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THE GOVERNMENT CONTRACTS UPDATE

INSPECTOR GENERAL REPORT QUESTIONS PHARMACY ARRANGEMENTS UNDER 340B PROGRAM

In a continuation of recent efforts at review and oversight of program compliance, on February 4, 2014, the Department of Health and Human Services' Office of the Inspector General issued a report (the "IG report") on contract pharmacy arrangements under the 340B Drug Pricing Program. Established in 1992 under the Veterans Health Care Act, the 340B program requires drug manufacturers to provide certain outpatient drugs on a discounted basis to eligible 340B program participants (e.g., community health centers and disproportionate share hospitals). 340B program participants are permitted to contract with pharmacies, referred to as "contract pharmacies," to dispense program drugs purchased on their behalf. The report is the latest in a line of reports and findings critical of covered entity compliance with 340B Drug Pricing Program requirements.

The IG report found that in dispensing drugs through contract pharmacies, 340B program participants handle compliance issues in different ways, leading to inconsistency in the program's application. The report found evidence of inconsistencies in the identification of program-eligible drugs, the treatment of uninsured patients, and inconsistent and often ineffective efforts being undertaken to avoid duplicate discounts (i.e., discounts under the 340B program and Medicaid). Finally, the report found that most 340B participants do not conduct contract pharmacy oversight activities recommended by the Health Resources and Services Administration ("HRSA"), such as retaining an independent auditor for the pharmacies with which they contract.

Although the report contained no recommendations, HRSA has announced plans to issue formal regulations to address various aspects of the 340B Drug Pricing Program, including contract pharmacy arrangements. Drug manufacturers participating in the 340B Drug Pricing Program should note the potential compliance issues associated with contract pharmacies, and keep in mind their audit rights in the event that non-compliance is suspected. In addition, as HRSA may address some of the issues identified in the IG report in the upcoming regulations, manufacturers should be sure to review carefully the proposed regulations and comment in the event that proposed regulations do not adequately protect manufacturers from duplicate discounts and inappropriate utilization.

GAO: FURTHER CHANGES REQUIRED IN STATE AND USAID CONTINGENCY CONTRACTING PROCEDURES

On February 14, 2014, the U.S. Government Accountability Office ("GAO") issued a report finding that although the U.S. Department of State ("State") and U.S. Agency for International Development ("USAID") have made progress in implementing changes to improve contract support in overseas contingency operations, further action remains necessary. GAO's report follows Section 850 of the FY 2013 National Defense Authorization Act, which required the agencies—both of which have faced

numerous contract management and oversight challenges while operating in contingency environments such as Iraq and Afghanistan—to identify changes necessary to improve contract support in contingency operations.

GAO concluded that although State has outlined a series of initiatives to address weaknesses in areas such as collection of contractor data, acquisition planning, contract oversight, risk management, and interagency coordination, the agency has not developed plans to assess the impact of these initiatives. For its part, USAID has identified several actions needed to improve areas such as the collection, inventory, and reporting of data; contractor performance evaluations; and risk management. Although USAID has established a "nonpermissive environment" working group to address these issues, the group's review is not expected to be completed until September 2014. GAO's report also noted that while State and USAID have increased their acquisition workforce by 53 and 15 percent, respectively, from their 2011 levels, competency and skill gaps exist in their respective acquisition workforces. The agencies are working to address those gaps, and have already committed to implementing certain remedial measures, such as creating a new regional Contract Management Office to better support contracting efforts in Iraq (State) and establishing a training division for its acquisition workforce (USAID).

FAR COUNCIL PROPOSES REVISIONS TO THE SMALL BUSINESS ADMINISTRATION 8(A) PROGRAM (79 FED. REG. 6135)

The Federal Acquisition Regulation ("FAR") Council has issued a proposed rule to amend the FAR and bring its provisions into harmony with the Small Business Administration's ("SBA") regulations implementing section 8(a) of the Small Business Act, which helps small, disadvantaged businesses compete in the marketplace. The proposed rule adds new FAR sections addressing protests of an 8(a) participant's eligibility or size status, procedures for releasing an 8(a) requirement for a non-8(a) procurement, and the ways a participant can exit the section 8(a) program. The new rule also makes a number of editorial changes and provides minor clarifications to the section 8(a) regulations. The new substantive proposed FAR provisions are as follows:

