

REAs and Claims: Maximizing Recovery

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Tim Sullivan has spent 45 years in the Government contracting world. He is a co-founder of the Public Contracting Institute, has lectured and written on Government contracting topics, both nationally and internationally, since 1983. He has dealt with the full range of Government contracting issues and has successfully litigated both bid protests at the GAO and the U.S. Court of Federal Claims and contract claims before the boards of contract appeals and the U.S. Court of Federal Claims.

Tim spent his last 19 years of practice as a partner at Thompson Coburn LLP, where he chaired the Government Contracts Group. Tim is widely acclaimed for his lectures on contract negotiations.

Tim earned a bachelor of arts degree from the University of Michigan and his Juris Doctor degree from Georgetown University Law Center, where he was a member of the Georgetown Law Journal. Tim also served as a counterintelligence agent for the U.S. Army and as a contract negotiator for the Central Intelligence Agency.

Claims

Claims are a standard element of any Government contract

Claims have many sources, but all are processed under the Contract Disputes Act and the “Disputes” clause at FAR 52.233-1

All claims are negotiated on a sole-source basis

In most cases, the best approach for pursuing a claim is to begin with a request for equitable adjustment

Breaking Down the “Disputes” Clause

All claims must be in writing

All claims must be filed with the C.O.

All claims over \$100,000 must be certified

The prescribed certification language should be followed verbatim

Interest runs from the date the claim is received

All claims must be decided by the C.O. within 60 days, unless the decision date is extended

Claim Recognition

The Loss Approach (Reactive)

- Contractor realizes the problem after-the-fact
- Money has already been lost
- Contractor may not have the means to mount the fight necessary to maximize recovery
- Evidence and witnesses are sometimes lacking
- Contractor is in great danger of filing an untimely claim



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Claim Recognition

The Event-Oriented Approach (Proactive)

- Contractor's personnel are trained to recognize a claim
- All costs are charged to a new job number
- Claim is timely filed
- Minimizes the spending of contractor's money
- Witnesses and evidence are generally available
- The use of ADR is encouraged

Pre-Claim Analysis

Selection of Forum

- Which forum(s) has jurisdiction?
- What kind of claims can it decide?
- How much will it cost to pursue this claim?
- How long will it take?
- Is there a chance it can be resolved short of going the full route?
- Does the forum provide for ADR?
- If more than one forum has jurisdiction, which forum's procedures or track record are more favorable?
- Do we want to file a claim or a request for equitable adjustment (REA)



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Claim or REA?

CDA Claim	REA
Four-pronged certificate if over \$100,000	Two-pronged certificate if over the simplified acquisition threshold (generally \$150,000) and submitted to DOD agency No certificate if submitted to non-DOD agency
Must request CO decision	Should request negotiation
Must state sum certain	Should contain statement of basis for compensation and pricing logic
Costs of preparation are unallowable claim prosecution costs	Reasonable costs of preparation are allowable contract administration costs
CDA interest starts to run when CO receives the claim	CDA interest does not start to run
If CO issues a decision (or fails to issue a timely decision), contractor can appeal to an appeals board or the Court of Federal Claims	If CO issues a decision, contractor has no right of appeal but can submit a CDA claim to start the appeals process

Claims Arising Under the Contract

Several standard clauses can give rise to claims:

- Changes clause
- Stop Work Order clause
- Government-Furnished Property clauses
- Differing Site Conditions clause
- Inspection clause
- First Article Approval clause
- Escalation clauses
- Payment clauses

Relief Available

Increased costs of performance

Delay and stand-by costs

Impact on other work (ripple effect)

Unrecovered overhead

Profit

Interest

Extension of time

Adjustment of other affected provisions of the contract

Elements of an Equitable Adjustment

Although it is accurate to say that an equitable adjustment consists of the costs of work added and the work deleted, there are other cost elements that must be factored in:

