Standard Clauses
 - ▶ Identify solicitation requirements, evaluation and selection criteria, terms and conditions that could give rise to unconventional cost/price modeling
 - ▶ Quantify risk and quantify consequence to identify exposure
- ▶ FAR 52.249-1 Fixed Price - Short Form
 - ▶ FAR 52.249-2 Fixed Price
 - ▶ FAR 52.249-3 Demolition Contracts
 - ▶ FAR 52.249-4 Services (short form)
 - ▶ FAR 52.249-5 Nonprofit Institutions
 - ▶ FAR 52.249-6 Cost Contracts
 - ▶ FAR 52.49-7 Architect-Engineer

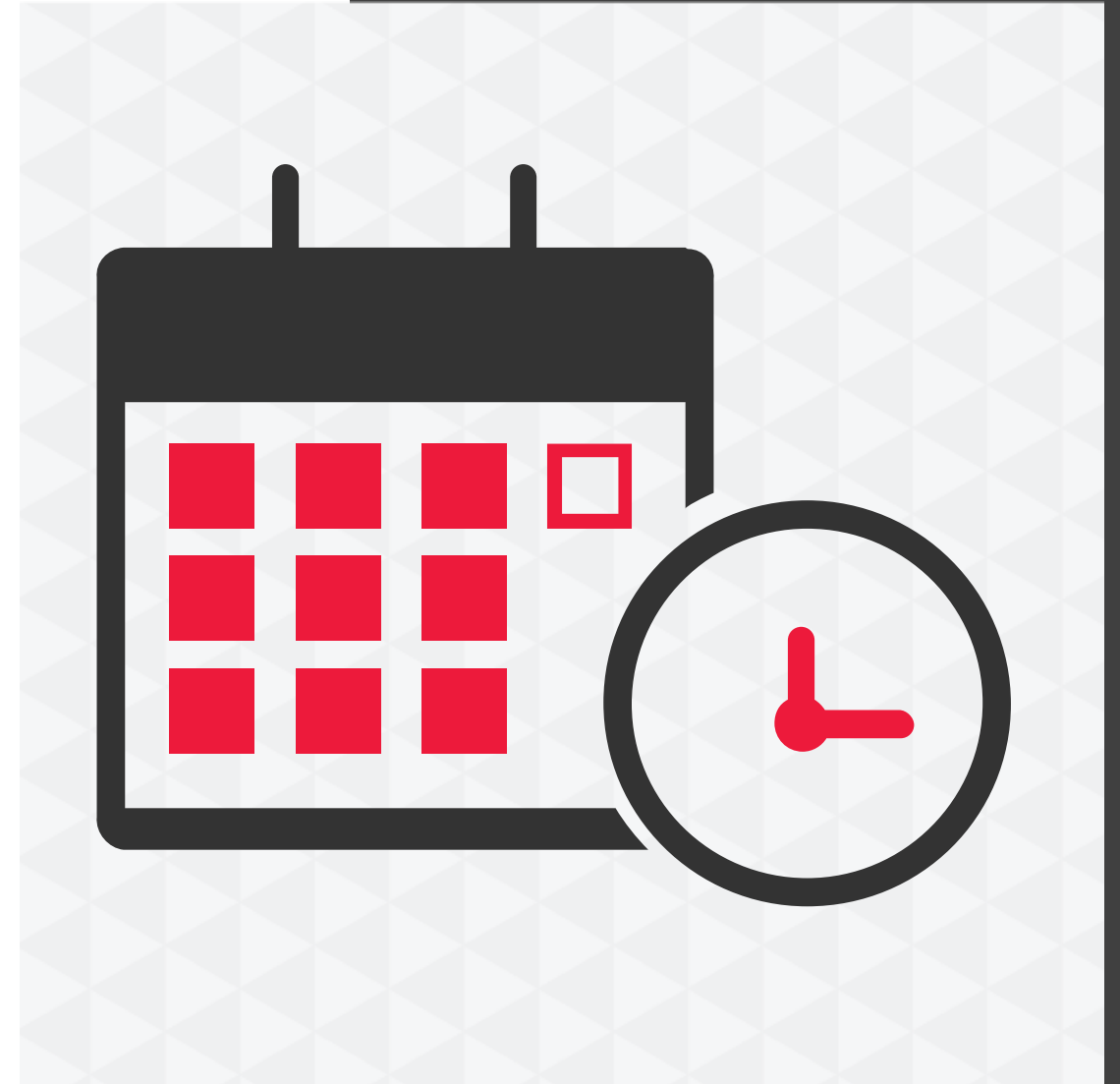
Settlement Proposal

- ▶ The objective is to negotiate a resolution
- ▶ Settlement may be affected by:
 - Negotiated agreement
 - Determination by the TCO
 - Costing-out under vouchers for cost-reimbursement contracts
 - Combination of these methods



