UNCLASS

SECURITY CLASSIFICATION REPRODUCED AT GOVERNMENT EXPENSE

AD-A147 779

REPORT DOCUMENTATION PAGE

READ INSTRUCTIONS BEFORE COMPLETING FORM

1. REPORT NUMBER AFIT/CI/NR 84-83T	2. GOVT ACCESSION NO.
3. RECIPIENT'S CATALOG NUMBER	
4. TITLE (and Subtitle) Cost-Plus-Percentage-of-Costs in Government Contracts	5. TYPE OF REPORT & PERIOD COVERED THESIS/~~DISSERTATION~~/
	6. PERFORMING ORG. REPORT NUMBER
7. AUTHOR(s) Samuel Joseph Roser	8. CONTRACT OR GRANT NUMBER(s)
9. PERFORMING ORGANIZATION NAME AND ADDRESS AFIT STUDENT AT: George Washington University	10. PROGRAM ELEMENT, PROJECT, TASK AREA & WORK UNIT NUMBERS
11. CONTROLLING OFFICE NAME AND ADDRESS AFIT/NR WPAFB OH 45433	12. REPORT DATE Sept 1984
	13. NUMBER OF PAGES 135
14. MONITORING AGENCY NAME & ADDRESS (if different from Controlling Office)	15. SECURITY CLASS. (of this report) UNCLASS
	15a. DECLASSIFICATION/DOWNGRADING SCHEDULE

16. DISTRIBUTION STATEMENT (of this Report)

APPROVED FOR PUBLIC RELEASE; DISTRIBUTION UNLIMITED

DTIC ELECTE NOV 20 1984 S D B

17. DISTRIBUTION STATEMENT (of the abstract entered in Block 20, if different from Report)

18. SUPPLEMENTARY NOTES

APPROVED FOR PUBLIC RELEASE: IAW AFR 190-1

6 Nov 84

Lynn Wolaver
LYNN E. WOLAVER
Dean for Research and Professional Development
AFIT, Wright-Patterson AFB OH

19. KEY WORDS (Continue on reverse side if necessary and identify by block number)

20. ABSTRACT (Continue on reverse side if necessary and identify by block number)

ATTACHED

84 11 14 144

DTIC FILE COPY

DD FORM 1 JAN 73 1473 EDITION OF 1 NOV 65 IS OBSOLETE

UNCLASS

SECURITY CLASSIFICATION OF THIS PAGE (When Data Entered)

83

Cost-Plus-Percentage-of-Costs in Government Contracts

By

Samuel Joseph Roser

B.A. with honors, May 1968, Brigham Young University

J.D. June 1971, University of Oregon

A Thesis submitted to

The Faculty of

The National Law Center

of the George Washington University in partial satisfaction of the requirements for the degree of Master of Laws

September 30, 1984

Thesis directed by

Ralph Clarke Nash, Jr.

Professor of Law

AFIT/CI/NR 84-83T

AFIT RESEARCH ASSESSMENT

The purpose of this questionnaire is to ascertain the value and/or contribution of research accomplished by students or faculty of the Air Force Institute of Technology (AU). It would be greatly appreciated if you would complete the following questionnaire and return it to:

AFIT/NR
Wright-Patterson AFB OH 45433

RESEARCH TITLE: Cost-Plus-Percentage-of-Costs in Government Contracts

AUTHOR: Samuel Joseph Roser

RESEARCH ASSESSMENT QUESTIONS:

1. Did this research contribute to a current Air Force project?

( ) a. YES ( ) b. NO

2. Do you believe this research topic is significant enough that it would have been researched (or contracted) by your organization or another agency if AFIT had not?

( ) a. YES ( ) b. NO

3. The benefits of AFIT research can often be expressed by the equivalent value that your agency achieved/received by virtue of AFIT performing the research. Can you estimate what this research would have cost if it had been accomplished under contract or if it had been done in-house in terms of manpower and/or dollars?

( ) a. MAN-YEARS _____ ( ) b. $_____

4. Often it is not possible to attach equivalent dollar values to research, although the results of the research may, in fact, be important. Whether or not you were able to establish an equivalent value for this research (3. above), what is your estimate of its significance?

( ) a. HIGHLY SIGNIFICANT ( ) b. SIGNIFICANT ( ) c. SLIGHTLY SIGNIFICANT ( ) d. OF NO SIGNIFICANCE

5. AFIT welcomes any further comments you may have on the above questions, or any additional details concerning the current application, future potential, or other value of this research. Please use the bottom part of this questionnaire for your statement(s).

NAME GRADE POSITION

ORGANIZATION LOCATION

STATEMENT(s):

TABLE OF CONTENTS

FORWARD iv

CHAPTER

I. INTRODUCTION 1

Definition 2
Four Point Criteria 2
CPPC Negatives 3
Succinct Sanction 4
Overview 5

II. HISTORICAL DEVELOPMENT 6

Before World War I 6
World War I 7
CPPC Justifications 9
Early CPPC Misgivings 10
Decisions and Rulings on
World War I CPPC Contracts 11
CPPC Between the Wars 12
World War II Legislation 14
World War II Statutes &
CPPC Subcontractors 14
Early Judicial Treatment:
94.68 Acres and Muschany 15
The Armed Services Procurement Act . . . 18
Regulatory Codification 19
Regulatory Restrictions
and Subcontractors 19

III. EXPLICIT PROVISIONS FOR PAYMENT AT
PREDETERMINED RATES APPLIED TO ACTUAL
COSTS 22

Fixed Rate of Entitlement 23
Cost Plus Fixed Fee 25
Cost Plus Incentive Fee 27
Decline at a Pre-established Rate 29
Bonuses and Incentive
Compensation Provisions 32
Incentives and Bonuses Measured
by Profits 33

Predetermined Rates and Executive Bonuses 34
Rate of Return on Investment 36
Facilities Capital Cost of Money . . . 38
Pre-Established Overhead Rates 39

IV. IMPLICIT PROVISIONS FOR PAYMENT AT A PREDETERMINED RATE 43

Firm Fixed Price Level of Effort Contracting 43
Time and Material Contracts 46
Payment of Profit on Economic Adjustments 47
Award Fee 50

V. AFTER THE FACT PRICING 51

Letter Contracts 51
Equitable Adjustments 54
Construction Contract Clauses 60
Delay Costs 62
Price Redeterminable Contracts 63

VI. POTENTIAL SAVING AND AVOIDANCE APPROACHES . 66

Ceilings 66
Estimated Costs 69
Post Determined Rates 70
Firm Fixed Price Contracts 71
Case Study: GAO Audit of Air Force Aircraft Maintenance and Overhaul Contracts 72
Sam Fleet Contract 72
F-4 Contract 74
Air Force Response to GAO CPPC Charges 76
GAO Rebuttal to Air Force Use of Forward Pricing 77
CPPC and Firm Fixed Price Contracts . . 77
Air Force Retort: F.F.P. Contracts and CPPC are Nonsequitur 79
CPPC Invalidity Impact 80
CPPC Prohibition Based on Cost Type Contracts 81
Safeguards to Prevent CPPC Cost Manipulations 82

VII. COMPENSATION UNDER ILLEGAL CPPC CONTRACTS 85

Plain Illegality Rule 85
Implied Contract Recovery Under the Tucker Act 86
Early GAO Treatment of CPPC Recovery . . 88
GAO Reliance on Judicial Precedence . . . 89
Evolution of Quantum Meruit Standards of Recovery 90
GAO and New York Mail 92
Supreme Court's Receive Nothing, Recover Nothing Rule 92
Yosemite Park: New York Mail Revisited 93
Illegal Contracts Sans Benefit Incurred: Plain Illegality and Void Ab Initio Rules 95
GAO Treatment of Compensation for Illicit Contracts Since the Early Seventies 97
Divisibility of Illegal Bargains 99
CA-FC Illicit Recovery Standards 100
Public Law 85-804 and CPPC Contract Compensation 102

VIII. CONCLUSION 105

Key Element: Ability to Manipulate Direct Costs 106
Recommendations 106
Fixed Price Contracts 107
Predetermined Overhead Rates in Cost Contracts 107

FOOTNOTES 109

SOURCES CONSULTED 127

Accession For
NTIS GRA&I ☑
DTIC TAB ☐
Unannounced ☐
Justification
By
Distribution/
Availability Codes
Dist | Avail and/or Special
A-1

FORWARD

The author is a Judge Advocate, Major, United States Air Force, currently assigned to Headquarters United States Air Force, Pentagon Washington D.C. The views espressed herein are solely those of the author and do not purport to reflect the position of the Department of the Air Force, Department of Defense, or any other agency of the United States Government.

CHAPTER I

INTRODUCTION

You can have your cake and eat it too! This might well have been the theme song of World War I Government contractors because many with cost-plus-percentage-of-cost (CPPC) contracts were in the lucky position of making more money by spending more money.

World War I wrought havoc on traditional Government procurement practices. The tremendous demand for war production, along with volatile labor and material prices, dictated a relaxing of the customary fixed price system of acquisition. Competitive bidding and fixed price contracts proved untenable because, not only did many contractors refuse to bid for war production contracts on a lump sum basis, those that did often factored in exorbitant contingencies. CPPC appeared to be the answer to Government prayer, since it seemed to solve the problem of reluctant or unventuresome contractors. Perhaps it was also apropos for that unsettled era, but in any event, CPPC soon became a virtual cornerstone of Government acquisition.[1]

Definition

Cost-plus-percentage-of-cost (CPPC) is a method of contracting or a type of contract under which the contractor is not only reimbursed his performance costs but is also paid a stated percentage of his cost. Under this arrangement the higher the contractor's cost of performance, the more entitlement he accrues. In what may well be the definitive pronouncement on the subject, the United States Supreme Court in Muschany v. United States,[2] succinctly defined the cost-plus-percentage-of-cost system of contracting as those contracts:

to p. 1

> under which the Government contracts and is bound to pay costs undetermined at the time the contract is made and to be incurred in the future, plus a commission based on a percentage of these future costs.[3]

Four Point Criteria

Over the years, this classic definition has been paraphrased by the GAO and legal writers to state four essential elements, all of which must be present in order for the CPPC system of contracting to be found. The Comptroller General has most recently stated these four elements in Department of State, as follows:

(1) payment is at a predetermined percentage rate;

(2) this rate is applied to actual performance costs;

(3) the contractor's entitlement is uncertain at the time of contracting, and

(4) it increases commensurately with increased performance costs.[4]

This four point definition was adopted verbatim by the GSBCA in Urban Data Systems, Inc.[5] In the words of the Board: "While not controlling in this Board's decision, we are persuaded by the logic of those decisions which establish criteria for determining whether a contract is a cost-plus-a-percentage-of-cost."[6]

The United States Court of Appeals for the Federal Circuit also blessed this GAO four point analysis in Urban Data's appeal to that forum:

> We accept, at the outset, the general criteria developed by the Comptroller General for determining whether a contract is a cost-plus-percentage-of-cost contract. [The Court then quotes the four point criteria] . . . These standards incorporate the common understanding of the "cost-plus-a-percentage-of-cost system of contracting," an understanding which was undoubtedly in Congress's mind when it enacted the prohibition.[7]

Both the GAO and the court definition assume the contractor's ability to control and manipulate the incurrence of performance costs in order to increase the element of payment based on a predetermined percentage rate. That element of entitlement based on a percentage rate or amount may be variously fee, profit, commission and in some cases overhead.

CPPC Negatives

CPPC worked wonders with reluctant contractors! Yet, despite CPPC's popularity, the Government increasingly

had second thoughts about the prudence of the CPPC system.[8] It became more apparent with increased utilization of CPPC that whatever its positive attributes, the system was repleat with negatives. Fraud, waste, and abuse were actually encouraged to a degree. This became more agonizingly obvious as costs skyrocketed and profits soared.[9] In fact some officials began to suspect that many contractors were intentionally driving up costs to make more profits.[10]

The problem became quiescent after World War I since there was no need for any special inducements for government contractors in the decades between wars. However, as hostilities increased in Europe in the late thirties, Congress was faced with an ever-increasing demand to take the guaranteed profit out of war contracting.[11]

Succinct Sanction

In the early years of World War II Congress finally acted to outlaw the CPPC system. The probibition is briefly stated in one sentence: "The cost-plus-a-percentage-of-cost system of contracting shall not be used."[12]

Yet, Congress in its wisdom gave precious little guidance to the scope of its prohibition. Perhaps there was no requirement for elaboration because:

> The whole system was erased. No longer would an agreement be tolerated which rewarded a contractor commensurately with the injury inflicted on the government in the form of higher performance cost. Plainly, it was the intent of Congress to put an end to

> this undesirable paradox, no matter in what garb it might be clothed.[13] [emphasis original].

Despite the terse simplicity of the proscription, the eradication of CPPC has proven no simple matter, principally because it can be "clothed" in a wide variety of "garb"! Yes, CPPC or the elusive appearance thereof, still haunts the Government contract world of the eighties. It can rear its ugly head in any number of contexts, much to the chagrin of Government contract personnel.

Overview

This paper first traces the historical development of the CPPC ban. Then, provisions for payment at predetermined rates applied to actual costs are analyzed as well as the applicability of CPPC to after-the-fact pricing situations. Potential savings and avoidance approaches are reviewed and compensation under CPPC contracts is also discussed. The final chapter sets forth conclusions and recommendations for the prevention of CPPC cost manipulations.

CHAPTER II

HISTORICAL DEVELOPMENT

Before World War I

The origins of CPPC can be traced to the building industry. It was in fairly common use, at least in the building trades by the late nineteenth century, as evidenced by the substantial number of cost-plus cases that were reported.[14] For example, in 1894, a New York state court ruled that where a construction contract called for the payment of the cost of labor and material used in a building, and ten percent added thereto as profit, the prime contractor could charge an additional ten percent mark up upon the amount paid to subcontractors.[15]

A different result was reached in Isaacs v. Reeve,[16] an 1899 New Jersey case. This case held that a contractor should not be allowed to charge a sum for the mere supervisory attendance of one of the contractors, who did not do any actual work, in addition to the ten percent profit on costs.

Savannah, A & N.R. Co. v. Oliver,[17] is an early federal cost-plus case. In Savannah a prime contractor was to receive the actual cost of the work and labor performed,

as well as material and supplies furnished either by himself or his subcontractor and, in addition, 7-1/2 percent thereof as general contractor's profit. The court held that the general contractor was not entitled to charge for depreciation of the equipment used.

A 1917 New Jersey Court of Errors and Appeals decision, Shaw v. Beaumount Company,[18] was the subject of an article in one of the first volumes of American Law Reports, Annontated.[19] The case involved a construction contract. Under the terms of the agreement the builder was "to receive for its entire compensation for its services in so doing [i.e., building] a sum equal to 10 percent of the entire cost of such building."[20] The court held that the builder was not entitled to receive for his services, in addition to cost plus 10 percent called for by the terms of the contract, a proportion of the salaries of its officers supervising the construction. The court also disallowed separate overhead charges as well as "ten percent on the cost of financing the building."[21] The contractor apparently was not satisfied with a mere cost plus 10 percent of cost!

World World I

The cost-plus-percentage-of-cost mode of contracting was initially sanctioned for government procurement by the National Defense Act of 1916.[22] During

World War I, the Government used the CPPC contract extensively to encourage inexperienced contractors to manufacture new types of war materials. According to the Rear Admiral McGowan, who adressed the subject of "cost-plus contracts" in the Paymaster's Report of 1918:

> When the contractor has no past experience on which to base a price, where the material is complicated and subject to changing plans and specifications or wide fluctuations in raw material cost, a cost-plus contract has been employed. Contracts for novel production, particularly along the lines of airplanes, large calibre guns, and shells for same, steel or wooden ships, and optical glass work, have been so handled. It has also been found necessary to place such contracts in cases in which the contractor, though deserving of confidence lacked sufficient capital and plant equipment and in certain engineering or building cases in which a cost-plus contract had been standard since its authorization by section 120 of the Act of 3 June, 1916.[23]

The Government was vindicated for its use of CPPC in World War I in the sense that war production was in fact rapidly increased. Yet, from a financial perspective, the costs were certainly excessive. This is borne out by an editorial in one of the leading technical journals of the time:

> Of course this method of procedure [cost-plus-percentage-of-cost contracting] will have its critics. There will be cries of favoritism and excessive costs. In the matter of cost we must realize at the outset that emergencies such as the present one are not times for bargain hunting. We want work on a vast scale done in an incredibly short time, and we will have to pay for it.[24]

CPPC Justifications

The justification for using CPPC during the First World War years have been summarized as follows:

GOVERNMENT WAR CONTRACTS

(1) It was tried and proved method of compensation for emergency work in contracting experience and was so recognized among construction engineers of the highest standing.

