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HEADLINE NEWS

Defense Secretary Gates Issues New Acquisition Guidelines for Defense Department

On September 14, 2010, Defense Secretary Robert Gates issued comprehensive new procurement guidelines (the "Guidance Memo") as part of his "Efficiencies Initiative." The goal of this initiative is to save $100 billion in the defense budget over the next five years. These anticipated savings would then be used to purchase additional goods and services.

The new guidelines require the following changes:

- determining at the start of every new program whether it is affordable, including both acquisition and ongoing maintenance costs. Going forward, program affordability will be considered a "design parameter" in the same way that speed or power is viewed;
- timelines for development of weapons system and other programs will be shortened and more tightly managed (time is money);

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CASE SPOTLIGHT

The Best Defense Is (at Least for Federal Contractors) a Required Offense

Recently, the United States Court of Appeals for the Federal Circuit held in a 2–1 opinion that a government contractor could not assert a set-off defense to the government's claim where the contractor had not asserted a formal claim for the set-off amount under the Contract Disputes Act. *M. Maropakis Carpentry, Inc. v. United States*, 609 F.3d 1323 (Fed. Cir. June 17, 2010). As a result of this decision, all government contractors must now evaluate whether it is necessary to raise defenses to a claim by the government as an affirmative claim prior to filing suit.

The case concerned M. Maropakis Carpentry, Inc. ("Maropakis"), which won a contract to perform roof repair at Naval Inventory Control Point in Mechanicsburg, Pennsylvania, but was 467 days late in completing the project. The contract contained a liquidated damages clause that imposed liquidated damages of $650 per day for each day that the project was late. Maropakis requested that the contract completion deadline be extended 447 days, but never sent a certified claim to the government requesting relief nor did it request a final decision by the contracting officer. Ultimately, the Navy instructed Maropakis that it owed $303,550 in liquidated damages (467 days x $650

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- redundant programs will be identified and either eliminated (if existing) or not approved; and
- the preferred contracting vehicle will be fixed-price contracts with incentives. *See* FAR 16.204; 16.401 *et seq*. This is a two-edged sword. Jobs that are performed under budget will result in increased profits for the contractor. But cost overruns will — at least in part — be borne by the contractor. This approach gives "both sides of the transaction an incentive for good performance." Guidance Memo, p. 6.

The Guidance Memo also proposes to change DOD's method of estimating costs for new programs. Currently, Defense Department acquisition professionals use independent cost estimates ("ICE") to forecast what a program "will cost." These ICEs are based on historical experience. Although ICEs can be useful, "[they do] not drive leanness into the program. In fact, just the opposite can occur: the ICE, reflecting business as usual management in past programs, becomes a self-fulfilling prophesy." Guidance Memo, p. 3. To address this concern, managers of all major programs will now be required "to perform a 'Should Cost' analysis justifying each element of program cost." *Id.*

There have been many industry complaints about excessive government monitoring and reporting requirements that increase overhead without improving the product. The Guidance Memo requires DOD acquisition staff to determine a plan for reducing at least 50 percent of the currently required reports and "to substantially shorten the ones remaining." Guidance Memo, p. 15.

In a move that demonstrates the seriousness with which this new procurement environment is being treated by the private sector, Lockheed Martin recently announced that 25 percent of its executive force will take buyouts as part of a companywide move to reduce headcount. Boeing will also reduce headcount and consolidate its military aircraft business.

Of course, it is one thing to issue guidelines and quite another to effect real change in a system as enormous and diverse as federal defense procurement. Bureaucracy is nothing if not entrenched. As evidenced by the increased number of recent protests that have been sustained, government contract professionals have difficulty writing clear procurement specifications. The Guidance Memo indicates that contract packages will become even more complex in the near future. Nevertheless, contractors should pay attention to this document and the changes that result from it. As Sherlock Holmes said to Watson, "The game is afoot!"

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per day). The Navy also held $244,036 in contract proceeds, which it applied against the liquidated damages claim. The Navy demanded payment from Maropakis in the remaining amount of $59,514. The Navy issued a final decision that reiterated its demand for liquidated damages but did not mention Maropakis's requests for a time extension.

Subsequently, Maropakis filed a complaint in the United States Court of Federal Claims ("CFC"). Maropakis alleged breach of contract by the government and sought two remedies: (1) an extension of 447 days to the contract completion date; and (2) remission of the liquidated damages assessment. The government counterclaimed, seeking $59,514, the balance it claimed was owed as liquidated damages. The government also moved to dismiss Maropakis's complaint for lack of subject matter jurisdiction, arguing that Maropakis had not submitted a "claim" for contract modification as required under the CDA. Maropakis answered the counterclaim and asserted it would prove at trial that the delays were caused by the government. The government moved for summary judgment on both its motion to dismiss and its counterclaim.

