E-ALERT | Government Contracts

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THE GOVERNMENT CONTRACTS UPDATE

BIPARTISAN BUDGET ACT PASSED IN DECEMBER

On December 26, President Obama signed the Bipartisan Budget Act (the "Budget Act"), which Congress passed in mid-December with bipartisan support. The new budget provides funding levels for the government for two years and helped avert a government shutdown that could have occurred in early 2014.[1] The Budget Act slightly increases FY 2014 spending to $1.012 trillion (an increase of $45 billion over previous limits), and it sets the FY 2015 budget at $1.1014 trillion. It also adds $63.2 billion back to domestic and military programs affected by the sequester, and it extends current Medicare pay rates for three months, thereby preventing a 20% cut to health care providers.

Of particular interest to government contractors, the Budget Act establishes a new, $487,000 allowability cap on executive employee compensation. President Obama signed the Budget Act after signing the 2014 National Defense Authorization Act ("FY 2014 NDAA"); thus, the Budget Act cap supersedes the $625,000 cap that had been set by the NDAA. The $487,000 cap will apply to all employees of the contractor and subcontractor, not just the five most highly paid executives. Federal agencies could still exempt highly skilled positions such as engineers or scientists from the cap. The implementing regulations that identify these exemptions will be critical to determining the impact of this new cap.

ADDITIONAL 2014 NATIONAL DEFENSE AUTHORIZATION ACT CONSIDERATIONS

Before adjourning for the holiday recess, Congress passed the FY 2014 NDAA. As discussed in an earlier E-Alert, the bill contains many provisions of interest to contractors. In addition to those we have already covered, it extends the authority of the Secretary of Defense to void, terminate, or otherwise place restrictions on the award of contracts supporting contingency operations in Iraq and Afghanistan if the Secretary "determines that a foreign entity or foreign individual performing on the contract is directly engaged in hostilities or is substantially supporting forces that are engaged in hostilities against the U.S. or its coalition partners." The bill provides an additional $34.8 million in funding for the Department of Defense ("DoD") Inspector General's Office to identify waste, fraud, and abuse, especially in procurement programs. Finally, the bill also includes the so-called Military Whistleblower Protection Act, which (1) widens the window—from 60 days to 1 year—during which military staff can report allegations of sexual assault and other misconduct, including fraud or waste; and (2) establishes a number of measures designed to protect such whistleblowers from retaliation.

[1] Lawmakers unveiled a new $1.1 trillion appropriations bill on January 13 that would further ease sequester spending cuts, fund federal agencies for the remainder of the fiscal year, and end any remaining threat of a government shutdown.

FAA ANNOUNCES SIX TEST SITES FOR CIVILIAN DRONE TESTING

On December 30, the Federal Aviation Administration ("FAA") announced six awardees—the University of Alaska, the State of Nevada, New York's Griffiss International Airport, the North Dakota Department of Commerce, Texas A&M University, and Virginia Polytechnic Institute and State University—that will operate and oversee separate test sites for civilian drones or unmanned aircraft systems ("UAS"). Test-site operators are required to manage parties interested in using the test sites to ensure that users observe safety and privacy standards. The selection of the test sites follows the FAA's release of a roadmap and final privacy rule for UAS operations.

As we discussed in a prior E-Alert, the selection of the test sites is mandated by the Federal Aviation Administration Modernization and Reform Act of 2012 ("FMRA"), and it is intended to allow the FAA to gather safety and technical information relevant to the integration of UAS in the national airspace by September 30, 2015. Until now, UAS operation in the national airspace has been largely restricted to military and public uses. The FAA has emphasized that broader UAS integration "must be accomplished without reducing existing capacity, decreasing safety, impacting current operators, or placing other airspace users or persons and property on the ground at increased risk."

OMB ISSUES FINAL GUIDANCE ON UNIFORM ADMINISTRATIVE REQUIREMENTS, COST PRINCIPLES, AND AUDIT REQUIREMENTS FOR FEDERAL AWARDS

On December 26, the Office of Management and Budget ("OMB") issued final guidance that supersedes and streamlines requirements from eight OMB Circulars—A–21, A–87, A–89, A–102, A–110, A–122, A–133, and A–50's guidance on Single Audit Act follow-up—into one consolidated set of guidance located in Title 2 of the Code of Federal Regulations. The guidance addresses existing government-wide requirements affecting Federal awards to non-Federal entities, including state and local governments, Indian tribes, institutions of higher education, and nonprofit organizations.