(2) It enabled well equipped building organizations to begin work almost instantly on essential parts of the contract without waiting for detailed plans and specifications which on the fixed amount system must be made the basis of estimates. It was therefore a time saver in an hour when time was almost everything.

(3) It admitted of the selection of contractors with special regard to their records of execution and reliability, as against the risky method of award of the lowest bidder who might be a "plunger," thus taking advantage of what amounted to a more effective kind of competition in such selection, on the basis of demonstrated merit.

(4) It -- the cost plus percentage of fee system -- appealed to the fair minded contractor on the basis of an exceptional opportunity to make a record of his best work, because it was to be done under conditions in which he was released from concern about his own profit, and was thereby freed to concentrate his efforts on the essential points of speed of execution, prime quality and the lowest cost practicable within the accompanying circumstances of war time work.[25]

No doubt this damn the torpedoes, full speed ahead approach to Government contracting did appeal to "fair minded" contractors, and maybe even to some not so fair minded!

Early CPPC Misgivings

In spite of the virtues extolled by the advocates of CPPC in the height of its glory, there were still strong misgivings harbored by many contract experts of the era. For example, the Interdepartmental Conference of July, 1917 (with delegates from Departments of War, Navy, Commerce, Federal Trade Commission and Council of National Defense) concluded:

> The interests of the United States and the contractor are inevitably opposed if the profit is based on a percentage of cost. The temptation is great to the contractors to inflate his own cost as well as the costs of subcontractors, and the task of the United States is difficult and burdensome in checking and determining proper costs.[26]

The Navy also expressed second thoughts in 1918 about the continued wisdom of using CPPC. It was viewed as an expedient of an emergency nature that "[s]o far as the supplies and materials are concerned, such a contract has practically outlived its usefulness."[27] Congress evidently agreed that CPPC had outlived its usefulness, but not with respect to supplies and materials. Public Law No. 164, 65th Congress (H.R. 12, 280) May 25, 1918, amended section 7 of the Housing Act of May 16, 1918 to prohibit CPPC in Government contracts for housing facilities. This was the first restriction placed on the power to employ CPPC in Government contracts. The act as amended read in pertinent part:

> Section 7. That no work to be done or contract to be made under or by authority of any provision of this act shall be done or made on or under a percentage or cost-plus percentage basis, ...[28]

It is interesting to note that the terminology "system of contracting" was not used as in subsequent legislation. The legislative history does not address section 7, so it is difficult to divine Congress's specific motivation in this first CPPC ban.[29]

Decisions and Rulings on World War I CPPC Contracts

In the decade after World War I, the Comptroller of the Treasury, and the Court of Claims ruled on matters involved in various war time CPPC contracts. In the case of James Stewart & Co.,[30] the Claims Court held that where it was necessary for a cost-plus contractor to employ men, designated as "expediters" to travel around to different places to secure labor and the prompt delivery of materials for the work under the contract, and the employment of such men received the approval of government officials in charge of the work, the expense of their employment was part of the cost of the work. In this same case the Comptroller of the Treasury had previously disallowed the expenses of the "expeditors."[31]

In a decision dated November 21, 1919, the Comptroller of the Treasury held that the cost of a small

publication by CPPC contractors for the purpose of stimulating their workmen and improving morale of the job was not one of the "actual and essential elements" in the cost of the work for which reimbursement was authorized.[32]

In the Austin Company v. United States case,[33] the expenses of securing labor and the purchasing and expediting delivery of materials were entitled to be reimbursed. Interest on loans to carry on work under CPPC contracts was held not to constitute part of the cost of the work, and in Fred T. Ley & Co. v. United States,[34] it was held that public liability insurance not required or approved by the contracting officer is not a part of cost of construction and cannot be reimbursed. Similarly, in the Hurley-Mason Company v. United States case,[35] the contractor was not entitled to reimbursement of fidelity insurance for protection of funds not approved or required by the contracting officer.

CPPC Between the Wars

The period between World Wars saw little concrete development on the CPPC front. This was because there was little need for any expedient or rush Government acquisitions of novel or untested war materials. However, there was an increasingly popular view holding the CPPC contract fostered inefficiency and "exorbitant" profits.[36] In fact, there was some lobbying in Congress as early as

1931 to eliminate CPPC as a method of government contracting. In his testimony before the War Policies Commission of the U.S. House of Representatives, Mr. Bernard Baruch called for a permanent ban on CPPC, since it provided industry with a positive incentive to be wasteful and inefficient in the use of labor and materials.[37]

A few years later in 1934, the "Nye Committee" was instituted in the Senate to investigate the munitions industry, review the findings of the War Policies Commission, and inquire into the desirability of creating a government monopoly with respect to the manufacture of munitions.[38] The hearings and recommendations of this committee were highly publicized. Senator Nye used the committee to further his argument that war was caused by the machinations of those who stood to gain financially therefrom. He proposed as a remedy the establishment of a government monopoly of all munitions manufacture. But, the establishment of the committee also served to stimulate a large number of proposals for eliminating profiteering, on the assumption that private industry would supply the bulk of munitions in peace and war. During the twenty-three years between the wars, approximately 200 bills and resolutions dealing with the limitation of war profits were considered by Congress.[39]

World War II Legislation

Yet, despite all the hoopla about profiteering by Government defense contractors, nothing was done to legally proscribe the use of CPPC until 1940. Through a series of acts in 1940, in response to the increased war tempo, the War Department was given wide discretion to place contracts by negotiation.[40] Although these acts prohibited the use of CPPC contracts, they did authorize the use of CPFF contracts but limited fees to six or seven percent of estimated costs. After Pearl Harbor the CPPC ban was repeated in the First War Powers Act.[41]

The Second War Powers Act passed in 1942 contained similar limitations: "the cost-plus-a-percentage-of-cost system of contracting shall not be used under the authority granted by this paragraph to negotiate contracts."[42]

World War II Statutes & CPPC Subcontractors

In accordance with the provisions of these statutes, Government contracting agencies discontinued the letting of prime contracts on a CPPC basis.[43] However, prior to 1942 no regulations were issued by the Government contracting agencies applying this limitation to subcontracts entered into by Government prime contractors and therefore, many prime contractors entered into subcontracts on a CPPC basis when such basis was deemed reasonable and necessary under the particular circumstances.

This was especially true in the building construction field, where the CPPC system of contracting was not uncommon.[44]

The question as to whether the inhibition upon the Government contracting agencies in entering into contracts on a CPPC basis applied to subcontracts was first raised March 13, 1942 by the Comptroller General's Decision B-23293.[45] The War Department, under the authority granted by the Act of July 2, 1940, entered into a CPFF prime contract with Day and Zimmerman, Inc. a building contractor. Day and Zimmerman subsequently subcontracted with the Western-Electro-Mechanical Co. on a CPPC basis for $150,194.19. The Comptroller General ruled that subcontracts on a CPPC basis were in contravention of the spirit and purpose of the CPPC statutory ban. He stated that it was evident that the prohibition against this form of contracting could be substantially evaded and the purposes thereof defeated, were it not applied to the performance of that part of the contract work sublet by the prime contractors. In 1965, the GAO reiterated this same principle applying the current statute.[46]

Early Judicial Treatment: 94.68 Acres and Muschany

The first case to interpret the statutory ban against the CPPC system of contracts was a 1942 United States District Court decision, United States v. 94.68 Acres of Land:[47]

> Congress, no doubt anticipated that learned, technical, and weird definitions of cost-plus-a-percentage-of-costs contracts would follow a prohibition of a particular species of such contract, wisely broadened the prohibition to extend to all transactions in which the system was used. What was the "system" and what was the vice to be eliminated? The system was the method of contracting whereby the Government agent's profit or compensation was increased in direct proportion to the cost of the object or commodity itself to the Government. The vice was the temptation, oftentimes not resisted to deliberately or carelessly cause or permit the cost of the object to be increased in order to increase the profit or commission.[48] [emphasis added].

The decision that still stands today as the most authoritative interpretation of Congressional intent in prohibiting the CPPC system of contracts is Muschany v. United States, 324 U.S. 49 (1945).

In this famous decision, the Supreme Court reviewed a War Department agreement which provided that a Mr. McDowell was to obtain options to purchase 18,000 acres of land near Weldon Springs, Missouri, where the Government was planning to construct a munitions factory. Pursuant to the original contractual arrangement, McDowell was to be paid by the Government a 5% commission on the gross sale figure for each parcel of real estate he acquired. Later McDowell, ostensibly with the concurrence of the contracting officer, "adopted a plan under which the landowners executed options for a price which included the 5% commission. The obvious result being that the more the land cost, the greater McDowell's commission." Not too surprisingly

McDowell rather quickly "obtained 270 separate options and promptly recommended their purchase to the Department at the stipulated prices." The Government accepted 120 options after only an apparent cursory review, and purchase contracts totaling about one million dollars were executed. Because of a Departament of Justice investigation of the matter, the remaining 150 contracts were "repudiated" and the Government obtained immediate possession of the land through condemnation proceedings. In the condemnation litigation the Government sought, as to the uncompleted McDowell transactions, to pay only a fair or reasonable amount for the property.[49]

By virtue of the nature of McDowell's contract, the harder he strived to reduce the purchase price of the real estate he acquired, the less he made. He obviously could not profitably serve his own interests and that of the government at the same time. "Only by acting to the financial disadvantage of the Government could he act for the financial advantage of himself."[50]

Nevertheless, the majority did not find any CPPC violation in the McDowell arrangement. They reasoned that McDowell was only getting a fee "based on a percentage of the purchase price." He was not reimbursed his costs. The offers to sell to the Government were at a definite fixed price. Upon acceptance of an offer the Government agreed to pay a set amount. There was no provision providing for

inflation or escalation of cost or price based on future contingencies. According to the Court, the cardinal CPPC "vice" was not present in the vendors' contract i.e., there was no incentive for "the contractor to inflate his future costs to increase his profits since the Government is already bound to pay any future undetermined costs."[51] This was because the contracts McDowell arranged were not subject to any future change by the vendors. The Government had knowledge of the exact total cost when it became bound on the contract. "If we read the vendors' contract as affected by the McDowell contract, no cost-plus-contract emerges." The court concluded, "[s]ince the United States is the purchaser of the land at the option price, no one can receive cost plus anything."[52]

Although the majority found no CPPC problems in the McDowell purchasing agreement, it was obvious from the following statement that they didn't consider it very prudent: "the fact that a procurement system is improvident obviously does not make it illegal."[53]

The Armed Services Procurement Act

In February 1948, Congress passed the Armed Services Procurement Act of 1947,[54] designed to give the services greater flexibility in procurement. Although the act does provide wide discretion and flexibility, especially with respect to negotiations and acquisition methods, there

is one obvious area which is clearly and succinctly limited i.e., CPPC. Use of the CPPC system of contracts is specifically forbidden. This law, along with the Federal Property and Administrative Act of 1949[55] governing procurement by the civilian agencies, stands today as the latest codification of the CPPC ban.

Regulatory Codification

The wording of the statutory prohibition is repeated in the Federal Acquisition Regulation (effective on 1 April 1984) in paragraph 16.102(c):

> The cost-plus-a-percentage-of-cost system of contracting shall, not be used (see 10 U.S.C. 2306(a) and 41 U.S.C. 254(b). Prime contracts (including letter contracts) other than firm fixed price contracts shall, by an appropriate clause, prohibit cost-plus-a-percentage-of-cost subcontracts.

The predecessors of the Federal Acquisition Regulation (FAR), the Defense Acquisition Regulation (DAR), the Federal Procurement Regulation (FPR) and the NASA Procurement Regulation (NASA PR) all contain similar language at paragraph 3-401(b) of the respective regulations.

Regulatory Restrictions and Subcontractors

FAR §16.102(c) DAR 3-401(b) and FPR 3-401(b) require all prime contracts not fixed price in nature, to include clauses to prohibit CPPC subcontracts. DAR 3-903.1 prescribes a subcontracts clause for cost prime contracts when there are subcontracts of $100,000, or if performance

is at a contractor plant involving predominately Government work, or if the prime contract value is a $1,000,000 or more. This clause requires the prime contractor to agree that no subcontract shall contain any CPPC payment provisions. This same agreement is contained in paragraph (g) of the standard subcontracts clause for cost reimbursement and letter contracts (DAR 7-203.8) and paragraph (b) of the standard subcontracts clause for time and materials and labor-hour contracts in FAR 52.244-3. The FPR did not have similar clauses, but this regulatory oversight was rectified by the FAR. However, the FAR dilutes the threshold requirements of the DAR and makes the CPPC prohibition provision applicable to any cost reimbursement, letter, time-and-materials and labor hour subcontract.[56]

In spite of the aforementioned regulatory provisions, the enforceability of the CPPC ban with respect to subcontracts is restricted principally to certain species or modes of acquisitions. Generally, the Government can supervise or review subcontracts under the primes only where they are subject to approval, e.g., when actual costs are reimbursed, under a mutually agreed upon make or buy plan or where proposed subcontract costs are analyzed. Thus, these conditions restrict the effectiveness and applicability of CPPC prohibition on subcontracts. Pragmatically, the ban can be enforced on subcontracts where submittals or certification of cost or pricing data must be submitted

under the prime contracts. The certificate of cost or pricing data is required by the "Truth in Negotiations Act"[57] and implementing regulations.[58] Generally, then the CPPC ban applies to subcontracts under prime cost contracts, letter contracts, time-and-materials as well as labor-hour and contract amendments of the same types, as these concepts are defined in the FAR.

However, generally there would seem to be no restriction or legal bar to the formation of a CPPC subcontract under a fixed price prime contract. Under a firm fixed price contract, the subcontractor's total performance costs would be absorbed by the prime contractor. No costs are passed on to the Government because under a fixed price contract there is no cost flow through. In fact, the FAR (16.102(c)) recognizes that the CPPC prohibition is not applicable to firm fixed-price contracts.

CHAPTER III

EXPLICIT PROVISIONS FOR PAYMENT AT PREDETERMINED RATES APPLIED TO ACTUAL COSTS

In spite of the unambiguous, succinct statutory sanction, there has been no shortage of explicit violations. Perhaps this isn't so surprising since the statutory language prohibits a "system of contracting" and not merely a type of contract.[59] Therefore many types of contractual provisions can come under the aegis of the CPPC prohibition. The most common type of CPPC arrangement is the use of predetermined percentages as a method of payment whereby a contractor is paid his costs plus a percentage of such costs. In recent years there have been a number of obvious CPPC transgressions involving the application of predetermined rates to actual costs.

Express application of pre-established rates to actual performance costs is apparently still fairly common in private industry, especially in the building trades.[60] Though most of the case law in this area deals with construction contracting, CPPC provisions are occasionally employed in advertising contracts. For example, in contracting for advertising services, preparation of exact

estimates is a problem that in the private arena is often "overcome by awarding contracts on a cost-plus-percentage of cost basis."[61] So in light of CPPC's continued use in private industry, it perhaps is not so unusual for express CPPC provisions to still crop up in government contracting.

FIXED RATE OF ENTITLEMENT

Violation of the CPPC statute may be present when payments to a contractor are made for actual cost incurred plus an amount of profit or entitlement which is determined by applying a predetermined rate or amount to the actual cost. It is a violation when the arrangement is such as to motivate the contractor to increase his cost of performance so that his profit will increase correspondingly. However, application of a predetermined rate will not violate the CPPC prohibition if the contractor can't escalate his entitlement by incurring more costs.