The significance of *Maropakis* arises from the trial court's decision *granting the government summary judgment on its counterclaim that sought liquidated damages against Maropakis*. We all know that a valid claim must be filed and a final decision on the claim by a contracting officer must be issued before the CFC can exercise subject matter jurisdiction over a lawsuit against the government. *Deponte Investments, Inc. v. United States*, 54 Fed. Cl. 112 (Fed. Cl. 2002). Since Maropakis did not submit a claim

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for contract modification seeking an extension of time based on government delays, the trial judge ruled that the court did not have subject matter jurisdiction to consider a ***defense*** based on those identical delays. Since that was the only defense to the counterclaim asserted by Maropakis, the trial court struck the defense and entered summary judgment in favor of the government.

The Federal Circuit affirmed that decision and was unambiguous in its holding:

> Thus, we hold that a contractor seeking an adjustment of contract terms must meet the jurisdictional requirements and procedural prerequisites of the CDA, whether asserting the claim against the government as an affirmative claim or as a defense to a government action.
>
> Because the Court of Federal Claims correctly held that it did not have jurisdiction over Maropakis's claim for time extensions, and because Maropakis's extension claim was the only defense asserted against the government's counterclaim for liquidated damages, we affirm the grant of summary judgment to the government on its counterclaim for liquidated damages.

Maropakis, 609 F.3d at 1331-1332.

Judge Newman of the Federal Circuit vigorously dissented. She argued that the majority confused the concepts of "defense" and "contract modification."

> The routine defense that the government contributed to delay is a defense, not a contract modification. Failure to meet the CDA requirements for certification, naming a sum certain, requesting a final decision, or modifying the contract, does not preclude defending against the government's claim.

Maropakis, 609 F.3d at 1334 (dissent).

Judge Newman believes *Maropakis* is a seismic shift in federal contract jurisprudence:

> The right to defend against an adverse claim is not a matter of "jurisdiction," nor of grace; it is a matter of right. The denial of that right, argued by the government on a theory of "jurisdiction" that was supported by the Court of Federal Claims and is now supported by this court, is contrary to the purposes of the CDA, contrary to precedent, and an affront to the principles upon which these courts were founded.

Maropakis, 609 F.3d at 1334-1335 (dissent).

This case thus illustrates a gray area of government contracts law. Where does a defense end and a claim begin? On the one hand, it seems wrong that Maropakis was denied the ability to present factual defenses to the government's claim. On the other hand, had Maropakis's "defense" prevailed, the government might have been ordered to refund part of the retained contract balance, when a valid claim for those funds had never been submitted.

Regardless, *Maropakis* makes clear that another level of analysis has been added to the evaluation of government contract disputes. The lawyer evaluating such disputes must now consider whether the government can assert claims against a contractor and the possible defenses to those claims. The lawyer must then determine whether any of those defenses might be characterized as a "claim" for contract modification. If so, all such defenses should now be included in the contractor's certified claim. Failure to file such an affirmative claim could result in viable defenses to the government's claim being struck due to lack of subject matter jurisdiction.

DID YOU KNOW?

Interim Rule Regarding Disclosure of Executive Compensation and First-Tier Subcontracts

Effective July 8, 2010, new interim rules went into effect that require federal contractors to report their executive compensation, award of first-tier subcontracts that exceed $25,000 in amount, and executive compensation for their first-tier subcontractors who have been awarded subcontracts in excess of $25,000. *See* Reporting Executive Compensation and First-Tier Subcontract Awards, 75 Fed. Reg. 39,414 (2010) (to be codified at FAR 52.204.10). The particulars are set out below.

These requirements have been implemented through an interim rule and two new clauses: FAR 52.204-10 (Reporting Executive Compensation and First Tier Subcontract Awards) and FAR 4.1403 (Requiring Contracting Officers to Insert FAR 52.204-10 in Solicitations and Contracts). The new requirements apply to all businesses regardless of size or ownership status. The new FAR 52.204-10 is required to be included in all new solicitations or contracts of $25,000 or more. For ID/IQ contracts, the contracting officer has the discretion to include the clause via unilateral change order before issuing new task orders.

Reporting Executive Compensation for the Five Most Highly Compensated Executives of Federal Contractors & Their First-Tier Subcontractors

This information must be reported by the end of the month following the month of a contract award. This data is to be reported at www.ccr.gov, but only if ***all*** three of the following tests are met:

A) In the contractor's or subcontractor's previous fiscal year, 80 percent or more of its total revenue came from federal contracts, subcontracts, loans, grants, etc.; **and**

B) In the contractor's or subcontractor's previous fiscal year, it received $25,000,000 or more in annual gross revenues from federal contracts, subcontracts, loans, grants, etc.; **and**

C) The public does not have this information about the compensation of the executives through periodic reports filed with the SEC (www.sec.gov/answers/execomp.htm).

Reporting Award of First-Tier Subcontracts with a Value of $25,000 or More

Unless directed otherwise by the contracting officer, the contractor is required to report this information at www.fsrs.gov by the end of the month following the month of award of a first-tier subcontract with a value of $25,000 or more.

This provision is being phased in as follows:

A) Until September 30, 2010, any newly awarded subcontract must be reported if the amount of the prime contract is $20,000,000 or more;

B) Between October 1, 2010, and February 28, 2011, any newly awarded subcontract must be reported if the amount of the prime contract is $550,000 or more; and

C) After March 1, 2011, any newly awarded subcontract must be reported if the amount of the prime contract is $25,000 or more.