- FAR 19.812 — adds new FAR procedures for contracting officers to seek a waiver permitting continued contract performance where an 8(a) participant transfers control to a non-eligible firm.
- FAR 19.813 — clarifies that an 8(a) participant's "eligibility" for either a sole-source or competitive 8(a) requirement may not be challenged at either SBA or any administrative forum by bid protest, size protest, or otherwise. However, the "size status" of the apparent successful offeror in a competitive 8(a) procurement may be protested to SBA by specified parties. This makes the FAR provision consistent with SBA's regulations for the 8(a) program.
- FAR 19.814 — clarifies that if the size of an 8(a) participant nominated for a 8(a) sole source contract is called into question, a formal size determination may be requested from the SBA, but only by the nominated 8(a) participant, the contracting officer, or the participant's SBA District Director.
- FAR 19.815 — contains procedures and criteria for obtaining the SBA's consent to release an 8(a) requirement from the 8(a) program in order to make it eligible for a non-8(a) procurement, again making the FAR provisions consistent with existing provisions of SBA regulations.
- FAR 19.816 — adds language advising contracting officers that a contractor who exits the 8(a) program is no longer eligible to receive 8(a) contracts, but is still contractually obligated to complete existing contracts and any priced options that may be exercised, consistent with existing provisions of SBA's 8(a) regulations.

Comments on the proposed rule are due by April 4, 2014.

NEW PROPOSED LEGISLATION WOULD REQUIRE GOVERNMENT TO PURCHASE 100% U.S.-MADE TEXTILES

Senator Sherrod Brown (D, OH) has introduced legislation that would require Federal agencies to buy textiles made from U.S. sources in an effort to reduce U.S. support for foreign companies that are noncompliant with labor, safety, and child labor laws. Under the "Wear American Act," the Federal Acquisition Regulation would be amended to require Federal agencies to procure textiles and apparel articles, including components for such articles, that are manufactured in the United States wholly from articles, materials, or supplies mined, produced, or manufactured in the United States. Under current requirements, such apparel is required to be composed of only 51% U.S.-based material. The proposed legislation also calls for the head of each Federal agency to ensure that each member of its acquisition workforce who participates substantially in the agency's acquisition of textiles and apparel to receive training on these requirements. Prospects for passage are uncertain. The bill would subject textile articles to a buy-U.S. regime even stricter than that applicable to "specialty metals," and does not appear to contain any exception for commercial items or goods purchased pursuant to existing international trade agreements.

CASE DIGEST

GAO Rules Supplemental Protest Timely Where Late Filing Due To Agency Delay (Motorola Solutions, Inc., B-409148, B-409148.2 (Jan. 28, 2014))

On January 28, 2014, the Government Accountability Office ("GAO") sustained the protest of Motorola Solutions, Inc. ("Motorola") of a $2.5 million Army contract for a turnkey land mobile radio system for the Detroit Army arsenal. Motorola had protested the award of the contract to Harris Corporation ("Harris"), arguing that Harris could not comply with the RFP's terms because Harris had proposed to meet the RPF requirement by providing a particular model of Motorola radio which Harris could not provide without Motorola's consent.

The decision is most significant for its clarification of GAO's timing requirements for the filing of supplemental protests. Motorola's challenge was contained in a supplemental protest filed more than 10 days after Motorola's counsel received the Agency Report in the initial protest, which served as the basis for the supplemental filing. GAO acknowledged that in most instances counsel "must effectively stand in the shoes of the client where information is covered by a protective order and counsel cannot properly obtain the benefit of his or her client's input." Nonetheless, in this case, GAO ruled that the supplemental protest was timely because prior to the protest, Motorola had diligently and persistently pursued information about the specific model of radio Harris had proposed to use. In particular, the GAO found the delay in filing was attributable to the agency's own delay in releasing a redacted version of the Agency Report, which contained this information.

On the merits, GAO concluded that the Army's award to Harris was improper because the Harris failed to demonstrate that it could furnish the Motorola radio, as required under the RFP. GAO noted that "to the extent that Harris was furnishing equipment that it did not manufacture, the RFP required it to provide written proof that the firm had a business relationship — specifically to furnish equipment for the Detroit Arsenal acquisition — with the OEM that manufactured the equipment." Motorola made clear that for Harris to acquire the Motorola-produced radio in question, it would have needed Motorola's consent — which Motorola represented it would not provide.

DOJ Agrees to Pay Honeywell $75 Million Over Night Vision Goggle Technology (*Honeywell International Inc. v. United States*, No. 02-1909 C (Fed. Cl. Feb. 5, 2014))

On February 5, 2014, Judge Braden of the U.S. Court of Federal Claims approved a $75 million settlement between the U.S. Department of Justice and Honeywell International Inc. ("Honeywell") to resolve claims by Honeywell that the government had infringed upon a Honeywell patent covering technology that makes full-color cockpit displays compatible with night vision goggles. As part of the settlement, Honeywell released the government from all claims for infringement, unauthorized use or manufacture, and agreed to grant the government a worldwide, non-exclusive, irrevocable and fully paid-up license for the technology. The settlement covers potentially hundreds more display models that Honeywell claims infringed the patent.