Some recent and blatant examples of explicit application of fixed rates of payment to actual costs involve three 1983 task order contracts for architect-engineering management services furnished to the Job Corps.[62] The Department of Labor agreed to reimburse three architect-engineering firms specific per day rates for different classes of employees who were to furnish office and field support. According to the contracts these rates incorporated not just salaries and wages, but also overhead,

G&A, and profit. Additionally, the contracts allowed the firms to add a percentage of costs to certain expenses:

> A maximum of [7.5 or 10] percent of basic costs shall be added by the contractor on all materials, subcontracts, travel, and other expense items to cover overhead and profit. A maximum markup of 5 percent will be added for all expenses that are not supervised and/or subcontracted for the contractor.[63]

There is nothing subtle or hidden about the CPPC aspects of this provision. It clearly provides that the contractor gets his costs plus a percentage of actual costs for profit. Also under this payment formula entitlement was uncertain and increased with greater performance costs. The GAO tersely concluded that this clause fell within the four point guidelines for determining whether a contract constitutes a CPPC system of contracting.

In Urban Data Systems v. United States,[64] the United States Court of Appeals for the Federal Circuit was confronted with some obvious contractual illustrations of the application pre-established percentage rates to performance costs. Urban Data Systems, Inc. was a contractor under the §8(a) program of the Small Business Act, 15 U.S.C. §§631 et. seq. (1970). One of the SBA/Urban subcontracts contained in the following provisions for price adjustment:

> It is further agreed that in the event the findings as contained in the audit report indicates [sic] that an increase in the unit price is in order such price shall be increased accordingly (utilizing the proposed 10% profit factor) and the total contract value adjusted. The price will not be increased in any amount above the price offered in the proposal.[65]

According to this clause Urban could increase its price after an audit, with a predetermined percentage rate profit of 10 percent applied to actual costs. The GSA Board of Contract Appeals ruled that this provision rendered the contract "void ab initio" since it constitutes a "cost-plus-a-percentage-of-cost" arrangement. The Court of Appeals for the Federal Circuit concurred after applying the GAO's four point standard:

> These gauges squarely apply to the subcontracts before us. Subcontract 103 provides for payment at a predetermined 10 percent rate to be applied to actual performance costs and Urban's entitlement, which was uncertain at the time of contracting, would increase commensurately with increased performance costs.[66]

Cost Plus Fixed Fee

The cost-plus-a-fixed-fee (CPFF) contract is a cost reimbursement type of contract which provides for the payment of a fixed fee to the contractor. The fixed fee once negotiated does not vary with actual cost.[67] In Program Resources, Inc. the ASBCA held:

> It is inherent in cost-plus-fixed-fee contracts that before the fixed fee may be increased or decreased there must be some change in the scope or nature of the work to be performed by the contractor. A contract in which the fee increases or decreases in proportion to the reimbursable cost of the work is a cost-plus-percentage-of-cost contract and is prohibited by law.[68]

A CPFF contract by definition then cannot violate the CPPC ban. No matter how extensive the costs incurred, there is no corresponding increase in entitlement or profit

since the fee cannot fluctuate. The contractor has no incentive to run up costs to get more profit. Since CPFF is apparently immune from CPPC possibilities, it is not surprising that occasionally CPPC provisions have been made to appear to be CPFF in an attempt to avoid invalidity. One way this has been attempted is by characterizing a predetermined percentage rate to be applied to actual costs as "fixed" and thereby avoid a CPPC challenge. The Agency for International Development (AID) tried this approach on two contracts for "maintenance, supply, and related services necessary to operate aircraft provided to the Government of Burma for its Narcotics Control Program." Both contracts were designated "fixed price technical service contracts." In fact many of the costs were fixed by either list prices or established wage rates. However, for many items, including supplies shipped from overseas and subcontracted work, the contractors were reimbursed actual costs plus a management fee on a sliding scale as follows:

Monthly Reimbursable Cost	Management Fee
$ 0 - 5,000	$ 250
5,001 - 10,000	750
10,001 - 15,000	1,250
15,001 - 20,000	1,750
above 20,000	$750 plus 500 for each additional $5,000 of invoiced costs[69]

AID asserted to the GAO that the management fee provisions did not violate the CPPC proscription because they are not a percentage of costs. AID characterized them as "several different fixed fees based on different levels of effort."[70] [emphasis added]. AID also argued that its contractors had little control over invoiced costs and usually they had little choice of supply sources. Additionally, AID asserted that contract performance was closely checked on by the contracting officer's technical representative. Finally AID concluded that the contractors under this arrangement had no realistic chance to manipulate their fees by selecting less efficient or high priced supplies or subcontractors.

The GAO wasn't very sympathetic to AID's fixed fee rationale for CPPC avoidance:

> We do not believe that characterizing these as fixed fee contracts, merely because some of the items to be delivered or services to be performed will be at a set price, or characterizing the management fee as a fixed fee which varies with level of effort, prevents these contracts as a whole from being contrary to statute. As we have pointed out, what Congress provided against was not a cost-plus-a-percentage-of-cost contract, but such a 'system of contracting.' 22 Comp. Gen. 784 (1943). The 'evil' of this system is that contractors have an incentive to pay liberally for reimburseable items, because high costs mean higher profits.[71]

Cost Plus Incentive Fee

The cost-plus-incentive fee contract (CPIF) is a cost-reimbursement contract that provides that the contractor's fee will be determined by the application of a

pre-established formula included in the contract. FAR 16.404-1 describes this type of contract as follows:

> (a) Description. The cost-plus-incentive-fee contract is a cost-reimbursement contract that provides for the initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs to total target costs. This contract type specifies a target cost, a target fee, minimum and maximum fees, and a fee adjustment formula. After contract performance, the fee payable to the contractor is determined in accordance with the formula. The formula provides, within limits, for increases in fee above target fee when total allowable costs are less than target costs, and decreases in fee below target fee when total allowable costs exceed target costs. This increase or decrease is intended to provide an incentive for the contractor to manage the contract effectively. When total allowable cost is greater than or less than the range of costs within which the fee-adjustment formula operates, the contractor is paid total allowable costs, plus the minimum or maximum fee.

This kind of incentive is not subjective because the fee paid the contractor is derived by a negotiated mathematical formula incorporated in the contract prior to award. As a result, the amount of the fee cannot be changed by any after-the-fact determination by the government. However, the government does have some discretion in selecting targets which are used to measure contract performance. Target selection regrettably is prior to commencement of performance when neither the contractor nor the government have very accurate data pertaining to the precise work that will be required. Thus, CPIF contracts can result in a contractor being entitled to a fee that is not indicative of the actual value of his performance if the complexity or difficulty of the work is not accurately estimated in creating the targets.[72]

The essential ingredients of the cost plus incentive fee formula covering the costs of performance as set forth in FAR 52.216-10 and DAR 7-2034(b) are: Target Cost, Target Fee, Maximum Fee, Minimum Fee and Sharing Arrangement.

The quintessence of the CPIF formula is that:

> [T]he contractor's earned fee varies inversely with the amount of costs incurred as long as the actual costs incurred fall within the range of sharing established by the points where the maximum fees take effect. Once these points are reached, the contract becomes a cost plus fixed contract at either the maximum or minimum fee depending on the circumstances.[73] [emphasis added].

Thus, CPIF in the final analysis is virtually the same as CPFF with respect to CPPC potential since CPIF "becomes a cost plus fixed fee contract when either maximum or minimum fee is reached."[74]

Decline at a Pre-established Rate

Of course not all CPPC violations involving explicit application of predetermined rates to performance costs are as obvious as those in Urban Data, or the Job Corps contracts previously mentioned. What if profit declines at a predetermined rate applied to actual cost? Such was apparently the case in one of the Urban Data contracts. A contract that was surprisingly complex and confusing in its payment provisions. At least the contractor, the contracting officer and the board (whose views were adopted by the CA-FC) all derived apparently

reasonable but different interpretations from the same contract language concerning entitlement.[75]

The controversial contract 016 was for "a definite quantity of tabulating paper in varying quantities, sizes and unit prices, totaling $1,699,064." Urban had originally suggested a price of $1,352,728. This proposed price was figured on the basis of Urban's "contemplated costs plus a profit of five percent of those costs." It was more like a target cost in a CPIF contract because it was subject to the following price adjustment clause:

> It is understood by and between the parties hereto that the individual prices for the items as stated herein will be subject to post-award audit.
>
> It is further agreed that in the event the findings as contained in the audit report indicates [sic] that a reduction in all or any of the unit prices *is in order* such prices shall be reduced accordingly (utilizing the proposed 5% profit factor) and the total contract value adjusted.[76] [emphasis added].

It is not clear who suggested this price adjustment clause *i.e.*, Urban or the Government. But since it provides for "reductions" in the "contract price" one would suspect that the Government probably authored this little gem.

The post-performance audits revealed that Urban underran the estimated price on 016 by $64,318. Judging from the figure ($64,318) submitted in its claim, Urban evidently did not believe a reduction was "in order," since the $64,318 figure constituted the full amount of the underrun without any reductions as contemplated by the price

adjustment clause. The contracting officer apparently felt that the audit report indicated a unit price reduction was "in order" because he factored in a profit reduction of 5% of the underrun in his final decision. He found that Urban owed the government a total of $67,533 ($64,318 plus the profit reduction factor of 5% of underrun, i.e., $3,215) on contract 016.

Interestingly enough, "the Board agreed with Urban's method of calculating the amounts due," and not with the contracting officer's approach. Yet, the GSA Board characterized the adjustment clause as a unique, but nevertheless prohibited, "cost-plus-a-percentage-of-cost" clause. It was unique according to the board because it provided "for reductions rather than increases in contract price."[77] [emphasis original].

At first blush it's hard to visualize how an arrangement for price reductions could possibly be held to be CPPC, especially if Urban gained less profit by incurring more cost. But was this really the case? The "contractual scheme" was not exactly crystal clear. The Federal Circuit adopted verbatim the GSA Board's conclusion that:

> [t]he contractual scheme envisioned by appellant was that the appellant was to be paid its audited costs plus five percent of those costs. We are driven to this conclusion by the mathematics of the contractual mechanism by which a 'contract price' is calculated on estimated costs plus a five percent profit with the contractor to receive payment of the 'contract price' with the profit applicable to such unincurred costs....In short the appellant under contract 016, was at all times under an incentive to incur costs to within ninety-five percent of the original 'contract

price'; i.e., its estimated costs plus five percent.[78] [emphasis original].

The mathematics driving this conclusion are a little suspect since they don't compute to 100%. But even without the ambiguous adjustment clause, the GSA Board and Federal Circuit might have struck the arrangement down for CPPC since the proposed price or target price "included a profit equal to approximately 5 percent of the total cost per unit." And if in fact the proposed price was meaningless (not an absolute ceiling) then it certainly could be argued that Urban would be entitled its cost plus five percent of those costs as profit. In other words, the court did "not consider that contract number 016 ever had a contract price in any true sense of the term..." because whatever the price stated, "The result would be the same."[79] The true basis then for Urban's entitlement was cost plus five percent of those costs as profit.

Bonuses and Incentive Compensation Provisions

Many commercial enterprises offer bonuses on other incentive compensation to their officers or employees. If the business involved happens to be a government contractor, problems may arise when the bonus or incentive expenses are charged to a government contract. A bonus has been traditionally viewed by the courts not to be a "gift or a gratuity, but is a sum paid for services, or upon a consideration in addition to or in excess of that which

would ordinarily be given."[80] In other words, a bonus is a benefit "over and above what is normally due as remuneration or the receiving money or its equivalent, given as a premium or an extra or irregular remuneration in consideration of officers' performance or to encourage their performance."[81]

The question of allowability of a bonus or incentive usually surfaces without regard to the type of contract concerned. In any instance, for a bonus to be reimbursable by the government, certain regulatory cost principles must be met as a condition of cost allowance. The principal requirements are that bonuses must be paid "pursuant to an established plan,"[82] and that the bonus be reasonable in light of the work performed.[83]

Incentives and Bonuses Measured by Profits

The regulatory language found in the DAR, FPR and now the FAR authorizing recovery of incentive compensation payments predicated upon "production, cost reduction, or efficient performance" has been employed to sustain recovery of such compensation measured by profits.[84] The ASBCA in Bell Helicopter Co., allowed costs of incentive compensation for management employees which the Government asserted constituted a distribution of profits. The board was "unpersuaded by the Government's argument that incentive payments representing the distribution of profits are unallowable."[85]

More recently in Lulejian & Associates,[86] the ASBCA has held that portions of cash bonuses paid to a contractor's chairman and vice-president, who happened to own a substantial interest in the corporation, was unreasonable. In arriving at this conclusion, the board cited DAR 15-205.6(a)(2)(i) calling for "special consideration" of the compensation paid to owners of a closely-held corporation in order to ascertain that such compensation is "reasonable for actual personal services rendered rather than a distribution of profits."[87] The FAR language is slightly different. The FAR allows such compensation to the extent that it is reasonable and does not constitute a distribution of profits."[88]

Predetermined Rates and Executive Bonuses

As a general rule, a CPPC violation in the arena of executive bonuses is possible only in the context of a closely held corporation, partnership or similar business enterprise. Even if a close corporation has an established bonus or incentive plan that is "reasonable," it is in violation of the CPPC ban if the bonus or incentive constitutes a distribution of profit at a set rate or stated percentage. This is because the true benefactors of the closely held corporation, the executive owners, get the benefit of not only reimbursement of their costs -- but additionally, a percentage of the same costs in the guise of

bonuses or incentives. In National Electronic Laboratories, Inc.,[89] the ASBCA was confronted with an executive bonus situation where the president owned "99% of the stock in the corporation" and his wife owned "one-half of the balance." The Government argued that the large bonus involved in this case constituted a distribution of profit and was therefore unallowable. There was no consideration of any CPPC possibilities. The board found the bonus unreasonable apparently since it was paid for the first time after the contractor had received a Government contract.[90]

Express use of predetermined rates not relating to profit or overhead was found to be in violation of the CPPC ban in Air Repair.[91] The ASBCA was confronted with a contractual arrangement that provided an executive bonus at the rate of 2-1/2 percent of gross company billings, including costs incurred under the contract. The board specifically found that the "bonus did not constitute a distribution of profit for the obvious reason that it was clearly a form of compensaton paid or promised him for services rendered or to be rendered." If no profit or overhead is involved, an argument can be made that there is no CPPC violation. The corporate contractor does not get cost-plus-a-percentage-of-its-costs in this instance. However, the board astutely observed that the executive, in this case "the director and principal individual in the appellant firm had the certain power to unfairly increase

the costs of performance to his own or the contractor's benefit..." The board in effect decided to pierce the corporate veil in dealing with a small company whose principal officer might well be tantamount to the alter ego of the firm. Ironically in this case there is no evidence of inequitable increases in costs, but nevertheless, "the theoretical contravention of the prohibition is adequate to make the arrangement illegal."[92]

RATE OF RETURN ON INVESTMENT

The Yosemite Park and Curry Company[93] (YPC) case provides a fascinating example of a unique cost-plus -fixed-fee contract involving a fixed rate of return on investment provision. According to the terms of the basic agreement YPC was to furnish free public bus service and the National Park Service (NPS) was to reimburse YPC for its "actual expenses" plus a "reasonable profit." A supplemental agreement permitted YPC to recover federal income taxes as an allowable cost. Additionally YPC was to be paid an annual operating fee at the predetermined rate of "12-1/2 percent of its average gross investment in the transportation equipment."[94]

The court held that the payment provision violated 41 U.S.C. § 254(b) which was quoted in full text at footnote 3 of YPC. The court focused on the contract's violation of the statutory 10% fixed fee limitation. The possible CPPC

aspects of the payment formula was not addressed. The court determined that allowing more than 10% of the cost of the contract on a "cost-plus" contract clearly violated 41 U.S.C. § 254(b). The court also took a dim view of the provision for income tax recovery as a reimbursable fixed cost since this was in obvious conflict with procurement regulations.[95]

But was there a CPPC violation also? YPC was to be reimbursed at a predetermined percentage rate of 12-1/2. This certainly satisfies the first prong of the classic fourfold CPPC test. Here YPC's entitlement percentage rate was clearly fixed before performance.