As we discussed in a February 2013 E-Alert, when OMB first issued its reform proposal, the drafters intended to establish a single set of administrative requirements, cost principles, and audit requirements for grant recipients, to eliminate duplicative language, and to clarify where and when policies are applied differently to different entities. As a result, the guidance includes several appendices with guidance organized by the type of non-Federal entity receiving the award. Although future reform efforts may incorporate the Cost Principles for Hospitals in Department of Health and Human Services regulations, the guidance does not extend to those principles at this time.

EXPORT CONTROL REFORM MOVES FORWARD

The Obama Administration's Export Control Reform ("ECR") Initiative has shifted from the proposal and comment phase into the implementation phase. On January 6, 2014, revisions to four U.S. Munitions List ("USML") categories—governing vessels of war; tanks and military vehicles; submersible vessels; and certain other miscellaneous items—became effective. In addition, final revisions to five categories on the USML—governing launch vehicles, missiles, and rockets; explosives and energetic materials; military training and equipment; protective personnel equipment; and nuclear weapons—were published on January 2, 2014, and will become effective on July 1, 2014.

These changes remove certain items from the USML and transition them to the Commerce Control List ("CCL"), which allows for greater licensing flexibility. The revisions are part of the broader effort to move away from an emphasis on design intent in determining applicable export controls and to instead establish the USML as a "positive list." The amendments are designed to enhance

U.S. national security by (i) improving the interoperability of U.S. military forces with allied countries; (ii) strengthening the U.S. industrial base by reducing incentives for foreign manufacturers to design-out and avoid U.S.-origin content and services; and (iii) allowing export control officials to focus government resources on the transactions that pose the greatest national security, foreign policy, or proliferation concerns.

Interim Rule To Make Open-Ended Indemnity Clauses Unenforceable Is Finalized

On December 31, the Federal Acquisition Regulation ("FAR") Council adopted as final, without change, an interim rule clarifying the unenforceability of certain contract provisions that would require the government to indemnify a contractor or any other person or entity for damages, costs, or fees, or any other loss or liability that could lead to a violation of the Anti-Deficiency Act. We discussed the details of the rule in a prior E-Alert. The interim rule went into effect on June 21, 2013.

DoD Solicitation For $1B Contract To Sustain Health Records

DoD's Defense Health Agency ("DHA") recently issued Request for Proposals No. HT0011-13-R-0045, advertising a contract to maintain the military's electronic health records system. Proposals are due by February 13, 2014. If all options are exercised, the firm-fixed-price contract could run through 2018 and be worth between $250 million and $1 billion.

The performance work statement indicates that the contractor will be expected to "provide all personnel, equipment, supplies, facilities, transportation, tools, materials, supervision and other items and nonpersonal services necessary to perform overall maintenance and sustainment of" the Composite Health Care System ("CHCS") and Armed Forces Health Longitudinal Technology Application ("AHLTA"). CHCS and AHLTA contain the electronic health records of approximately 9.6 million Army, Navy, Air Force and Marine Corps personnel and dependents. CHCS is the primary medical information system for the DoD, allowing medical providers to order laboratory tests, access results, and prescribe medications via one interface. AHLTA is configured to meet DoD's specialized requirements to provide access to complete medical records in care environments that range from forward-deployed medics to large medical centers. Both systems interface with Department of Veterans Affairs records, as well. The DHA plans to use the contract to establish a "central hub" to manage AHLTA and CHCS at all military hospitals and clinics around the clock from a single location. A separate Integration Contractor will be responsible for fully integrating separate development components to enable data sharing and interoperability between and among relevant applications.

DoD Revises Requirements for Item Unique Identifications

On December 16, DoD published a final rule revising requirements for contractors to use unique markings and identify the cost of items delivered under DoD contracts. The rule, which revises Defense Federal Acquisition Regulation Supplement ("DFARS") 252.211-7003, does not change existing policy for reporting item unique identification ("IUID"), or permanent markings used to give equipment a unique ID. Rather, it clarifies the categories of items subject to the requirement and the methods for reporting those items to the DoD Item Unique Identification Registry. Under the policy, DoD IUIDs or an approved equivalent are required: when the government's unit acquisition cost of the item is $5,000 or more; for mission-essential or controlled-inventory items; for DoD serially managed or a warranted serialized items; when a parent item contains an IUID-embedded subassembly, component, or part; when an item of special tooling or special test equipment for a major defense acquisition program is designated for preservation and storage; or when the item is identified as vulnerable to supply chain threats, cyber threats, or counterfeiting.