The settlement comes after a 2012 ruling by Judge Braden that Honeywell was entitled to $1,892,551 in damages resulting from the government's use of the technology described in the patent in three display systems. The technology at issue had been subject to a U.S. Patent and Trademark Office determination in 1985 under the Invention Secrecy Act ("ISA") that granting the patent would be detrimental to U.S. national security. The Invention Secrecy Order was not lifted until 2000, and no patent was issued until 2002. That same year, Honeywell filed suit claiming that the Government had used the technology in question in specifications for military aircraft both before and after the patent had been issued.

The Court found that although the Government had infringed the patent, it was not liable under the ISA because Honeywell had not provided evidence sufficient to establish that the military specification had resulted from the Government's disclosure of the information in the patent application. However, the Court found that Honeywell was still entitled to damages under 29 U.S.C. § 1498(a),which permits actions against the United States for unauthorized use of a patented invention, for use of the invention after the patent was issued. The unfortunate lesson for contractors appears to be that they will face significant practical difficulties in proving infringement of an invention kept secret under the ISA unless and until a patent is issued.

Forest Service BPAs That Make Order Acceptance Optional Are Not Enforceable Contracts (*Crewzers Fire Crew Transport, Inc. v. United States*, No. 2013-5105 (Fed. Cir. Feb. 6, 2014))

In a February 6, 2014 ruling, the U.S. Court of Appeals for the Federal Circuit held that two blanket purchase agreements (BPAs) with the U.S. Forest Service were not binding contracts and therefore the Court of Federal Claims lacked jurisdiction over challenges to their termination. In 2011, Crewzers Fire Crew Transport, Inc. ("Crewzers") was one of several awardees of Forest Service BPAs to provide crew carrier buses and flame retardant tents in fire disaster areas. When emergencies arose, the Forest Service would submit orders to BPA holders on a dispatch priority list. Under the terms of the BPAs, (1) a contractor was obligated to provide requested services only after the Forest Service had placed a specific order that was accepted by the contractor; (2) the Forest Service had discretion to deviate from the dispatch lists to effectively fire conditions; (3) BPA holders were required to accept orders only to the extent that they were "willing and able"; and (4) the placement of orders was not guaranteed.

In August 2011, the Forest Service terminated Crewzers' BPA for the crew carrier buses because Crewzers had allegedly responded to several orders with unauthorized vehicles and in one instance, attempted to bill the Forest Service at a higher-than-authorized rate. In November 2011, the Forest Service terminated Crewzers' BPA for tents because Crewzers had delivered tents that did not meet the BPA's specifications or did not deliver tents on time. Crewzers challenging both terminations at

the Court of Federal Claims. As discussed in a prior e-alert, on May 31, 2013, the Court held that it lacked jurisdiction over Crewzers' claims, finding that the BPAs were not binding contracts because they lacked the necessary mutuality of consideration required for an enforceable contract. On appeal, the Federal Circuit affirmed, concluding that the BPAs are merely "frameworks of future contracts" because no obligations are assumed by either party until orders are given by the government and accepted by the contractor. Accordingly, the BPAs cannot be used to invoke the Tucker Act jurisdiction of the Court of Federal Claims.

Federal Circuit Clarifies and Eases Showing Required for Claims of Government Breaches of Duty of Good Faith and Fair Dealing (*Metcalf Construction Company, Inc. v. United States*, No. 2013-504, (Fed. Cir. Feb. 11, 2014))

On February 11, the U.S. Court of Appeals for the Federal Circuit vacated a Court of Federal Claims decision rejecting a claim for breach of the duty of good faith and fair dealing stemming from a Navy construction contract. In 2002, the Navy awarded a contract to design and build housing units to Metcalf Construction Company ("Metcalf"). Almost immediately after the Navy authorized Metcalf to begin performance, Metcalf discovered that the soil conditions at the construction site were inconsistent with the government's pre-bid representations. When Metcalf raised the issue, the Navy denied there was any material difference between the pre-bid and post-award soil assessments, and provided only a small amount of additional compensation for the extensive remedial measures that Metcalf was required to take to address the soil conditions. Metcalf alleged that the Navy's compensation was insufficient, because the cost of the construction escalated to $76 million as a result of the soil issues, while the Navy had paid Metcalf less than $50 million.