Settlement Proposal Deadline

- ▶ Submitted within one year after effective date of termination
- ▶ Prepared using standard forms
 - SF 1424, 1427, 1428, 1429 - Inventory related
 - SF1435 - Settlement Proposal Form Inventory Basis
 - SF1436 - Settlement Proposal Form Total Cost Basis
 - SF1437 - Settlement Proposal Form for Cost Reimbursement Type Contracts
 - SF 1438 - Settlement Proposal Short Form
 - SF 1439 - Schedule of Accounting Information
 - SF 1440 - Application for Partial Payment



Settlement Proposal Audit

- ▶ The TCO shall refer each prime contractor settlement proposal valued at or above the threshold for obtaining certified cost or pricing data to the appropriate audit agency for review and recommendations. The TCO may submit settlement proposals of less than the threshold for obtaining certified cost or pricing data to the audit agency.
- ▶ The responsibility of the prime contractor and of each subcontractor includes performance of accounting reviews and any necessary field audits.
 - This will avoid delay in government review/audit
 - Cost of contractor's audit is an allowable administrative cost. Recoverable as part of settlement proposal
- ▶ The audit report is advisory only and is for the TCO to use in negotiating a settlement or issuing a unilateral determination.
- ▶ The TCO may furnish audit reports to prime and higher tier subcontractors for their use in settling subcontract settlement proposals.

Settlement by Determination

- ▶ TCO may settle proposals unilaterally via determination
 - If TCO and contractor are not able to reach agreement
 - If proposal is submitted late
 - If contractor fails to provide adequate information
- ▶ Contractor may appeal any settlement by determination Contractor should be responsive to TCO's requests for information, documents
- ▶ Legal fees for appeals may not be recovered



Price Adjustment for Remaining Work

- ▶ Partial termination may adversely impact cost of performance for remaining (unterminated) work
- ▶ Price adjustment using form at FAR 15-2, under FAR 15.408
 - Form facilitates government audit
- ▶ Contractor must validate that amount sought in price adjustment are not also included in settlement proposal
 - No double recovery



Adjustment for Loss

- ▶ Not all contracts are profitable
- ▶ Where loss results from increased cost of performance due to **contractor error**:
 - The amount to be paid for settlement proposal must be adjusted proportionately to preserve the loss position
 - Contractor cannot be made whole for its own errors
- ▶ Where loss results from increased cost of performance due to **agency directed changes or constructive changes**:
 - Contractor should pursue a contract adjustment to reduce or eliminate the loss
 - Recover increased costs and cost of delays (impacts)
 - Claims for changes and other government caused cost increases must be expressly preserved to avoid waiver, release



Assigning Profit

Allowable:

- ▶ Profit on work completed or in process but terminated
- ▶ TCO discretion to arrive at Fair Profit Allowance
- ▶ Nine factors drive the profit analysis, including complexity of work, level of staffing, efficiency, quality, quantity, etc.

Not allowable:

- ▶ Lost profit on terminated future performance
- ▶ Materials and services undelivered to primer contractor as of effective date of termination
- ▶ Administrative costs and expenses (Settlement expense)
- ▶ Consequential damages

Indirect Cost Rates



- ▶ Obtaining audited indirect cost rates for every period of performance up to effective date
 - Can take years to conduct and complete audits
 - Still longer to negotiate final rates
- ▶ TCO has discretion to negotiate with contractor to set indirect rates for the termination settlement
 - Provisional rates
 - Lump sum for indirect costs
 - Reserve for later settlement the indirect costs to allow completion of remaining settlement elements
- ▶ Lump sum allowances for indirect costs will require contractor to adjust affected cost pools to avoid double recovery

Excess Contract Funds



- ▶ TCO is required to recommend deobligation of excess contract funds
 - Any funds in excess of what is needed to pay for termination claims
 - This can impair the ability to receive a partial payment
 - This may delay final resolution of the settlement proposal of associated termination claim
- ▶ Contractor should prepare and submit to TCO a “rough” estimate of the value of its settlement proposal
 - Only the final, actual settlement is to be certified
 - Early drafts and estimates are for information purposes only

Certification of Proposal

- ▶ Standard termination forms include extensive certification
 - Must be signed by contractor
- ▶ False Claims Act liability for knowingly submitting false statements, false claims, false certifications
- ▶ Due diligence plan is focused on mitigating risk of FCA liability stemming from the settlement proposal



Questions?



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