The full extent of the impact of the revised regulations remains unclear, but DoD has emphasized that the expenses associated with implementing the IUID requirements are recognized as allowable costs. If contractors do not operate on a cost basis (*e.g.*, the IUID parts are commercial items), contractors may need to submit claims for the added costs associated with implementing these requirements for existing contracts or include the costs in pricing on new contracts.

TRADE AGREEMENTS' THRESHOLDS ARE RAISED

On January 1, 2014, the U.S. Trade Representative published a final rule revising thresholds for the application of the World Trade Organization Government Procurement Agreement ("WTO GPA") and Free Trade Agreements. Every two years, the trade agreements' thresholds are adjusted according to a pre-determined formula under the agreements. The new WTO GPA threshold for service and supply contracts is $204,000, and the new WTO GPA threshold for construction contracts is $7,864,000. DoD issued a separate notice for a final rule incorporating the increased thresholds into the DFARS.

CONTRACTOR AGREES TO PAY $300,000 TO SETTLE FCA SUIT OVER SALE OF CHINESE-MADE BOOTS IN VIOLATION OF THE TRADE AGREEMENTS ACT

A General Services Administration ("GSA") contractor has agreed to pay $300,000 to settle allegations that it falsely claimed that its Chinese-origin boots actually originated in the U.S. or other countries designated under the Trade Agreements Act ("TAA"). The U.S. alleged that Georgia-based Giga Inc. had violated the TAA by concealing the true origin of the boots, and it sought treble damages and a civil penalty of $5,000 and $10,000 for each falsely designated shipment. Although Giga will pay $300,000 in 24 monthly installments, it did not admit any wrongdoing.

Under the TAA, all products listed on a GSA schedule contract must be "substantially transformed" either in the U.S. or in a "designated country." Designated countries include all World Trade Organization Government Procurement Agreement countries, Free Trade Agreement countries, Least Developed Countries, and Caribbean Basin Countries. Notably, China, India, and Brazil do not, at this time, qualify as designated countries.

CASE DIGEST

Contractors At Risk for Suspension for Actions of Their Affiliates (*Agility Def. & Gov't Servs. v. Dep't of Defense*, No. 2013-10157 (11th Cir. Dec. 31, 2013))

On December 31, the U.S. Court of Appeals for the Eleventh Circuit held that a federal agency can indefinitely suspend an affiliate of an indicted contractor so long as legal proceedings have been initiated against that indicted contractor. In November 2009, The Public Warehousing Co. K.S.C. ("Public Warehousing") was indicted on multibillion-dollar allegations of fraud related to food supply contracts with the Defense Logistics Agency ("DLA"). When DLA suspended Public Warehousing shortly thereafter, it also suspended affiliates of Public Warehousing that had not been indicted. DLA suspended these entities based solely on their affiliation with Public Warehousing. Under 48 C.F.R. § 9.407-4(b), an agency may suspend a contractor for improper conduct and that suspension may be extended to affiliates of the contractor if the affiliate is specifically named, given written notice, and given an opportunity to respond. However, suspensions of affiliates may not extend beyond 18 months unless "legal proceedings" have been initiated.

Here, in one of many challenges to these suspensions, two of the Public Warehousing affiliates—Agility Defense & Government Services, and Agility International, Inc. (together, "Agility")—sued DLA for injunctive and declaratory relief. Agility argued that DLA had unreasonably refused to terminate its suspensions, ignoring that Agility (a) was not implicated by Public Warehousing's indictment, (b) had instituted sufficient compliance procedures to guard against fraud, and (c) had even proposed a buy-out of existing management. At the trial court level Agility prevailed. The U.S. District Court for the Northern District of Alabama held that legal proceedings initiated against Public Warehousing could not be used as a basis for extending the suspension of Public Warehousing's affiliates. The district court reasoned that the continuation of Agility's suspensions was contrary to law because legal proceedings had not been initiated against Agility within 18 months of the notice of suspension.

The Eleventh Circuit's three-judge panel reversed the trial court decision in an opinion that relied on a narrow reading of the FAR and largely ignored the broader purpose of suspension and debarment. The court found that, "[b]ecause the suspension of an affiliate is 'include[d]' as part of the suspension of the indicted government contractor, … legal proceedings initiated against the indicted government contractor tolled the 18-month time limit for the suspension of the affiliates." The court also rejected Agility's due process arguments, concluding that a suspension based purely on affiliation does not infringe liberty interests, and that in any case the notification of suspension and opportunity to respond mandated by 48 C.F.R. § 9.407 affords constitutionally adequate process.