Important note — if either the contractor or the subcontractor in the previous tax year had gross income from all sources of less than $300,000, then the contractor and/or the subcontractor are exempt from the requirement to report subcontract awards.

Comments on this Interim Rule

If you are interested in submitting comments on this interim rule, here is the relevant information.

Identify comments as FAC 2005-44, FAR case 2008-039;

Submit online at www.regulations.gov and follow the prompts;

Submit by fax at 202-501-4067;

Submit by mail to:
General Services Administration
Regulatory Secretariat (MVCB)
1800 F Street NW
Room 4041, ATTN: Hada Flowers
Washington, DC 20405

House Unanimously Passes Bill Requiring that All Contractors Violating the Foreign Corrupt Practices Act be Proposed for Debarment

On September 17, 2010, the House of Representatives passed the 2010

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Overseas Contractor Reform Act, which now moves to the Senate. This bill is an effort to impose more stringent penalties on companies and individuals found to have violated the Foreign Corrupt Practices Act. The bill contains a provision that permits the head of a federal agency to waive the debarment requirement, providing the waiver is reported to Congress within 30 days, along with an accompanying justification. If this bill becomes law, federal contractors may find themselves in more debarment proceedings — which could be a corporate death sentence. Keep an eye on this one.

Federal Acquisition Thresholds Increase

Effective October 1, 2010, the threshold for simplified acquisitions increased from $100,000 to $150,000. *See* 75 F.R. 167 pages 53129-53135 (August 30, 2010). Several other thresholds were also increased, including the requirement that prime vendors submit subcontracting plans on all contracts worth more than $650,000. The old ceiling was $550,000. The floor for Miller Act performance and payment bonds that must be provided on construction projects has also been increased from $100,000 to $150,000. Contractors should be aware of these changes.

Federal Contractors & Subcontractors Must Post Notice Advising of Right to Unionize

If you missed this, shame on you. Effective June 21, 2010, contractors and subcontractors who contract with the federal government must post an "Employee Rights Notice," which advises employees of their rights under federal law to unionize. The notice can be downloaded from the website of the United States Department of Labor. It must be posted anywhere an employer posts other required employee notices. The full text of the rule can be found at 29 CFR Part 471.

CONSTRUCTION CORNER

Strict Interpretation of Government Contractor Immunity May Make it Difficult for Construction Contractors to Take Advantage of the Defense

The United States Court of Appeals for the Fifth Circuit recently ruled that a construction contractor could not assert the defense of government contractor immunity because the construction specifications for the work at issue were not precise enough. Since the contractor exercised at least some discretion in the project, it could be held negligent in its exercise of that discretion. *See In re: Katrina Canal Breaches Litigation*, No. 09-30449 (5th Cir. Sept. 14, 2010). The case arose after Hurricane Katrina caused certain levees to fail in New Orleans. The levees at issue were constructed by Washington Group International, Inc. ("WGI"), under contract with the U.S. Army Corps of Engineers ("the Corps").

The plaintiffs in several consolidated actions sued WGI, the Corps and other defendants for harm resulting from failure of the levees. The plaintiffs alleged that WGI used improper fill material and improper compaction methods in constructing the levees. Finding that WGI constructed the levees to the Corps's precise specifications, the district court granted summary judgment to WGI based on government contractor immunity. The Fifth Circuit reversed.

The Fifth Circuit employs a strict interpretation of government contractor immunity. It held that an essential element of the defense is government-approved reasonably precise specifications. The government-approved reasonably precise specifications must also be

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related to the exact feature of the project that is alleged to be defective. The Fifth Circuit held that the specifications in WGI's contract were not sufficiently precise on two issues.

First, WGI's contract with the Corps to construct the levees specified that WGI should use on-site material as the primary source of the backfill material. The contract also specified that if there was insufficient on-site material, WGI should import off-site backfill material to complete the project. The Fifth Circuit held that the authorized use of on-site backfill was not reasonably precise in regard to how WGI should parse through all of the on-site material to determine which was suitable for use as backfill. The Fifth Circuit also held that the Corps did not provide reasonably precise specifications regarding the composition of the off-site backfill material that could be used in the event there was not enough suitable on-site material. The Fifth Circuit held that WGI exercised its own discretion on these issues.

Second, WGI's contract with the Corps specified that backfill material would be placed in lifts and compacted. But the contract did not specify the exact specifications for compaction. The Fifth Circuit concluded that by not specifying the compaction method, the contract allowed WGI the discretion to choose its own specifications on this issue and to dictate the final result. The court held that these specifications were not sufficiently precise to satisfy the test for government contractor immunity.

This decision demonstrates the difficulty of asserting government contractor immunity in the context of a construction contract. Even detailed construction contracts leave certain construction issues up to the discretion of the contractor. For example, when an architect renders detailed drawings that are incorporated into the contract, the contractor may still be responsible for construction details such as minor steel connections or (as in the WGI case) earthwork. As a result, government contractor immunity may have limited utility in cases involving government construction contracts.