Work Added

- The proper measure of work added by a change is the reasonable cost of that work, which has two aspects:
 - First, any costs unallowable under FAR Part 31 are by definition unreasonable
 - Second, costs that are incurred by unreasonable contractor conduct are unreasonable
 - Examples of unreasonable conduct include (a) some management decisions; (b) choosing poor suppliers; (c) inefficient organization and management; (d) buying defective components; (e) making parts in-house when the contractor knew it could buy suitable parts at a lower cost; (f) failure to negotiate vigorously with a subcontractor; (g) failing to negotiate with a subcontractor; (h) using inefficient performance methods

Overhead

Under standard accounting practice, overhead is spread evenly over the appropriate base, usually direct labor dollars for plant overhead

This can lead to a windfall when pricing an equitable adjustment because when a change causes an increase in direct labor, the overhead costs do not usually increase proportionately

Profit

The contractor is entitled to a fair and reasonable profit

The contractor is not tied to the profit it bid, but if the modification is for essentially the same type and mix of work, FAR 15.404-(c)(6) permits the use of the profit rate used in the basic contract

Agencies have implemented a requirement for a “structured profit approach” when the modification involves a significant change in dollar amount--FAR 15.404-4(B)(1)

That usually means the agency will use a “weighted guidelines” approach

When pricing occurs after the costs of the change have been incurred, some boards have held that a lower risk exists, and therefore the contractor will get a lower profit

Elements of an Equitable Adjustment, cont.

Interest

- Interest on borrowed funds is an unallowable cost that may not be included in an equitable adjustment
- However, *imputed interest* is available under the Contract Disputes Act from the date the C.O. receives a properly certified claim until the date of payment—it is computed as simple interest for each six-month period at rates specified by the Secretary of the Treasury

Elements of an Equitable Adjustment, cont.

Costs of Contract Administration vs. Prosecution of CDA Claims

- All costs of prosecuting a CDA claim are unallowable per FAR 31.205-47(1)
- On the contrary, all costs of preparing an REA and negotiating with the agency are allowable as contract administration costs (including consultant, accounting and legal costs)
- *This is why the recommended approach is to first file an REA and only convert it to a CDA if the REA fails—for whatever reason*

Elements of an Equitable Adjustment, cont.

Delay and Disruption Costs

- Costs of delay and/or disruption of non-changed parts of the contract are properly included in an equitable, but such costs must be mitigated to the extent possible
- The biggest challenge comes in dealing with costs of lost efficiency
- The best measure of of such reduced efficiency is the “measured mile” technique where the contractor compares its productivity during the impacted period with its productivity during an unimpacted period
- Construction contractors have also recovered “unabsorbed overhead” in such situations
- There are well-recognized formulas for dealing with such losses (The *Eichleay* formula in construction contracts and the *Therm-Air* formula in production contracts)

Proof of Costs

The contractor bears the burden of proof for an additive change

The Government bears the burden of proof for a deductive change



Three Types of Proof

1. Actual Costs

- Courts and boards prefer this method—it consists of the contractor introducing actual cost data to support its numbers
- The key here is to have and use solid documentation practices and to segregate costs wherever possible

2. Estimated Costs

- When actual costs are not available, estimates are acceptable if they are supported by all of the available data
- The estimates can be made by company personnel or outside experts, but they will not be convincing if they are not based on supporting data

Three Types of Proof, cont.

3. Total Cost Method

- The courts and boards do not like this approach
- It assumes that all of the excess costs that have been incurred by the contractor should be attributed to the claims against the Government
- It subtracts the costs estimated from the costs incurred and uses the difference as the claim amount—*e.g.*, We estimated this part of the work would cost us \$300,000, but it actually costs us \$700,000, therefore our claim is for \$400,000.

Sample Equitable Adjustment Calculation

Scenario: The contractor had a firm-fixed-price contract for the maintenance of family housing at an Air Force base in the western U.S. Shortly after beginning work, the contractor discovered asbestos problems in several units. This problem was not mentioned in the Statement of Work and was not something that could have been seen or otherwise detected in a pre-proposal site inspection. The Air Force C.O. directed the contractor to resolve the asbestos problem.