Unfortunately, the opinion did not address the trial court's opposing interpretation of the same regulatory language on which the Eleventh Circuit based its decision. Nor did the circuit court account for the investigatory purpose of affiliate suspension—namely, that the immediate suspension of a company based solely on affiliation provides the government an opportunity to investigate whether the affiliate itself engaged in any wrongdoing. Although 48 C.F.R. § 9.407-4 indicates that the government has 18 months to investigate the affiliate and determine whether further action against it is warranted, the Eleventh Circuit's ruling would allow an affiliate to be suspended indefinitely even absent any evidence of misconduct, in apparent derogation of the requirement that suspension be imposed only "on the basis of adequate evidence."

Our colleagues Steven Shaw and Mike Wagner provide further analysis of this case in a recent article published in Law360.

Government's Privity with Subcontractor Established Through Bills of Lading (*Estes Express Lines v. United States*, No. 2013-5056 (Fed. Cir. Jan. 3, 2014))

The U.S. Court of Appeals for the Federal Circuit recently ruled that the Court of Federal Claims ("COFC") incorrectly dismissed breach of contract claims filed by a subcontractor, Estes Express Lines ("Estes"), against the Marine Corps Community Services ("MCCS"), a U.S. government entity. The MCCS had awarded a shipping contract to Salem Logistics, Inc. ("Salem"). Salem, in turn, arranged for Estes to carry the shipments. Estes did not have a written contract with Salem and handled all shipments under its common carrier tariff. When Estes did not receive payment from Salem on certain invoices, it filed suit against the Marine Corps. The COFC dismissed Estes' complaint after finding that only Salem, not Estes, had privity of contract with the government.

On appeal, the Federal Circuit reversed. The three-judge panel found privity between Estes and the government because the government was listed as the "bill to" party and the shipper on certain bills of lading which also identified Estes as a party. The court found "no indication that Estes agreed to any terms in the Salem-MCCS contract purporting to allocate liability" and "no evidence that Estes agreed to release MCCS from liability upon MCCS forwarding payment to Salem, or that Salem otherwise acted as an agent of Estes in collecting payment." As a result, the court concluded that "the provisions of the MCCS-Salem contract cannot alter any contractual obligations arising separately under the bills of lading." Had Salem and Estes executed a written subcontract allocating liability, the outcome of this case likely would have been different.

Contractors Need Not Seek All Possible Costs When Submitting a Claim (*Duncan Aviation, Inc.*, ASBCA No. 58733 (Dec. 3, 2013))

The Armed Services Board of Contract Appeals ("ASBCA") recently held that a contractor is not required to seek all possible costs to which it is potentially entitled when submitting a claim. Duncan Aviation, Inc., submitted a claim for its "over and above" direct material costs incurred in connection with an indefinite delivery, indefinite quantity contract to overhaul landing gear systems. Because these direct material costs were the vast majority of the costs that it was entitled to collect, Duncan did not seek reimbursement of its direct labor costs, indirect costs, or profit. In response, however, the Navy moved to dismiss because Duncan did not include all of the costs to which it was entitled. The ASBCA denied the government's motion, holding: "We are not aware of any requirement in the CDA [Contract Disputes Act] or the FAR that a contractor seek all possible costs in a claim in order for this Board to exercise jurisdiction over the claim that is submitted."

Government Claim Not Required To Identify a Contract Number (*The Boeing Company*, ASBCA No. 58587, Dec. 3, 2013))

The ASBCA refused to dismiss an appeal for lack of jurisdiction where the government's claim failed to specifically identify a valid contract with the contractor. The matter arose from a claim that the government filed against The Boeing Company after Boeing allegedly allocated its corporate costs for the procurement of non-production goods in a manner inconsistent with applicable Cost Accounting Standards. In the final decision, the government's corporate administrative contracting officer identified one representative contract, which the parties later agreed was not, in fact, a Boeing contract. Boeing argued that the government's failure to specifically identify a Boeing contract rendered its claim invalid. For its part, the government requested that the ASBCA simply substitute a Boeing contract number as a representative contract.

The ASBCA determined that it was "irrelevant" that the one contract number that the government cited in its claim was not a Boeing contract, as the CDA does not require the government to identify any contract by number in its claim. The claim must merely relate to a contract. Here, that requirement had been satisfied because the "claim clearly relates to contracts with Boeing, and it is clear that Boeing knows what they are." Indeed, Boeing had "communicated for years with the government about [its] cost allocation and impact upon its government contracts, providing the government with GDMs regarding those impacts, without indicating it had any difficulty identifying the relevant contracts."

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