However, was this predetermined rate applied to actual performance costs? The issue here is whether "average gross investment in the transportation equipment" constitutes actual performance costs. If capital investment in buses comes within the purview of the term cost even though it is an investment in physical assets (buses) and is treated separately from costs under the agreement, then a predetermined rate is in fact applied to actual costs.

YPC's arrangement certainly does satisfy the third element of the CPPC test since its total entitlement was indeed uncertain at the time of contracting. YPC's entitlement would vary depending on the amount of investment in buses.

The fourth element of the CPPC test is whether the contractor's entitlement increases commensurately with increased performance costs. Does buying more buses increase the cost of performance? Could YPC manipulate its entitlement by buying more buses? Arguably, yes, since for example, if YPC bought two buses for $100,000 it would be entitled to $112,500 reimbursement based on the 12-1/2% fee. But better yet, if YPC invested $200,000 in buses the fee would be $25,000. The more the investment or cost, the more the fee because it is a percentage of direct investment cost in this case. Not only was YPC's predetermined rate on investment in violation of the 10% limit, but it is also a potential CPPC provision that did not come to the attention of the court.

Facilities Capital Cost of Money

Does any CPFF contract which provides that facilities capital cost of money is an allowable cost of performance potentially violate the CPPC ban? Probably not, because if a contractor is compensated for facilities capital cost of money both as a direct cost, as well as indirectly in profit or fee, it would be double charging but not CPPC. Office of Federal Procurement Policy (OFPP) Policy Letter 80-7 specifically addresses this problem of double compensation by stating that: "Agencies shall ensure that contractors are not compensated for facilities capital

cost of money both as a direct or indirect cost and in profit or fee."

Pre-Established Overhead Rates

The GAO has long held that contractor payment predicated on predetermined overhead rates rather than on the basis of actual performance costs violates the CPPC proscription.[96] In the first published opinion to strike down predetermined overhead rates, the GAO was confronted with contract provisions providing for payment of allowable overhead costs on a basis of a fixed rate that was 100% of salaries and wages reimbursable under the contracts. The decision succinctly stated that:

> An agreement to pay a stipulated percentage of cost undetermined at the time the contract is negotiated, is illegal, being contrary to the long-established policy of the Government as evidenced by the provisions contained in the statutes and Executive order cited as authority for the contracts involved, which expressly prohibit the use of the cost plus a percentage-of-cost system of contracting.[97]

The following year, the Comptroller addressed similar fixed rate overhead provisions, but this time the GAO provided a little more in-depth analysis justifying the conclusion that such fixed overhead rates violate the CPPC ban.[98] Two of the contracts considered by the Comptroller, were Air Force CPFF contracts which provided for the payment of overhead at the rate 115 and 55 percent of direct salaries and wages. The other two contracts reviewed in the opinion were Army ordinance contracts with 36% and 38% fixed

overhead rates as a percent of the direct cost of employee compensation. None of the contracts had any provision for retroactive adjustment to actual cost.

The GAO observed that the predetermined overhead rates involved "were intended to represent payment for reimbursable indirect costs." These costs were not for the purpose of enhancing "the net return of the contractor." Notwithstanding their intended purpose, as long as the overhead ultimately paid varies "in proposition to direct costs incurred rather than the overhead incurred by the contractor, we are of the opinion that the contracts violate the express prohibition against cost-plus-a-percentage of cost..." It was also the GAO's opinion that use of predetermined overhead rates may prove to be "unfair" for either the contractor or the government because:

> [S]uch fixed rates are inconsistent with the basic principles of a cost-type contract in that they will not normally result in reimbursement of the actual cost. Accordingly, the practice of paying overhead on the basis of fixed percentage rates...should be discontinued.[99]

Nevertheless the Comptroller did in this same decision endorse the practice of using "provisional percentage rates" with provisions for retroactive adjustments to actual costs.[100] In response to this GAO position, the Department of Defense formally discontinued the use of predetermined overhead rates on July 1, 1956. Thus, current cost reimbursement contracts which employ specific overhead rates as a criteria for payment do so on a

provisional basis, with the rate subject to recomputation to conform with actual costs upon completion. DAR 3-707, and FAR 42.707 provide that "ceiling" rates may be used as long as the contractor is paid the lower of ceiling or actual cost.

However, because of legislation enacted in 1962, there exists a major exception to the ban versus employing predetermined overhead rates. Pre-established overhead rates can be used in contracts with "universities, colleges, or other educational institutions."[101] Even though not set forth specifically in 10 U.S.C., this statute is obviously applicable to all government procuring agencies, [102] and such practices have been permitted by the regulations.[103]

The FAR does not give carte blanche or unfettered authority to use predetermined rates for "reimbursable indirect costs" with educational institutions. The FAR sets forth the following guidance for deciding whether to use predetermined overhead (indirect) rates:

> (2) In deciding whether the use of predetermined rates would be appropriate for the educational institution concerned, the agency should consider both the stability of the institution's indirect costs and bases over a period of years and any anticipated changes in the amount of the direct and indirect costs.
>
> (3) Unless their use is approved at a level in the agency (see subparagraph (a)(2) above) higher than the contracting officer, predetermined rates shall not be used when —
>
> (i) There has been no recent audit of the indirect costs;
>
> (ii) There have been frequent or wide fluctuations in the indirect costs rates and the bases over a period of years; or

(iii) The estimated reimbursable costs for any individual contract are expected to exceed $1 million annually.[104]

CHAPTER IV

IMPLICIT PROVISIONS FOR PAYMENT AT A PREDETERMINED RATE

Firm Fixed Price Level of Effort Contracting

In recent years, Firm Fixed Price Level of Effort (FFPLOE) contracting (DAR 3-404.7 & FAR 16.207) has become increasingly popular on large dollar government contracts. The FAR adds the word "term" to the title making Firm Fixed Price Level of Effort Term (FFPLOET) and describes it as a contract that:

> requires (a) the contractor to provide a specified level of effort, over a stated period of time, on work that can be stated only in general terms, and (b) the government to pay the contractor a fixed dollar amount.[105]

If a FFPLOE contract literally follows the regulatory recipe there would appear to be little if any CPPC potential since the government is required to pay only a fixed dollar amount. The CPPC possibilities materialize, however, when hybrid payment or entitlement clauses are added to a FFPLOE or FFPLOET contract.

For example in July 1983, Air Force auditors requested legal guidance as to whether certain price reduction clauses then used in many Air Force FFPLOE contracts (being audited) violated DAR 3-401(a)(2), the

regulatory embodiment of the CPPC statutory prohibition. The auditors asserted: "We believe the price reduction clauses creates [sic] a cost-plus-percentage-of-cost contract line item because it allows payment to the contractor for expended other direct cost (ODC) plus the negotiated profit percentage."[106]

One of the audited contracts exemplary of the auditors' concern contained two line items for a study on "Defendable Modular Array Basing." Item 1 required the contractor to furnish a maximum of "5,053 direct equivalent engineering labor hours." Item 2 permitted the contractor to spend a maximum of $32,283 for "other direct costs" (ODC) in support of item 1. The contract also incorporated a special provision, H.94 entitled "Recoupment of Unexpended Hours and Non-Labor Dollars." This clause required reduction of the contract price when the number of labor hours of the amount specified for non-labor effort has not been expended.[107]

It was the reduction method for item 2 that caused the CPPC concern. The reduction for item 2 (ODC) was determined by multiplying the difference between the actual other direct costs expended and the direct costs originally estimated by a predetermined percentage rate (108.378%) which included profit. Air Force General Counsel (AF/GC) concluded that this arrangement guaranteed the contractor his "allowable costs plus 8.378% for every dollar of

allowable cost spent by the contractor." AF/GC was not persuaded that maximum $32,283 limit for ODC saved H.94 from violating the CPPC ban as evidenced by the following legal analysis furnished the Air Force auditors:

> The predetermined rate of 8.378% for profit is applied to actual costs of performance through the reduction mechanism contained in H.94. The contractor's entitlement is uncertain at the time of contracting since neither the effort nor the amount for ODC is fixed (the contractor merely being authorized a 'maximum of $32,283'); the costs are determined by the application of DAR Section XV, and the payment depends upon application of a predetermined percentage rate to the actual costs. Finally, the contractor's entitlement increases with additional performance costs because the amount recouped under H.94 is reduced when the contractor spends a larger amount of money on 'other direct costs.' Presumably, if effort is required in excess of the maximum amount it will be increased or the contractor need not perform the effort. While we recognize that the provision is a laudable attempt to prevent overpayment of the contractor, we believe that the result constitutes an illegal system of contracting.[108]

Not all the audited FFLOE contracts with price reduction clauses were determined to be in violation of the CPPC ban because in many instances there was "no application of a predetermined percentage to incurred cost to determine contractor entitlement." Nevertheless, AF/GC was very concerned that the FFLOE hybridized Air Force arrangements might constitute "a form of contract without basis in the Defense Acquisition Regulation." Nor was the General Counsel enthusiastic about the sagacity of the FFLOE approach, at least under the circumstances highlighted by the Air Force Audit Agency. To dramatize this point the following excerpt from the Supreme Court in Muschany was quoted:

> ...the arrangement may have been improvident from the point of view of the Government. But the question goes to the quality of the management by its procurement officers. The fact that a procurement system is improvident obviously does not make it illegal.[109]

The AF/GC reply to the auditors concluded with this terse judgment: "Simply put, there is no law against a stupid business arrangement."[110] [emphasis original].

Time and Material Contracts

A time and material (T&M) contract is one providing for the acquisition of services or materials "on the basis of (1) direct labor hours at specified fixed hourly rates that include wages, overhead, general and administrative expenses, and profit, and (2) materials at cost..."[111] The *labor-hour contract* is a variety of the T&M in which materials aren't involved or at least not supplied by the contractor.[112]

Not only is a T&M contract difficult to efficiently administer, "since it requires almost constant Government surveillance," it has some other familiar sounding disadvantages. In fact the FAR openly acknowledges that: "A time-and-materials contract provides no positive profit incentive to the contractor for cost control or labor efficiency."[113]

These T&M disadvantages parallel closely the cardinal negative aspect of CPPC, i.e.; the contractor's ability (or lack of incentive) to control the incurrence of

direct costs to which overhead and profit are added, based on a predetermined formula. The important difference is that generally in a T&M contract a contractor is reimbursed his costs but not additional percentage payments for profit or overhead.

However, a T&M contract with percentage payments has been held to be an unenforceable CPPC arrangement. The GAO in 1967 reviewed a Department of Agriculture time and materials contract that provided for payment of "material cost plus 15 percent for overhead and 10 percent for profit." The Comptroller directed that the contract "should be cancelled and the procurement made by other than a cost-plus-a-percentage-of-cost system of contracting."[114] Nevertheless, a time and material contract without percentage payments is clearly still an acceptable method of contracting as long as there is "appropriate Government surveillance of contractor performance," to give assurance that inefficient methods and cost controls are not being used.

Payment of Profit on Economic Adjustments

FAR 16.203-1 and DAR 3-404.3 set forth three types of economic price adjustments (E.P.A.'s). The first is adjustment based on established prices.[115] The DAR defines this variety of adjustment as one "based on an increase or decrease from an agreed upon level in published or

established prices of either specific items or price levels of contract end items.[116] Similar language is contained in FAR 16.203-1(a). The second mode of price adjustment is the "actual costs method."[117]

This EPA method is described as an adjustment "based on an increase or decrease in specified costs of labor or material actually experienced by the contractor during performance of the contract." The last variety of EPA approach is the "Cost Index Method."[118] Under the Cost Index Method, "[p]rice adjustments are based on an increase or decrease from specified costs of labor or material cost standards or indices made applicable to the contract."[119]

Generally CPPC is not a relevant concern in the E.P.A. arena. With respect to the cost index and established price method there is no CPPC possibility since actual costs incurred are not used to determine the size of adjustment. However, even under the "actual cost method" where actual costs are used, there is little CPPC potential because the FAR prohibits the inclusion of overhead or profit in any price adjustment under the "actual cost method."[120]

Early in 1982 concern was expressed in the Air Force about the then Deputy Secretary of Defense Carlucci's procurement reform initiatives. Specifically appropos for CPPC concern was Carlucci's reform 5e which reads in pertinent part that "...contract price adjustments made in

accordance with EPA provisions should recognize the impact of inflation on profits."[121]

Some high level Air Force price analysts formally expressed the concern to the Air Force General Counsel "that payment of profit on escalation adjustments is, or gives, the appearance of CPPC; hence it is illegal."[122]

Air Force General Counsel (AF/GC) concurred with the price analyst's concern to the extent that the statutory prohibition against CPPC might be violated if profit were paid on an EPA adjustment made under the "Actual Cost Method."[123]

However, AF/GC was quick to point out that "the DAR itself currently rejects the possibility of including G & A profits or overhead in any price adjustment using this method."[124] Specifically this DAR provision states: "the price adjustment shall not include general and administrative expenses, profit, or overhead..."[125]

With respect to the other two types of EPA provisions, the AF/GC generally found no CPPC potential since neither approach uses the actual cost incurred to determine the size of the adjustment. Furthermore, no CPPC appearance arises since there is no adjustment involved "over which the contractor can exercise direct control."[126] Yet, AF/GC did express the following CPPC caveat: "[T]o avoid possible misuse, however, the contracting officer shall select indices for the adjustments which are not susceptible to manipulation by a government contractor."[127]

Award Fee

In a cost-plus-award-fee contract (CPAF)(FAR 16.404-2(a)) the contractor's entitlement (award fee) is uncertain at the time of contracting. Yet, the award fee provision hasn't been challenged as violative of CPPC since the award of fee is discretionary with the Government. Ordinarily the contractor has no incentive to run up costs just to get morefee. Most award fee criterias are based on contractor performance levels. Usually the better the performance in specified areas (such as quality, ingenuity, timeliness, and cost effectiveness) as subjectively determined by the Government, the greater the probability of maximum award fee.[128] However, the possibility for CPPC type abuse exists if the award fee procedure becomes too predictable. When an award fee is given as a matter of routine, the contractor may have little motivation to keep a lid on costs since the fee will be awarded without correlation to costs. The CPPC potential is certainly apparent if the award fee increases or decreases in proportion to actual costs. Nevertheless, where the award fee is definite in amount and virtually certain to be awarded, there would be no CPPC violation because the award fee would in effect be tantamount to a fixed fee.

CHAPTER V

AFTER THE FACT PRICING

A number of after-the-fact situations have come under judicial and GAO scrutiny for possible CPPC violations, principally: letter contracts, equitable adjustments, delay costs and price redeterminable contracts.

Letter Contracts

According to FAR 16.603-1 a letter contract is defined as a "written preliminary contractual instrument that authorizes the contractor to begin immediately manufacturing supplies or performing services." Or in other words: "Letter contracts are those which authorize the contractor to proceed with the work before it is fully defined, subject to a maximum limitation on expenditures and on payments by the buyer or the Government."[129]

FAR 16.603-2 and DAR 3-408(c) set forth certain letter contract "limitations" including issuance of a definitive contract (referred to as "definitization" in the regulations) within 180 days or before 40% of contract completion. These limitations are by no means ironclad however, since additional time is allowed in "extreme

cases."[130] DAR 3-408 also provides for amendments to letter contracts "if the new procurement is inseparable from the procurement covered by the existing letter contract."[131] There is similar language in FAR 16.603-3. The regulatory letter contract framework is flexible then with respect to the postponement of issuance of a definitive contract. However, the longer "definitization" takes, the greater the potential risk of CPPC violations.