The contractor hired a firm that was known for the quality of its asbestos-removal work and ultimately paid them \$750,000 to resolve the problems to the Air Force's satisfaction.

Sample Equitable Adjustment Calculation

Additional Direct labor for Prime: 450 hours at \$22.50/hr.: \$10,125.00

Overhead* at 12%: \$1,215

Asbestos All-Stars (Subcontractor): \$750,000

Subtotal: \$761,340

G&A** at 10%: \$76,134

TOTAL COSTS: \$837,474.00

Profit at 8%: 66,997.92

TOTAL: \$904,471.92***

*Applied to direct labor; **Assumes the contractor uses a total cost input base for the allocation of G&A;

***These figures do not take into account any delay and disruption costs incurred by the contractor. If such costs were incurred, the contractor would have to be careful to point that out to the agency and alert the agency that an REA for those costs will be coming.

Initiating the Claim

The Contracting Officer

- Start the claims process here
- Submit a written claim, certified if necessary
- Submit before the six-year statute of limitations expires
- Remember that the C.O. is not an island – she has advisors
- Write your claim to persuade the key advisors

Investigating and Documenting the Claim

Document Review

- Collect and review all pertinent contract documents, including the solicitation as amended
- Review all pertinent correspondence, particularly e-mail
- Interview all involved personnel
- Preserve the product of each interview (video, tape, statement)

Obtaining Government Information

- Consider a FOIA request



Preparing the Claim

Statement of Facts

- Probably the most important document of all
- Needs to be straightforward and unemotional
- Avoids inflammatory language
- Tells your story

Must be able to back up each statement with evidence



Legal Analysis

- Identify all legal issues in their order of merit
- Identify legal argument that might apply if additional information were available
- Discuss each legal issue and the case law relative to it
- Identify areas where further factual investigation is required
- Identify possible counter-claims that the Government might have



Legal Analysis

Discuss the correct forum for processing the claim

Discuss recommended techniques for preserving the evidence

List additional means to bolster the claim (*e.g.*, hiring an expert, producing a video)

Certification

Required in all claims over \$100,000

If not certified, it is not a claim

Must be signed by someone duly authorized to bind the company

Should track the prescribed language in FAR 33.207(c)

QUANTUM

Tell them how much they owe you and how you arrived at that number
Reference all attached documentation



Litigation Hold Notice

While a contractor obviously wants to resolve its claim without resorting to litigation, that is not always possible

As a result, it is prudent to include a “litigation hold notice” in your claim letter

That puts the agency’s lawyers on notice that they must instruct their client to retain all relevant documents and communications and to not destroy anything related to the claim

Litigation Hold Notice

Here is a sample:

Although (Company name) is hopeful that this matter can be resolved without resort to litigation, our counsel has recommended that we ask you to preserve—and not destroy, delete or alter—any documentation and electronically-stored information related to this contract and the procurement and evaluation of offers that preceded it. We also request that you distribute a copy of this request to all personnel who may have relevant documentation and electronically-stored information and that they comply with the request.

The Decision to Submit a Claim

It is a business decision

You need to assess its potential impact on your relationship with this customer

You need to understand what it will take to meet your burden (*e.g.*, Will you need to show that a certain Government employee is a liar?)

You need to discuss and consider how it will be received by the customer

Will it be a surprise?

Should ADR be elected early?

Claim Submission

Make sure that your files contain clear records of when and how the claim was submitted



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The C.O.'s Final Decision

Due within 60 days of receipt if the claim is under \$100,000

If over \$100,000, due within 60 days after receiving a certified claim; however, C.O. can extend that period

C.O.'s failure to issue a timely decision will be deemed a denial (FAR 33.211(g))

The C.O.'s Final Decision

Under FAR 33.211, the decision should:

- Describe the claim or dispute
- Reference the pertinent contract terms
- State the factual area of agreement and disagreement
- State the C.O.'s decision, with supporting rationale
- Include a paragraph advising the contractor that the decision is final and advising of the appeal deadlines

QUESTIONS?

Thank you



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