After the Navy denied its claims for additional costs, Metcalf sued in the Court of Federal Claims, alleging that by failing to acknowledge the differing soil conditions and interfering in design revisions, the Navy had breached its duty of good faith and fair dealing in connection with the soil conditions at the construction site. The court rejected this claim, stating that it required a showing that the government "specifically designed to reappropriate benefits the other party expected from the transaction." Underscoring this view, the Court stated that "incompetence and/or the failure to cooperate or accommodate the contractor's request do not trigger the duty of good faith and fair dealing, unless the Government 'specifically targeted,' action to obtain the 'benefit of the contract,' or where Government actions were 'undertaken for the purpose of delaying or hampering performance of the contract.'" The Court ruled that Metcalf had failed to demonstrate any such "specific targeting" by the Navy.

The Federal Circuit disagreed and vacated that ruling. In so doing, it explained that the lower court had applied an overly narrow standard for determining a breach of the duty of good faith and fair dealing. The Federal Circuit held that the trial court had misread the precedent established by the Federal Circuit's prior decision in *Precision Pine & Timber, Inc. v. United States*, 596 F.3d 817 (Fed. Cir. 2010), which "did not hold that the absence of specific targeting, by itself, would defeat a claim of breach of the implied duty — i.e., that proof of specific targeting was a requirement for a showing of breach." Rather, the *Metcalf* panel observed, the *Precision Pine* decision stated only that the government "*may* be liable" when government action is "specifically designed to reappropriate the benefits the other party expected to obtain from the transaction," but that specific targeting is not a baseline requirement for finding a breach of the duty of good faith and fair dealing. *Precision Pine*, 596 F.3d at 829. Thus, the *Metcalf* panel found that the "general standards for the duty apply here," and that the duty focused on "honoring the reasonable expectations created by the autonomous expressions of the contracting parties." In particular, the Federal Circuit cited *Centex Corp. v. United States*, 395 F.3d 1283, 1304 (Fed. Cir. 2005), for the proposition that "the covenant of good faith and fair dealing . . . imposes obligations on both contracting parties that include the

duty not to interfere with the other party's performance and not to act so as to destroy the reasonable expectations of the other party regarding the fruits of the contract." The Federal Circuit's decision is good news for contractors, as it provides them with another tool by which to challenge unreasonable government action during contract performance, and shows that inaccurate pre-bid estimates by the Government may be the source of claims for breach of the duty of good faith and fair dealing if the Government fails to deal cooperatively with a contractor after the inaccuracies surface.

Election Doctrine Bars Jurisdiction Over Lease Dispute Claim (*Palafox Street Assocs. L.P. v. United States*, No. 13-247 C (Fed. Cl. Feb. 12, 2014))

On February 12, the Court of Federal Claims held that the election doctrine precluded it from exercising jurisdiction over an appeal of a General Services Administration ("GSA") decision in a lease agreement dispute. The election doctrine provides that once a contractor makes an "informed, knowing, and voluntary decision" to pursue an appeal in a forum of appropriate jurisdiction, the contractor's choice is binding, and the contractor is no longer able to pursue its appeal in an alternate forum.

Palafox Street Associates L.P. held an agreement with GSA to construct and lease a federal courthouse. A dispute between the GSA and Palafox arose over the interpretation of a tax adjustment clause in the lease, and resulting monies owed to GSA by Palafox. On April 9, 2012, the contracting officer issued a final decision on the matter, determining that GSA was entitled to reimbursement in the amount of $824,416. The decision letter advised that it was the final decision of the contracting officer, and that Palafox could appeal the decision to either the Civilian Board of Contract Appeals (CBCA) or the Court of Federal Claims.

Palafox appealed the decision to the CBCA on July 2, 2012, but that action was dismissed based upon a question of whether Palafox claim had been properly certified. Palafox later submitted a certified claim to the contracting officer, which was denied in a final decision on December 20, 2012. Palafox then filed a complaint in the Court of Federal Claims challenging both the April 9, 2012 and December 20, 2012 decisions. GSA moved to dismiss the matter, claiming that the election doctrine barred the Court's jurisdiction because Palafox had previously pursued it in the CBCA. The Court agreed, ruling that the contracting officer's April 9, 2012 decision was a final decision that Palafox had already challenged in the CBCA, which had jurisdiction over the claim. Accordingly, based upon the election doctrine, the Court dismissed Palafox's claim based on the contracting officer's April 9, 2012 decision for lack of subject matter jurisdiction. However, the court reserved judgment on whether the separate claim arising from the contracting officer's December 2012 decision was also barred by the election doctrine pending the submission of written briefs by the parties on the issue.

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