The GAO has held that it is a CPPC violation to not replace a letter contract with a definitive contract until after performance has been substantially completed or until "the work was in the last stages."[132]

The Comptroller General's decision in 33 Comp. Gen. 291[133] involved a letter contract for repair and alteration of Government building. The prime would enter into subcontracts and was authorized to incur up to the stated maximum amount pending negotiation of the definitive contract on a lump sum basis. The Comptroller General stated in actual performance the execution of definitive contracts were not affected, but rather were negotiated and executed in the form of formal contracts after being substantially completed, stipulated ceilings exceeded, and after successive amendments. In that case the Comptroller stated the execution of the so-called lump sum contract was more in the nature of a settlement of the contractor's claim than the negotiation of a contract. Additionally the GAO

noted that late definitization violated the administrative and the regulatory provisions of the procuring activity.[134]

Although not specifically enunciated by the GAO, late formalization of a letter contract would appear to violate the CPPC ban primarily because the contractor's entitlement is uncertain, and he has no incentive to control costs. Implicit in this GAO rule are the other CPPC elements i.e., predetermined rate or amount applied to actual costs. However, what if absolute cost limits are imposed on a letter contract "definitization?" Would this approach avoid any CPPC entanglements? Not in recent years in any event, since now neither the courts nor the GAO put much stock in ceilings as a CPPC avoidance mechanism.[135] This was not always the case as evidenced by the following GAO observation made in 1954:

> It is true that at one time this Office took the view that absolute cost limitations, and provisions for Government supervison of costs and expenditures, would protect sufficiently the interests of the United States even where a fee of profit on a percentage basis was provided for.[136]

At what point then is it too late to formalize (definitize) a letter contract without risk of a CPPC violation? The GAO has been interpreted to be more conservative than the courts on this question. One commentator views the GAO as holding there is a CPPC problem any time a letter contract is definitized after more than fifty percent complete.[137]

The courts have apparently taken a more liberal approach to this issue. In Blake Construction Co. v. United States,[138] the D.C. Circuit implicity acknowledged the validity of a fixed price definitive contract negotiated after 90 percent of the performance was completed on a letter contract.[139]

Nevertheless, because of the conservative position of the federal procurement regulations[140] and the GAO, any letter contract definitization after over 50% of the performance is completed, would certainly be subject to scrutiny for potential CPPC invalidity.

Equitable Adjustments

The phrase, equitable adjustments, has evolved as "a term of art and wherever used in Government contracts is given the same interpretation."[141] The Court of Claims summarized this evolution in General Builders Supply Co. v. United States:[142]

> The concept of an "equitable adjustment" has had a long history in federal procurement, going back for about fifty years. See United States v. Callahan Walker Constr. Co., 317 U.S. 46 (1942); United States v. Rice, 317 U.S. 611 (1942); Ribakoff, Equitable Adjustments under Government Contracts, Government Contracts Program, the George Washington University, Changes and Changed Conditions 26, 27 (Gov't Contracts Monograph No. 3. 1962). First used in the standard "changes": and "changed conditions" articles, the term has been taken over for other clauses, such as the "suspension of work" and "government-furnished property" provisions. See J. Paul, United States Government Contracts and Subcontracts 430 (1964). The consistent practice appears to have been that an "equitable adjustment", as that phrase is used in these articles, can cover an allowance for profit on work

> actually done, but does not encompass unearned but anticipated profits. See United States v. Callahan Walker Constr.Co., supra, 317 U.S. at 61; Bennett v. United States, 178 Ct. Cl. 61, 60-70, 371 F.2d 859, 864 (1967); cf. Bruce Constr. Corp. v. United States, 163 Ct. Cl. 97, 324, F.2d 516 1963). This is far from an unnatural interpretation since, in these clauses, the "equitable adjustment" is usually tied by express words to an increase or decrease in the contractor's costs.[143]

Equitable adjustments are generally characterized as changes in costs, prices, fees, deliveries and/or other contract provisions negotiated as a result of revisions in performance or contract terms "ordered or otherwise effected by the customer under contract clauses allowing or recognizing such actions, such as the Changes, Stop Work Order, and Suspension of Work clauses." [141]

A more specific definition of a contractor's entitlement under the equitable adjustment concept is "the difference between what it would have reasonably cost to perform the work as originally required and what it reasonably cost to perform the work as changed."[145]

Although not expressly mentioned in the Modern Foods definition, equitable adjustments whether achieved prospectively or retrospectively have traditionally been viewed as including a reasonable allowance for profit.[146] The purpose for the inclusion of profit in an equitable adjustment was summarized by the ASBCA in New York Shipbuilding:[147] "Without the payment of a profit which is fair under the circumstance, the Government would be getting something for nothing and the contractor would not truly be made whole."[148]

In a recent 1983 reported decision, the DOT CAB reiterated this position by treating profit as an axiomatic ingredient of an equitable adjustment compensation formula.[149] Nevertheless, this rationale has not been used for adjustments under either the Government delay[150] or suspension of work clauses.[151] However, DAR 7-105.3, the Stop Work Order Clause, does include an allowance for profit in any equitable adjustment resulting from Government ordered delays.

Since contractors are routinely expected to expeditiously comply with change orders or similar equitable adjustment engendering actions, negotiation of compensation is often after most, if not all the changed performance is complete. As a general rule, the mere fact that most equitable adjustments are negotiated "after the fact" (i.e., pricing of changes after the completion of work) does not of itself form the basis for a CPPC infraction. However, if an equitable adjustment is negotiated after the fact and persuant to a predetermined percentage rate of costs as profit, you certainly have CPPC potential. Payment at a predetermined percentage rate is of course the first element of the four point CPPC criteria mentioned in Chapter One. If a contractor performing work under a change order does so with the percentage rate fixed before performance, he is placed in the envious "position of knowing for certain that he will be rewarded proportionately at the rate for every dollar of allowable expenditure."[152]

A good restatement of the court's and board's traditional attitude towards allowing profit as an element of equitable adjustment pricing is contained in Allison Div. General Motors Corp.,[153] where the ASBCA stated:

> The Government also contends that to grant an increase in fixed fee for a "comparatively minor" change in the contract would transform the contract into a cost-plus-percentage-of-cost contract which is prohibited by law. 10 U.S.C. 2306. No argument or reasoning, other than the bare assertion, has been advanced by the Government in support of its contention. The change here, as we have concluded, was not minor. It substantially increased appellant's work under the contract. The fixed fee was earned when appellant had exerted the level of effort specified in the contract (i.e., 73,200 hours) in performing the work called for ASPR 3-405.6 (d)(2). In cost-plus-fixed-fee contracts, the fixed fee once negotiated does not vary with actual cost, but it may be adjusted as a result of any subsequent changes in the work or services to be performed under the contract. ASPR 3-405.6(a). cf. Martin-Marietta Corporation ASBCA No. 10062, 65-2 BCA ¶4973. The granting of additional profit in connection with increased work under change orders has never been considered, to our knowledge, a violation of the cost-plus-a-percentage-of-cost system of contracting. The changed work, in effect constitutes a new procurement under which a contractor is entitled to profit.[154]

An argument can be made that the CPPC ban pertains only to a system of initial contracting, and that it is not relevant to subsequent equitable adjustments for additional work.[155] Nevertheless, caution should be exercised in negotiating equitable adjustments to avoid scrutiny for CPPC infractions. Predetermined rates should be avoided. The parties should also refrain from routinely adding to agreed allowable costs, the same percentage rates that were employed in ascertaining the overhead and profit or fee

under the basic contract. This would certainly raise the specter of CPPC improprieties. And "if a contract were to state that the contractor is to be paid a fixed rate of profit on his costs, there might be a violation...", of the CPPC ban.[156] A 1968 Court of Claims case contained just such a clause. In Sun Shipbuilding & Dry Dock v. United States,[157] the contract provided that:

> Notwithstanding a dispute in connection with the Contractor's estimate of the cost of a change, the Contractor shall, nevertheless, proceed promptly with the work covered by such directed or approved change. One hundred and ten percent (110%) of the net increase in estimated cost, if any, resulting from all change cost estimates, as approved or as finally determined, shall be added to contract price as an adjustment thereof.[158]

Because of the guaranteed predetermined fixed rate of profit in this clause, it certainly has the appearance if not in fact the cardinal characteristic of CPPC. Yet ironically, no mention of the CPPC issue was made in the case.

The ASBCA had no trepidation though about raising the CPPC issue in American Pipe & Steel Corp.[159] The board reasoned that arbitrary application on a 7 percent fee to actual costs incurred under a change in a CPPF contract without regard to the value of the extra work done would be illegal. In the words of the board:

> Appellant claims for the equitable adjustment the amount of $23,353.77. This appellant computes by taking 7% of the additional funds added by change orders 2 & 3, i.e., $69,661.84 and $263,963.45, thus equating extra costs to additional work. The possibility that there would be such precise and accurate estimation of costs in CPPF is somewhat remote.

> Such a computation would be subject to the justifiable suspicion that the contract had been converted into an illegal cost-plus-a-percentage-of-costs contract. [emphasis original].[160]

Another instance where the ASBCA disallowed an equitable adjustment on CPPC grounds was in Program Resources, Inc.[161] where the board reasoned that to permit the contractor greater fee because of increased labor rates when there had been no "change" in the nature of the work would violate the CPPC ban.[162]

Ideally, the Government should negotiate new or different rates for overhead and fee. It should also be borne in mind that "fee or profit is composed of a number of elements, one of which is risk."[163] Risk may be minimal after performance has been completed and "all the costs are known." The lack of risk "can be considered by the contracting officer in arriving retrospectively at a fair return for fee or profit."[164] Therefore normally the post-determined profit rate on an equitable adjustment will be lower than the basic contract rate.[165] One enterprising contractor asserted the right to an increased profit rate for an equitable adjustment on a construction contract because of the "aggravation and the expense of litigation."[166] The DOT CAB rejected the contractor's request. In the words of the DOT Board: "The circumstances, essentially aggravation, which appellant states justify an increased profit, result primarily from appellant's own acts in submitting substantially overstated

claims on two occasions under this contract...This Board will not allow any party to profit from its own misdeeds. This is precisely what would occur if we accepted appellant's argument for an increased rate of profit."[167]

In Keco Industries Inc. the ASBCA, referring to Newport News Shipbuilding and Dry Dock Co. v. United States,[168] "reasoned that the weighted guidelines risk factor was to be applied prospectively and not with the benefit of hindsight." The board, however, in apparent error, stated that "the risk factor is not applicable on a prospective basis."[169] In any event weighted guidelines are not relevant in instances where a percentage limitation on profit is incorporated into contract provision.[170]

Construction Contract Clauses

Government construction contract clauses which limit the amount of equitable adjustment for profit, commission and overhead have been the subject of frequent litigation. Most of the clauses detail what items can be recovered by contractors or their subs and set out maximum percentages for recovery. For example, the Veterans Administration clause,[171] permits up to four percentages, but employs a declining scale to determine percentage limitations for profit and overhead:

> 10 percent overhead and 10 percent profit on first $20,000; 7-1/2 percent overhead and 7-1/2 percent profit on next $30,000; 5 percent overhead and 5 percent profit on balance over $50,000.

> 10 percent fee on first $20,000; 7-1/2 percent fee on next $30,000 and 5 percent fee on balance over $50,000.[172]

Understandably such limitation provisions have not been too popular with contractors, especially with respect to potential mark-up for profit and overhead from one tier to another. In Norair Engineering Corp.,[173] the GSBCA upheld the government percentage limitation citing a potential pyramid effect:

> Moreover, if paragraph 1-26(f) were to be interpreted as appellant contends, it would be possible for subcontractors to subcontract work to be performed pursuant to change orders to successive lower tier subcontractors and for each succeeding higher tier subcontractor to take a profit on the work of its lower tier subcontractor and in that fashion pyramid the cost of change order work out of all proportion to the reasonable value of the work. Clearly such a result was not intended by paragraph 1-26(f) and indicates the unreasonableness of the appellant's interpretation.[174]

This pyramiding of costs out of "proportion to the reasonable value of the work" of itself does not raise CPPC concerns especially if predetermined fixed rates of entitlement (profit, commission, overhead) are not applied to actual costs. The construction clauses' limitations on the amount of equitable adjustment profit, commission and overhead avoid CPPC invalidity "by stating the percentages as maximums."[175] In any event, the pyramiding problem is not an CPPC issue. It more closely parallels the problem addressed in OFPP Policy Letter 80-7 on double charging for facilities capital cost of money.

Delay Costs

It is sometimes asserted that any allowance for profit on equitable adjustment after the fact, violates the CPPC ban.[176] This assertion would appear to be highly dubious since there is little if any authority to sustain it.[177] Nevertheless, allowance of profit on delay claims has long been considered "verbotem" according to a venerable line of cases in the Court of Claims. In Laburnum Construction Co. v. United States, the court pronounced:

> The allowance of so-called profit on the costs incurred during the delay would violate the statutory prohibition against cost-plus-percentage-of-cost procurement (10 USC § 2306) and would be manifestly unfair to defendant.[178]

This bold statement in Laburnum, barring profit on delay costs because of the CPPC rule, has been highly criticized.[179] According to one commentator, the court's pronouncement that profit allowance on delay costs violates the CPPC prohibition is "[o]pen to serious question."[180]

One fundamental reason that the Laburnam rule has been so openly denounced is that one of the basic tenants of the CPPC prohibition was apparently ignored by the Court of Claims. The cardinal principle apparently overlooked is that "the CPPC prohibition relates to a "system" of initial contracting, rather than to adjustments made in the amount due the contractor as a result of Government action or other events occurring after contract award."[181] [emphasis original].

Indeed, the Laburnum rule that allowance of profit on delay claims violates the statutory prohibition against cost-plus-percentage-of-cost procurement, has not been applied to equitable adjustments.[182]

Price Redeterminable Contracts

Contracts with provisions providing for determination of the price after performance, based on historic or actual costs are treated virtually the same as equitable adjustments. Both have the judicial seal of approval if there is no provision encouraging the contractor to incur additional costs.[183] In other words, if a post determined percentage rate is used to ascertain profits, the CPPC evils apparent with predetermined rates are avoided. The contractor has no incentive to escalate costs. "The exact measure of reward is held in limbo; and the Government remains free to determine the measure of regard retroactively based on an overall judgment of the contractor's demonstrated efficiency and economy."[184]

Pricing after incurrence of costs was judicially sanctioned in National Electronic Laboratories, Inc. v. United States.[185] In National the Signal Corps of the Army entered into a contract to supply seven shutter assemblies, with appurtenances, for $31,677.61. The negotiated contract contained a provision authorizing revision of the contract price by bilateral agreement after the contractor finished

performance. Within sixty days of contract completion, the contractor had to file a statement documenting costs. The parties would then use these costs as a basis to negotiate a "reasonable revised price." The contract provided that the contractor's entitlement to profit as an element of the revised price would be based on the extent to which he "performed with efficiency, economy, and ingenuity." There was also a designated upper limit which the revised price could not exceed.[186] A dispute developed over the magnitude of the revised price, culminating with a lawsuit in the Court of Claims.

In court, the contractor tried to persuade the judge to vacate the contract because it allegedly violated the CPPC proscription. The court was not overly impressed with this argument. Although the court did not detail at length its rationale, the apparent controlling reason for sustaining the validity of the price revision provision was that is resulted in an obligation to pay post determined rather than a predetermined rate of costs as profit. Under such a formula the contractor would not be encouraged to run up costs since he would not profit from deliberate or careless performance expenditures. The judge also saw little "difference between the expressly permitted cost-plus-fixed-fee contracts, and the fixed-price-subject-to revision contracts of the plaintiff..."[187]

The ASBCA has followed the lead of National Electronics. For example, in Watts Construction Co.,[188] the board held that pricing of changes following completion of work did not violate the CPPC prohibition. A similar result was reached by the ASBCA in E.V. Lane, Corp.,[189] a year later.

CHAPTER VI

POTENTIAL SAVING AND AVOIDANCE APPROACHES

Ceilings

Use of ceilings to avoid CPPC is an illusory approach at best in light of recent GAO and judicial precedent. Perhaps the most forceful denouncement of ceilings as a CPPC avoidance mechanism was made by the Federal Circuit in Urban Data v. United States.[190] Both Urban Data contracts had designated ceiling prices or upper limits. In the words of the court:

> There is nothing in the statute, or its background or objectives, to distinguish a 'cost-plus-a-percentage-of-cost-up-to-a-designated-limit' system of contracting from an unlimited cost-plus-a-percentage-of-cost system. Neither the method of computing final cost to the Government nor the evils inherent in such a process are significantly altered by the inclusion of an upper limit. Cf. 38 Comp. Gen. 38, 40 (1958) (cost limitations are not sufficient to save such contracts from violating the prohibition.) As in any cost-plus-a-percentage-of-cost contract, there still remains an incentive to the contractor 'to pay liberally for reimbursable items because higher costs mean a higher fee to him, his profit being determined by a percentage of cost.' Muschany v. United States, 324 U.S. 49, 62 (1945). The key is that the contractor is penalized for efficient and economical performance and rewarded for non-economical performance...At the same time, Congress's prohibition tends to prevent the development of a 'buddy system' between contractors with the well-known advantages of that form of contracting. Were the statutory prohibition inapplicable to agreements stipulating a ceiling price, the contracting parties could avoid the legislative stricture simply by setting high ceilings. We cannot

> imagine that Congress envisioned such a loophole in establishing protection for the Government against the exploitation possible in cost-plus-a-percentage-of-cost contracts.[191]

The GAO has been equally unfriendly to ceilings. In Department of Labor[192] all three Job Corps contracts[193] (previous analysis) had explicit fixed ceiling figures. The ceilings did not save these contracts "from violating the statute."[194]

In Federal Aviation Administration - Request for Advance Decision[195] the GAO was faced with contractual arrangements that called for the contractor's profits to be based on "15 percent of actual direct labor and overhead costs."[196] The FAA did not consider these contracts to be CPPC because they contained "not to exceed" cost limitations. The Comptroller was quick to observe that a provision for cost ceiling "does not save the contract from violating the prohibition..."[197]

The Air Force in 1958 requested the Comptroller General to review a contract with Curtiss-Wright Europa, N.V. (CWE), that contained a provision reimbursing the contractor for actual costs (estimated to be $24,884,447) "plus the lesser of: (1) a fee of $2,115,553 (8-1/2 percent of that amount); or (2) a fee equal to 8-1/2 percent of the total contract costs reimbursed, costs and fee not to exceed the total contract cost of $27 million."[198] The Assistant Secretary of the Air Force (material) wrote the GAO that he did not believe this contract had any CPPC problems,

essentially because of the ceiling involved. He stated that "it is considered that the contract involved here differed so much from the normal cost-type contract contemplated by Congress in its proscription of the 'CPPC' system of contracting that the contract in question cannot be considered in contravention of the statute."[199] The reason that this arrangement was so different according to the Assistant Secretary was that"...the use of a contract containing a cost ceiling beyond which the fee could not be increased, while providing for a proportionate downward adjustment of the fee on incurrence of costs lower than the ceiling, coupled with government supervision over the usage of labor and materials, is not a violation of a prohibition against the cost-plus-a-percentage-of-cost system of contracting."[200]

The GAO did concede that some of its earlier precedent did hold that absolute ceilings coupled with provisions for close government supervision of costs adequately shielded the government against the abuse of CPPC manipulations "even where a fee or profit on a percentage basis was provided for."[201]

However, since 1945 the GAO has consistently ruled that ceilings or other "dubious cost limitations" are insufficient to salvage contracts with CPPC provisions from violating the statutory proscription. Ceilings in CPPC arrangements are considered only in the context of

allowability of "the reasonable value of services or supplies furnished under such unauthorized contracts." Nor was the GAO impressed with the Air Force's argument that close government supervision over CWE's usage of labor and materials constitutes a CPPC safeguard. The Comptroller reasoned that routine administration of cost contracts normally involves approval by the contracting officer of subcontracts and major items of reimbursable cost. No substantial additional element of control was noted in the CWE contract. More cost control or supervision would have been of little efficacy in this instance in any event since CWE's contract virtually guarantees "a fee of 8-1/2 percent of costs incurred up to the contract ceiling of 27 million."[202]

Ceilings, then, are nothing more than traps for the unwary in the CPPC area. The judiciary and GAO are unanimous in their denouncement of limits, pay caps or ceilings as a vehicle for CPPC avoidance. Even coupled with close government supervision of contractor expenditures ceilings have been universally unsuccessful in affording CPPC protection.

Estimated Costs

Of course, express application of predetermined rates doesn't violate the CPPC ban if actual costs aren't used.[203] Use of estimated costs instead of actual costs

appears to be a viable approach to CPPC avoidance. For instance, in Grey Advertising, Inc.,[204] the GAO determined that a provision in a cost type indefinite quantity contract, which specified that the fee paid on each delivery order be based on "costs being paid" didn't run afoul of CPPC. The GAO characterized the phrase "costs being paid" as "inartfully worded" since the fixed fee was actually based on "the estimated cost" of the delivery order.[205]

If a predetermined rate is applied to estimated costs, you have a contractual situation virtually the same as CPFF contract, because the contractor's fee is determined in advance. Several Comptroller General decisions have held that CPFF contracts pose no CPPC problems.[206] In fact, the same statute that bans CPPC expressly sanctions CPFF.[207]

Post-Determined Rates

Another way to cure a CPPC arrangement involving predetermined rates is either to make them redeterminable or convert from predetermined to post-determined.[208] In one case the GAO did not invalidate negotiated predetermined rates that were subject to audit and retroactive revision.[209] This of course would be tantamount to a post-determined rate. If a post-determined rate is used to ascertain profit or overhead, the CPPC evils apparent with predetermined rates are avoided. The contractor has less incentive to escalate costs.

Firm Fixed Price Contracts

There is at least one contractual type now that is immune to CPPC. The "firm-fixed price contract provides for a price that is not subject to any adjustment on the basis of the contractor's cost experience in performing the contract."[210] This is the ultimate ceiling in effect because there is no opportunity or incentive for the contractor to increase costs and thereby gain greater profit. The contractor has "maximum risk" and is completely responsible for all costs and profits or losses. The firm fixed price contract affords "maximum incentive for the contractor to control costs"[211] and is the most preferred type for harnessing profit motive.[212]

The Federal Acquisition Regulation recognizes that the CPPC prohibition is not applicable to firm-fixed-price contracts. This is evidenced by the regulatory embodiment of the CPPC ban contained in FAR § 16.102(c):

> (c) The cost-plus-a-percentage-of-cost system of contracting shall not be used (see 10 U.S.C. 2306 (a) and 41 U.S.C. 254 (b). Prime contracts (including letter contracts) other than <u>firm-fixed-price contracts</u> shall, by appropriate clause, prohibit cost-plus-a-percentage-of-cost subcontracts...[emphasis added].[213]

Firm fixed price contractors are not required to include a CPPC prohibition in any subcontract. A CPPC arrangement then in a subcontract with a firm-fixed-price government prime contractor is perfectly legal. So this is one instance where you can apply an explicit predetermined

rate to actual performance costs without running afoul of CPPC.

Even though it is axiomatic that firm fixed price contractual arrangements are not subject to the CPPC prohibition, what constitutes firm fixed price contracting in a given situation is not always crystal clear. A fascinating illustration of this potential ambiguity is provided by a review of some unpublished GAO decisions pertaining to audits of Air Force aircraft maintenance contracts and the Air Force response to the GAO CPPC concerns.

Case Study: GAO Audit of Air Force Aircraft Maintenance and Overhaul Contracts

In a report dated January 12, 1978, to the Secretary of Defense, the GAO Procurement and System Acquisition Division concluded that Air Force payment provisions for subcontracted overhaul and repair work of the aircraft in the Special Air Mission (SAM) Fleet, as well as direct material purchases for an F-4 maintenance contract, contained "all the elements of a cost-plus-percentage-of-cost contract."[214] The contracts all had forwarding-pricing-rate agreements.

SAM Fleet Contract

The GAO examined four Air Force SAM Fleet contracts for depot maintenance and modification of the

aircraft. One contract in particular with E-Systems Inc., Greenville Division, Greenville, Texas, was determined to possess payment provisions for materials overhauled and repaired by subcontractors "that violated the CPPC statutory prohibition."[215]

Under the terms of the contract direct materials obtained by the contractor were cost reimbursable i.e., "the contractor was reimbursed for the cost of materials plus general and administrative expenses involved with the purchase." The overhead rates were annually audited and adjusted retroactively to coincide with actual costs. E-systems was not allowed any profit on these purchases. While the GAO found this payment arrangement "permissible" the Air Force was faulted for providing no incentive for the contractor to control costs.

However, with respect to E-Systems subcontracts, the Comptroller was not so charitable. The contract audited by the GAO covered forty months (May 1973 through September 1976). During this period E-Systems applied predetermined percentage rates for procurement support, general and administrative expense, and profit, "after the fact, to invoice amounts billed by subcontractors for materials overhauled and repaired." With respect to forward pricing the GAO specifically found that:

> For this same period, the procurement support and general and administrative expense rates ranged from 3.4 to 7.1 percent and 14.5 to 20.1 percent, respectively, on the basis of negotiated forward-pricing rates. Although these rates changed

> during the contract period, the amounts resulting fromthe rate application were not subject to any retroactive adjustment to actual costs. Additionally, E-Systems added profit at a fixed percentage rate to these invoices after the addition of amounts for procurement support and general and administrative expense. During the first year of the contract, a 10-percent profit rate was used for all purchase orders originating from either the E-Systems facility at Greenville, Texas, or the contractor's liaison office located at Andrews Air Force Base, Camp Springs, Maryland...The cost for materials overhauled or repaired by subcontractors increased during the first year of the contract from an estimated amount of $1,118,000 to $1,634,000, or about 46 percent. The invoice cost for such materials totaled $4.6 million over the life of the contract. In addition to this cost, we estimated that about $1 million was paid for procurement support and general and administrative expenses. This amount was based on the negotiated predetermined percentage rates previously mentioned. Profit rates were then applied, resulting in a $500,000 profit to E-Systems for subcontracted overhaul and repair work. [emphasis original].[216]

F-4 Contract

The E-Systems, Inc., Donaldson Division, Greenville, South Carolina, contract for F-4 maintenance provided reimbursement of contractor-furnished materials on a negotiated cost basis. This approach allowed the E-Systems recovery of general and administrative expenses as well as profit on material purchases. In reviewing the contract, the GAO observed that:

> In October 1975, the procuring contracting officer and the administrative contracting officer negotiated with the contractor a 23 percent rate for general and administrative expense and a 6 percent rate for profit. The rates were fixed for the entire contract period and applied to all material invoice prices. No retroactive adjustments were made to these rates to reflect actual costs.[217]

After detailing the audit analysis of the SAM Fleet and F-4 contracts, the GAO Director of Procurement and Systems Acquisition Division, concluded that both contracts met all the CPPC criteria. E-Systems was compensated for profit and indirect expenses "on the basis of predetermined, fixed percentage rates." [emphasis original]. The predetermined rates were applied to all the material invoice prices. Neither contract provided a specified amount for contractor-furnished materials. Therefore, in the words of the GAO, "the Air Force in effect agreed to pay an uncertain sum for these material costs plus a fixed percentage of that sum, whatever it might be. On this basis, it is clear that payments under E-Systems contracts will increase commensurately as these percentage rates are applied to increased performance costs."[218]

After concluding that these Air Force maintenance contracts met all the CPPC requirements, the GAO issued detailed recommendations to resolve the CPPC infractions and to prevent future CPPC repetition. The GAO first suggested that the "Secretary of the Air Force determine the amounts properly allowable under the contracts involved and recover any excess payments." Next the GAO admonished the Air Force to conduct a complete audit of all its aircraft maintenance contracts for the specific purpose of eliminating CPPC contracting. And finally, three alternatives were propounded for Air Force consideration in correcting its CPPC problem:

1) Eliminate the allocation of general and administrative expenses and profit to material costs. Such charges would be allowed on labor costs because the labor charges are determined early in contract performance.

2) Negotiate a fixed price for materials at the point when the amount of material that will fulfill contract requirements can be determined. This should be as early as possible in contract performance to provide the contractor an incentive to control material costs.

3) Provide for the retroactive revision of general and administrative expenses based on actual material costs incurred.

While this alternative would correct the problem, it would not give the contractor an incentive to control costs.[219]

Air Force Response to GAO CPPC Charges

The Air Force responded to the GAO on March 27, 1978, disagreeing with the Comptroller's conclusions and recommendations. The Air Force asserted in its response that the rates employed for profit and overhead in determining fixed prices for the contractor-furnished material and the subcontracted work were "forward-pricing rate agreements" pursuant to DAR 3-807.12. The Air Force also maintained that the GAO CPPC allegations were not relevant, since the contracts were all firm fixed priced, and the Government had the right to approve the need and quantity of contractor work. Therefore, the Government wasn't under any obligation to accept any work or pay any price not considered necessary and reasonable by the contracting officer.[220]

GAO Rebuttal to Air Force Use of Forward Pricing

The GAO formally replied to the Air Force by way of a letter dated August 22, 1978, to the Secretary of Defense reasserting their initial CPPC conclusions.[221]

The GAO found little merit in the Air Force's use of forward pricing rate pursuant to DAR 3-807.12 as a way out of the CPPC thicket:

> The use of forward pricing rates under ASPR 3-807.12 is appropriate where those rates are properly applied in the context of negotiated procurements. However our examination revealed that both rates for overhead and profit were established prospectively on a percentage basis and the rates remained unchanged. Regardless of whether these rates were established under ASPR 3-807.12, they were treated in such a manner as to become fixed in their application. The fact that these rates were not contractually required does not affect the results of their application under the contracts.[222]

Nor did the GAO give much credence to the Air Force position on contracting officer approval of subcontract work and contractor furnished material:

> ...we have consistently held that this provision is not sufficient to save a contract from being construed in violation of the CPPC system of contracting, but is for consideration only in connection with determination of amounts properly allowable as the reasonable value of services or supplies furnished under such unauthorized contracts.[223]

CPPC and Firm Fixed Price Contracts

The Air Force position that CPPC is not relevant to firm fixed priced contracts was not enthusiastically received by the GAO. The Air Force asserted in its initial GAO rebuttal that:

> As we interpret the cases you cite regarding CPPC contracts, the essential ingredients to establish a CPPC situation is that profit or overhead must function as a contractually required predetermined percentage. That ingredient is missing in the contracts reviewed.[224]

The GAO conceded that many of the precedents it cited in the Air Force audit dealt with cost type contracts with overhead rates applicable to some element of direct cost.[225] However, the GAO was quick to emphasize that:

> The cases are not limited to such instances. In fact, we have decided cases involving situations similar to that under the subject contracts, where the prohibited CPPC arrangements are not provided in the agreements between the Government and its prime contractor, but form the basis of the contractual relationship between the prime and its subcontractors.[226]

The GAO report cited 33 Comp. Gen. 533 (1954) as an example where the prohibited CPPC arrangement was in the subcontract. The cost-reimbursable prime contract with the Army during the Korean War did not dictate the method of subcontract payment. The subcontractors were paid for their costs plus a percentage of costs -- pure CPPC! Even though the subcontract work was certified as proper for payment by a contracting officer representative, the GAO ruled the payments illegal.

The GAO report next cited 22 Comp. Gen. 784 (1943) for the proposition that contractual results, rather than technical form, is the ingredient essential to the determination of a CPPC infraction. The report than concluded with the following telling excerpt from <u>98.64 Acres of Land v. United States</u>:

> Congress, no doubt anticipating that learned, technical and weird definitions of cost-plus-a-percentage-of-cost contracts would follow a prohibition of a particulr species of such contracts, wisely broadened the prohibition to extend to all transactions in which the system was used. What was the "system" and what was the vice sought to be eliminated? The system was the method of contracting whereby the Government agent's profit or compensation was increased in direct proportion to the cost of the object or commodity itself to the Government. The vice was the temptation, oftentime not resisted, to deliberately or carelessly cause or permit the cost of the object to be increased in order to increase the profit or commission.[227] [emphasis added].

The GAO used this classic passage as a basis to pronounce that the Air Force contracts reviewed came with the broad scope of the CPPC "system" of contracting even if they were firm fixed prices. The report closed with the recommendation that "unless immediate action is taken to eliminate the CPPC system of contracting, we will be forced to take exception to any properly allowable costs under the contracts reviewed."[228]

Air Force Retort: F.F.P. Contracts & CPPC are Nonsequitur

Needless to say, the second GAO opinion was not warmly received. The Air Force, particularly the cognizant Major Air Command for the Audited contracts (Air Force Logistics Command) disclaimed the wisdom of the GAO conclusions.[229]

The reasons for the opposition were legion. A parade of horribles was envisioned in the nature of drastic negative impacts to Government contracting if the GAO view

prevailed. The Air Force went to great lengths to substantiate that the audited contracts (E-Systems) were not in violaton of the CPPC ban. The cases cited by the GAO in its reports were distinguished as irrelevant to firm fixed priced contracts. "Adequate safeguards" were outlined for CPPC pr ntion that were present in the E-Systems Contracts. The bottom line Air Force position was that CPPC doesn't apply to FFP contracts and that increased costs resulted primarily from additional work requirements, not from escalating costs.[230]

CPPC Invalidity Impact

The unmitigated impact of the GAO position as set forth in its January 12, 1978, and August 22, 1978, reports was asserted by Air Force Counsel to:

> ...require significant changes to DAR and the pricing of all fixed priced change ideas within the government ...all firm fixed priced contracts would have to utilize provisional billing rates for overhead costs and profit. These provisional rates would have to be finalized after the completion of contract performance. This would require significant and substantial increases in the workload and manpower requirements of purchasing activities, DCAA audit staffs, and contract administration activities. It would additionally increase contractor costs due to the extra effort contractors would be required to perform to support such overhead rate redeterminations. In short, adoption of the GAO's stated opinion would result in a drain on the taxpayers and the Treasury, far in excess of the GAO's and Congress's falsely perceived cost in the cases involved.[231]

CPPC Prohibition Based on Cost Type Contracts

The Air Force legal review of the GAO reports emphasized the cost contract origin of the CPPC prohibition, i.e., World War I cost reimbursable contracting. "The prohibition did not arise from nor should it be applied to fixed price contracting, where the rules of contract pricing are significantly different." The application of CPPC to fixed price contracts was characterized as "ill-founded" and an expansion of the CPPC ban without statutory foundation. "Such an extension would be far beyond the intent and purpose of the Congressionally enacted prohibition." To bolster this assertion the following excerpt from Muschany v. United States was quoted:

> It is a matter of public importance that good faith contracts of the United States should not be lightly invalidated only dominated. Only dominant public policy would justify such action. In the absence of a plain indication of that policy through long governmental practice or statutory enactments, or of violations of obvious ethical or moral standards, this Court should not assume to declare contracts of the War Department contrary to public policy. The courts must be content to await legislative action.[232]

This same passage has been quoted frequently by many lower Federal Courts.[233]

Another argument advanced to bolster the contention that CPPC prohibition is applicable only to cost type contracts is the language of DAR 3-401(a)(2). This provision states that "...all prime contracts (including letter contracts) on other than a firm fixed-price basis shall prohibit cost-plus-a-percentage-of-cost subcontracts..."[234]

Safeguards to Prevent CPPC Cost Manipulations

In responding to the GAO's challenges the Air Force outlined the following detailed points for implementation to avoid future CPPC problems and to preclude contractor abuses:

1. Use of commercial market prices to establish subcontractor price paid by the prime and direct cost of effort.

2. Use of catalogue prices to establish vendor price to prime.

3. Use of other vendor price analysis.

4. 100% failure verification by the Government.

5. 100% repair needs verification by the Government.

6. 100% completed work verification by the Government.

7. 100% bench test of repaired components returned to USAF.

8. Warranty on vendor's work which prime contractor must enforce.

9. Negotiation and continual review of FPRA.

10. Use of weighted guidelines for review of profit and establishment of profit rate.

11. 85% of items removed and repair thereof directed by Government.

12. 15% of items contractor removed for repair, but only after Government approval of repair/removal requirement.

13. Negotiation of each work request.

14. Approval of, and continuing review of, contractor purchasing systems.

15. Approval and review of contractor's procedures for handling of GFP.

16. Vendor compliance with FAA repair certificatin regulations and requirements.

17. Review of contractor's compliance with Cost Accounting Standards and consistency in pricing and accounting for costs.

18. Compliance with DAR (ASPR) pricing requirements.

19. Government direction as to repair source.

The thrust of these safeguards was for tighter Government approval, control and supervision of contractor work. The Air Force also agreed to lower profit objectives to reflect decreased cost risk in certain instances.[235]

Subsequent to the final GAO rebuttal of August 22, 1978, Air Force representatives met with the GAO on several occasions to resolve lingering CPPC concerns. Air Force General Counsel analyzed the pragmatic legal ramifications for the Air Force as follows:

> The basic legal question is whether certain aircraft maintenance contracts contain provisions which are in violation of the 10 U.S. Code 2306(a) prohibition of CPPC systems of contracting, as alleged by the GAO. If the contracts are determined to be in violation of the statute, a price adjustment would be required. This price adjustment would be a recomputation of the affected prices to reflect the fair and reasonable value of the goods and services received, in accordance with established DOD pricing policy. With respect to the two contracts reviewed by the GAO, both of which have not expired, we estimate that the potential adjustment to the Special Air Mission (SAM) fleet contract, which is valued at about $23 million over a four year period, would be a price <u>increase</u> of about $5000, and that the potential adjustment to the F-4 contract, which is valued at about $8 million over a two year period, would be a price decrease of about $8,000. The Air Force is prepared to rewrite existing

> contracts and to use an alternative payment procedure in FY79 contracts if the questioned payment provision is determined to be in violation of the statute. The Air Force is continuing its discussion with the GAO.[236]

Heated discussions did go on for some time with the GAO reluctantly agreeing not to take exception to any payments based on Air Force assurances of implementation of the aforecited preventative measures. The Air Force also emphasized in these 11th hour discussions "that contractor is entitled to additional profit for additional work," and that the cardinal ingredient of CPPC (the contractor's ability to deliberately or carelessly increase his costs and thereby increase his gain as a percentage of the increased costs) would be virtually eliminated by the vigorous enforcement of the nineteen CPPC safeguards.[237]

CHAPTER VII

COMPENSATION UNDER ILLEGAL CPPC CONTRACTS

There is no question that contracts which violate the CPPC prohibition are illegal. Generally, in most jurisdictions at least in the context of private law, illegal contracts are considered void.[238] Thus, as a matter of public policy, illegal contractors are usually denied any judicial relief including restitution.[239] However, in the Government contracts arena, this is not the case. A CPPC or any other illegal Government contract may be void ab initio, yet the contractor may be entitled to some relief.

Plain Illegality Rule

Traditionally, as a general rule, illegal Government contracts that are plainly illegal or violate the principal purpose of a procurement law, afford no basis for recovery.[240] There is a long and venerable line of cases sustaining this proposition. An 1875 Supreme Court decision held, for example, that "generally the law leaves parties to an illegal contract where it finds them and affords relief to neither."[241] The GAO in 1961 pronounced that:

> [T]here exists strong precedent for holding that a contract within the authority of the public body, which is invalid because entered into without following the required procedure gives rise to no entitlement to payment other than that already received prior to the determination of invalidity, notwithstanding the good faith of the parties. 43 Am. Jur. Public Works and Contract sec. 88, Reemheld v. City of Chicago (Ill. 1907), 83 N.E. 291; Shulse v. City of Mayville (Wisc. 1937), 271 N.W. 643; Federal Paving Corp. v. City of Wauwatosa (Wisc. 1939), 286 N.W. 546; Tobin v. Town Council (Wyo. 1933) 17 P.2d 666.... Layne-Western Co. v. Buchanan County, MO. (8th Cir. 1936), 85 F.2d 343.[242]

A relatively recent case sustaining this principle in Acme Process Equipment v. United States.[243] In Acme, the Court of Claims rejected the Government's asserted right to cancel a contract for contractor violation of the Anti-Kickback Act reasoning that cancellation was not a sanction specifically authorized by the Act. The court may have been influenced by the fact that the contractor had expended considerable funds in preproduction preparation and that none of Acme's officers were aware of any kickbacks. However, the Supreme Court apparently was not swayed by any equitable concerns for the contractor. The Supreme Court reversed, reasoning that even if Acme "appears entirely innocent," the contract is unenforceable because it would violate the basic purpose of the kickback statute.[244]

Implied Contract Recovery Under the Tucker Act

The specific language of the Tucker Act providing jurisdiction for the Court of Claims is as follows:

> The Court of Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress, or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort.[245]

The Supreme Court has consistently viewed the Tucker Act jurisdiction for implied contracts to be limited to contracts implied in fact. Implied in law contracts have traditionally not been considered true contractual obligations subject to the Tucker waiver of immunity.[246] Contracts implied in law or quasi contracts are fictional creations of the judiciary to prevent unjust enrichment. Quasi contracts aren't based on a manifestation of assent found in the conduct of the parties.[247]

Although the *difference* between implied in fact and implied in law contracts is clear in theory, it has been cloudy in application.[248] The Court of Claims and the Federal district courts occasionally have stretched the concept of implied in fact contract to cover implied in law situations in order to fashion some form of judicial relief and avoid the Tucker Act restrictions.[249] One Federal district court in a law suit involving an alleged parole agreement, candidly conceded that the remedy it devised was in essence "quasi" contractual.[250] Yet, in the words of one case not written in spite of some " . . . apparent excursions into the realm of contracts implied in law, lower courts have not fully disregarded the Supreme Court's

interpretation of Tucker Act jurisdiction." Most federal courts have been hesitant to provide "anything resembling quasi contractual relief on illegal contracts because the rule prohibiting such recoveries deters contractors from entering illegal bargains."[251]

Early GAO Treatment of CPPC Recovery

One of the more ubiquitous types of GAO protests concerning illegal contracts is CPPC. There have been numerous GAO treatments of the issue since the enactment of the CPCC prohibition in the early 40's.[252] Some early GAO decisions allowed quantum meruit relief for prime contractor's actual costs plus a "reasonable fee",[253] while others denied contractors any recovery for work accomplished under a CPPC contract.[254] Subcontractors were consistently out of luck.[255] In the war years of the 40's, the Comptroller disallowed cost-reimbursement primes' requests for exact payment[256] or quantum meruit relief[257] for work done by their CPPC subs, "even when the subcontractor had furnished valuable, tangible services, or goods,"[258] apparently the theory being that the statutory restrictions on CPPC contracts might otherwise be side-stepped.[259]

In the words of the GAO: "Allowing reimbursement on a quantum meruit basis would be tantamount to circumventing the statutory inhibition applicable in the case of the subcontract."[260] In Day and Zimmerman[261] the

Comptroller went on to state that not only is a CPPC "contract unenforceable according to its terms, but no contract may be implied where a statute positively prohibits the transaction." The GAO further held that estoppel and ratification didn't apply to CPPC contracts, even when the Government is benefited thereby, because "general principles of equity will not be applied to frustrate the purpose of such laws or to thwart public policy."[262]

GAO Reliance on Judicial Precedence

This rule was softened in 1954. The Comptroller ruled that prime contractors who held cost reimbursable contracts entered into with the Department of the Army during the Korean War could be reimbursed the reasonable price for services and supplies provided by subcontractors on CPPC, "advise price" and "price to be negotiated" subcontracts.[263] In coming to this conclusion the GAO relied on a 1952 Court of Claims decision, Pacific Maritime Assn. vs. United States.[264]

In Pacific the court held:

> While it cannot be said that the parties entered into an express contract in the instant case, we are of the opinion that an understanding to compensate the association for the fair and reasonable value of its services furnished after its demand for payment may be fairly implied in fact from all the circumstances, especially the fact of the Army's continued use of such services subsequent to that demand. Clark v. U.S. 539, 542; Niagara Falls Bridge Commission v. U.S. 111 C. Cls. 338; Buffalo & Fort Erie Public Bridge Authority v. U.S., 1 De C. Cls. 731, National Carloading Corp. v. U.S., 105 C. Cls. 479.[265]

Pacific Maritime has been cited frequently by the GAO since 1954 as the judicial hallmark standing for the principle of quantum meruit/quantum valebat recovery on an implied in fact contractual obligation arising from a void contract.[266]

Evolution of Quantum Meruit Standards of Recovery

The judicial limits on the quantum meruit recovery are a little hazy at best. The most liberal approach is epitomized by New York Mail and Newspaper Transportation Co. v. United States.[267] This is a 1957 Court of Claims case in which the contractor had completed only three years of a ten year contract when the Government terminated performance declaring the contract void for noncompliance with formal advertising statutes. The plaintiff incurred costs not meeting the traditional parameters of the reasonable value of benefits conferred, normally encompassed in quantum meruit relief, for only three years of performance. These included capital investments and preparation costs. The Court of Claims had no trepidation in including these costs in a quantum meruit recovery: "Here, as there was bona fide purpose to render services to the United States, as agreed to by the Postmaster General, we think the parties should be put substantially in the position they would have occupied without the attempted contract, rather than a strict quantum meruit."[268]

One thing is certain, placing a Government contractor, who has performed a void contract, back in virtually the same position he would have been in if the contract had not been attempted certainly is not a "strict quantum meruit"! However, the liberal quantum meruit relief espoused by the New York Mail court has engendered uncertainty and confusion for subsequent cases litigated in the courts and considered by the GAO as to what facts dictate implementation of the generous (put him back in the same position) relief.

The liberal approach has been adopted in later Court of Claims cases,[269] but the court has vacillated in its subsequent interpretations of New York Mail. For example, the Prestex[270] court denied a Government contractor quantum meruit recovery because he conferred no benefit on the Government. This court apparently characterized New York Mail as a quasi case: "In certain limited fact situations, the courts will grant relief of a quasi-contractual nature when the Government elects to rescind an invalid contract...Nowhere is this more clearly demonstrated than in New York Mail and Newspaper Transportation Company v. United States. . . ."[271]

Yet, this same prestigious Court two years later in Acme Process Equipment Co. v. United States[272] apparently did not think New York Mail was so "quasi"! The Acme Court held that it "has permitted quantum meruit recovery for contracts implied in fact (see, e.g. New York Mail . . .)[273]

GAO and New York Mail

The General Accounting Office has not been very sure how to interpret New York Mail either, as evidenced by the following statement:

> In New York Mail and Newspaper Transportation Co. v. United States, the majority opinion stated that, rather than providing for payment on a strictly quantum meruit basis, the parties should be placed substantially in the position they would have been in had there been no attempted contract. While the matter is not entirely clear, it may be that the judgment awarded exceeded the amount which would have been paid under quantum meruit, i.e., value received by the Government agency. However, even accepting the rule in that case (overlooking the precedents to the contrary and the dictum in the strong dissent under which no payment would have been awarded the contractor had there been no valid contract) it does not appear that the preaward position of the parties could any more be restored if the United States were to pay the claim than if the parties were left in status quo.
>
> In any case, we think the matter has been specifically decided by the Supreme Court in United States v. Mississippi Valley Generating Co. (1961) . . . [274]

Supreme Court's Receive Nothing, Recover Nothing Rule

In Mississippi Valley,[275] the Supreme Court ruled that a conflict of interest in violation of 18 USC 6434 (a consultant represented the Government in a business transaction from which he and his company could be expected eventually to derive profit) prohibited enforcement of a contract with the Atomic Energy Commission. The Court concluded: "Since the government has received nothing from the respondent, no recovery quantum valebat is in order," even though this policy "may seem harsh in a given case."[276]

Yosemite Park: New York Mail Revisited

The Court of Claims endorsed quantum meruit recovery for illegal contracts as recently as 1978.[277] Yosemite is a fascinating case involving cost plus fixed percentage fee contract for transportation services in Yosemite National Park. Under the contract terms, Yosemite Park and Curry Co. (YPC) was to provide bus service to the public without charge. The National Park Service (NPS) agreed to reimburse YPC for its actual expense plus a reasonable profit for providing this service. A modification to the contract authorized YPC "to recover federal income taxes as a reimbursable fixed cost" and allowed YPC to calculate its annual operating fee "as 12-1/2% of its average gross investment in the transportation equipment employed in the service.[278] The Court of Claims ruled that the 12 1/2% fee provision violated 41 USC § 254 (b) (1970) because the fee exceeded the 10% limitation for a cost-plus-a-fixed fee contract. The Court also determined that YPC's federal income tax was an unallowable cost in accordance with 41 CFR § 1-15.205-41 (a)(1)(1977).

As a result the Court concluded that these provisions were unenforceable and "patently illegal" citing W. Penn Horological Inst. v. United States, 146 Ct. C. 540 (1959).[279] Nevertheless, because the NPS "bargained for,

agreed to pay for, and received the benefit of YPC's services . . . over the four year period that YPC operated under the belief and on the representation of the NPS that agreement was valid," the Court of Claims held that YPC "is entitled to a quantum meruit recovery for the reasonable value of the service received by the defendant."[280] YPC was allowed to recover its "entire, total provable costs . . . incurred in performance of the agreement plus 10 percent . . .[281] It is noteworthy that this judgment allowed the payment of more money than permitted by the fee limitation statute 41 U.S.C. § 254 (b).

YPC apparently relied on New York Mail as precedent permitting implied in fact recovery when the express contract is illegal.[282] However, YPC has been criticized for being less than lucid as to a theory of recovery.[283] YPC doesn't spell out whether quantum meruit is used as a form of recovery independent from implied in fact or implied in law contracts. Because the court's recovery rationale is difficult to define, there may well be some validitiy to the following case note speculation:

> The court may have sought what it considered a fair result but left its reasoning intentionally vague to rob the decision of precendential value. On the other hand, the decision may be an additional venture by the Court of Claims into the realm of quasi contract.[284]

Illegal Contracts Sans Benefit Incurred: Plain Illegality and Void Ab Initio Rules

Since 1978 the courts have been relatively quiescent on the issue of quantum meruit recovery for illegal contracts. There has been no scarcity of decisions though on the threshold issue of what constitutes illegality, and what effect an illegality has on the rights of the parties in absence of any benefit conferred on the Government.

The Court of Claims, whose precedent is binding on the new Court of Apeals for the Federal Circuit,[285] has recently declared that:

> It is now settled law that this court will not declare a contract between the government and a private party void ab initio unless there was "plain illegality" in the contract. John Reiner & Co. v. United States 163 377 U.S. 931, 84 S.Ct. 1332.[286]

What the Court of Claims meant by "plain illegality" is not "plain" by any means. A couple of situations which the Court of Claims has held to be not clearly illegal are: 1) "good faith but erroneous responsibility judgments";[287] and 2) disregard by a contracting officer of a Defense Acquisition Regulation requiring assemblage of sufficient facts concerning a prospective bidder to make an informed responsibility determination.[288]

On the other hand, other federal courts have recently had no trepidation in finding implied or even express Government contracts void/illegal in the following

circumstances: 1) Erroneous issuance of a certificate of eligilibility showing a veteran was entitled to 31-1/2 months of entitlement to educational assistance under the Veterans Readjustment Act, when in fact, the veteran was entitled to only four months of entitlement;[289] 2) a plaintiff sued for retroactive Social Security benefits which she missed because a Social Security field representative failed to inform her of the mandatory requirement of filing a written application;[290] 3) a grant of immunity by SEC agents was held invalid "since the SEC's agents lacked actual authority to limit contractually the prosecutorial discretion of the Department of Justice...";[291] 4) a plaintiff's claim to continued employment in the Air Force was held invalid because "The Air Force must act within the authority delegated to it by Congress...Any 'regulations' or 'contracts' attempted in excess of that authority must be void."[292]

In all the above-cited void contract cases no recovery against the Government was allowed. Since no benefit was conferred on the Government, no quantum meruit relief was even considered in accord with Mississippi Valley.[293] This harsh treatment of illegal contracts or claims was poignantly summarized by the Supreme Court in a 1947 decision quoted recently by the Eleventh Circuit:

> Men must turn square corners when dealing with the Government, does not reflect a callous outlook. It merely expresses the duty of all courts to observe the conditions defined by Congress for charging the public treasury.[294]

GAO Treatment of Compensation for Illicit Contracts Since the Early Seventies

Numerous GAO decisions in the last ten years sanction contractor compensation on a quantum meruit basis in absence of a valid contract.[295] Recent Comptroller opinions are widely divergent in regards to the requirements or criteria that must be satisfied to allow Government compensation as well as what constitutes just compensation.[296]

Some of the more current GAO cases hold that quantum meruit or quantum valebat recovery is permissible only if the Government received a benefit, the price is fair and reasonable, and there is express or implied ratification by an authorized contracting official of the Government.[297]

Is quantum meruit or quantum valebat recovery permissible if the procurement violates a federal statute or regulation? The recent Comptroller response to this question has been anything but consistent. In Action[298] the GAO allowed a claim for preparation of transcripts on a quantum meruit basis in spite of agency failure to comply with procurement regulations. The Comptroller boldly pronounced:

> The fact that ratification of the contract award pursuant to FPR § 1-1.405, supra, was impermissible due to illegal improprieties in the procurement is no bar to quantum meruit relief. Bureau of Land Management Mobile Home Purchase Unauthorized B-200095, October 8, 1980, 80-2CPD 257, Deloss Construction Co. B-196004 in November 2, 1979, 80-1 CPD 201.[299]

In Department of State[300] the Comptroller had no qualms about sanctioning quantum meruit relief even where a contract violated a Federal statute.[301]

In Selective Service System the GAO allowed payment on quantum meruit basis for services performed by a contractor pursuant to the improper oral direction of the Selective Service System Director. In this case both statute and regulation were violated since "no sole source contract properly could have been awarded here because the Director did not comply with the requirements of 41 U.S.C. § 253 (1976) and of the Federal Procurement Regulations (FPR) regarding the award of sole source contracts."[302]

Yet, as recently as September 13, 1982, the Comptroller ruled that quantum meruit compensation can only be made if "it can be established that the government received a benefit, the price is fair and reasonable, payment would not violate a statute or regulation, and the action was ratified by an authorized official of the government."[303] [emphasis original]. The Comptroller wasn't distinguishing payment impropriety from procurement violations, since the same opinion also specifically holds that either an illegal express or implied in fact contract precludes quantum meruit recovery.[304]

Divisibility of Illegal Bargains

What if a CPPC or other illegal provision constitutes only a portion of an otherwise valid contractual arrangement? Does CPPC create an "infectious invalidity" voiding other legal payment provisions in the same contract? The GAO confronted these issues recently in The Department of Labor -- Request for Advance Decision.[305] The Comptroller determined that certain sections of Department of Labor contracts were void CPPC provisions. However, the remaining contractual portions were found to be valid. According to the GAO:

> [T]he contract is divisible into a legal portion, supported by valid consideration, and an illegal portion invalid because the method of payment specified is contrary to statute.[306]

Although the GAO cites no case law for this division principle, reference is made to "6A Corbin on Contracts § 1528 (1962)." Professor Corbin suggests that questions of "divisibility" have been decided in the final analysis on the basis of "judicial instinct for justice" rather than invoking general rules governing the separability of tainted provisions.[307] Professor Corbin's observation has been sustained generally by the courts. For example, the Fifth Circuit Court of Appeals has held that:

> [I]f the degree of illegality is not great, and enforcement is not unfair and unreasonable, then a court is justified in declaring the transaction divisible and enforcing the lawful part.[308]

In the final analysis, this divisibility rule amounts to little more than judicial common sense and "instinct for justice," especially since "analysis in terms of 'divisibility' or some verbal formula may well be circular, see 6 Corbin Contracts § 1520."[309]

CA-FC Illicit Recovery Standards

The most current judicial guidance on quantum meruit or quantum valebat recovery for illicit contracts was rendered in Urban Data Systems Inc. v. United States,[310] a 1983 Court of Appeals for the Federal Circuit decision. The Urban Data Court had no problem not finding any infectious invalidity stemming from CPPC payment provisions. This was because it was "plain that only the price terms of the two [8a] subcontracts were invalid -- not any other part of those agreements." The court went on to hold that Urban could recover the reasonable market value of its supplies and services provided the Government on a quantum valebat basis, citing Cities Services Gas Co. v. United States, 500 F.2d 448, (1974).[311] With respect to the judicial interchangeability of the terms quantum meruit and quantum valebant the court made the following enlightening comment by way of footnote:

> Cities Service discusses a quantum meruit rather than a quantum valebat basis for recovery. The difference is of no significance here. The former is said to apply to services and the latter to goods, but the Court of Claims generally considered questions of recovery for any contract implied in fact -- whether for services or goods -- on a quantum meruit basis.

See also Allstates Van Lines Corporation v. United States, 215 Ct. Cl. 1075 (1978). Here we deal with a contract implied in fact because the parties did have an actual agreement to supply and buy the paper, see Somali Development Bank v. United States, 508 F.2d 817 (Ct. Cl. 1974), and we follow the Board's use of the term quantum valebat.[312]

The Urban Court remanded the case to the Board of Contract Appeals on the issue of how much "quantum" was appropriate. But the court didn't remand without some strings of guidance attached. The Court emphasized four points:

> First, the value to be determined should be based "on the reasonable value in the marketplace of the property sold," not on costs. Cities Services, supra, 500 F.2d at 457 (emphasis added). Second, the "marketplace" in this case is not the competitive arena of all businesses, large and small, who could have supplied the contract goods. Rather, the marketplace is only that of 8(a) businesses because the original GSA/SBA contracts both properly stipulated that SBA was to "subcontract[ing] with an eligible concern pursuant to the provisions of Section 8(a) of the Small Business Act." Under the 8(a) program, contracts may be let at a price in excess of that at which a non-8(a) business could perform, as a means of encouraging small businesses to achieve a competitive place in the market. See Eastern Canvas Products, Inc. v. Brown, 580 F.2d 675, 685-86 (D.C. Cir. 1978); Ray Baillie Trash Hauling, Inc. v. Kleppe, 447 F.2d 696, 708 (5th Cir. 1973), cert. denied, 415 U.S. 914 (1974); see also 13 C.F.R. §§ 124.8-1(b), 124.8-2(d)(1975). Third, the circumstances of the case require that the Board also take into account the general advantages to the Government inherent in the 8(a) program of contracting with small business. The Government contracts, not only for the specific goods, but for the less tangible advantages of training Urban, a small business, and giving it experience in the business world. This is a benefit of some value to the Government, which should be melded into the ultimate determination (unless it is found that no such benefit was in fact received at all in this case). Fourth, the appropriate amount of interest should be included in Urban's recovery, pursuant to the general provisions of both contracts.[313]

Not only did the Urban Court's liberal view of quantum meruit include interests, it also encompassed profit. The Court stopped short of mandating profit as an element of recovery, however, "observing that this can be one possibility for compensation."[314]

Perhaps the best summary of the new Federal Circuit Court of Appeals' treatment of compensation for illicit contract provisions is revealed in the Court's approval of a quote from Pacific Maritime:

> In similar circumstances the Court of Claims noted that [n]o better answer [to the question of fair compensation] can be given than what the parties agreed upon.[315]

Public Law 85-804 and CPPC Contract Compensation

In addition to the authority the Government has to purchase goods and services in the normal acquisition process, the Executive Branch has been given extraordinary powers which may be used in the course of procurements for the national defense. "One of these powers, Public Law 85-804, permits procuring agencies to grant relief to the contractors who may not have a legal right to such relief and contains broad authority to act outside of the normal procurement statutes."[316] The current codification of 85-804 found at 50 U.S.C. §§ 1431-1435 reads in pertinent parts as follows:

> Section 1431. The President may authorize any department or agency of the Government which exercises functions in connection with the national defense, acting in accordance with regulations prescribed by the

President for the protection of the Government, to enter into contracts or into amendments or modifications of contracts heretofore or hereafter made and to make advance payments thereon, without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts whenever he deems that such action would facilitate the national defense. The authority conferred by this section shall not be utilized to obligate the United States in an amount in excess of $50,000 without approval by an official at or above the level of an Assistant Secretary or his Deputy, or an assistant head or his deputy, of such department or agency, or by a Contract Adjustment Board established therein. The authority conferred by this section may not be utilized to obligate the United States in any amount in excess of $25,000,000 unless the Committees on Armed Services of the Senate and the House of Representatives have been notified in writing of such proposed obligation and 60 days of continuous session of Congress have expired following the date on which such notice was transmitted to such Committees and neither House of Congress has adopted, within such 60-day period, a resolution disapproving such obligation. For purposes of this section, the continuity of a session of Congress is broken only by an adjournment of the Congress sine die, and the days on which either House is not in session because of an adjournment of more than 3 days to a day certain are excluded in the computation of such 60-day period.

Section 1432. Nothing in this Act shall be construed to constitute authorization hereunder for --

(a) the use of the cost-plus-a-percentage-of-cost system of contracting:

(b) any contract in violation of existing law relating to limitation of profits;

(c) the negotiation of purchases of or contracts for property or services required by law to be procured by formal advertising and competitive bidding;

(d) the waiver of any bid, payment, performance, or other bond required by law;

(e) the amendment of a contract negotiated under section 302 (c)(13) of the Federal Property and Administrative Services Act of 1949, as amended (63 Stat. 377, 394), to increase the contract price to an amount higher than the lowest rejected bid of any responsible bidder; or

> (f) the formalization of an informal commitment, unless it is found that at the time the commitment was made it was impracticable to use normal procurement procedures.[317] [emphasis added].

It is inherently obvious from the highlighted segments of the statute that 85-804 recovery for CPPC type illegal contracts would be extremely circumscribed at best! Nevertheless, 85-804 relief was invoked in the CPPC context when predetermined overhead rates were discontinued by the Department of Defense in 1956.[318] At that time, many contracts were initiated without referencing the allowability of general research costs mandated by the regulations to allow recovery of such costs. Several contractors were granted relief under P.L. 85-804 on the theory that they had mistakenly relied on the previous conduct of the coordinated overhead rate negotiating committee in incorporating such costs in the predetermined overhead rates.[319]

CHAPTER VIII

CONCLUSION

In Government acquisition few will dispute that there are many less than sagacious contractual arrangements. However, "[t]he fact that [a] procurement system is improvident obviously does not make it illegal."[320]

The difficult task in identifying CPPC violations is discerning the illegal from the unwise (and in some instances provident) contractual modes. Any formula for payment based on a fixed percentage rate of performance costs is suspect. Each formula should be analyzed to ascertain if the four essential ingredients discussed in Chapter I are present: (a) payment is on a predetermined percentage rate; (b) the predetermined percentage rate is applied to actual performance costs; (c) contractor's entitlement is uncertain at the time of contracting; and (d) contractor's entitlement increases commensurately with increased performance costs.

Key Element: Ability to Manipulate Direct Costs

The bottom line in both the Court's and GAO's characterization of CPPC is the contractor's ability to control and manipulate direct costs to which overhead and profit are added predicated on a predetermined percentage formula. Simply put, if a Government contractor can increase his profits percentage and/or allowable overhead pursuant to a predetermined formula by running up his reimbursable costs, the CPPC proscription has been violated. If he can't manipulate his performance costs to obtain more profit or overhead reimbursement based on a predetermined rate, no CPPC exists, no matter what other trappings or garb may be present.

Recommendations

In spite of some of the liberal precedent concerning compensation for illegal CPPC provisions discussed in Chapter VII supra, the fact remains that CPPC is an illicit, imprudent malady that should be studiously avoided by both contractor and Government personnel. "Every Government official is alive to the embarrassment, admonition or even more serious stigma which can flow from the creation of an illegal contract under his aegis."[321] Even if a contractual provision has just the appearance of CPPC, much administrative headache is often generated for Federal agency personnel concerned as evidenced by the

extended Air Force and GAO controversy (Chapter VI) over the CPPC potential of payment provisions for subcontracted aircraft maintenance.

In the increasingly complex world of Government acquisition there is no simple panacea for CPPC prevention. However, some general guidelines can certainly be proffered.

Fixed Price Contracts

There is less chance for CPPC manipulations in a fixed price mode as opposed to a cost environment. But even fixed priced contracts are not completely immune from the potential infectious invalidity of CPPC. For example, special caution should be exercised in the use of fixed price contracts with economic price adjustments (discussed in Chapter IV). Profit paid on the actual cost method type of economic price adjustment (EPA) clearly violates the CPPC ban. If a cost index method EPA is utilized, care should be taken to choose indices for the contract price adjustments which are not capable of manipulation by the contractor.

Predetermined Overhead Rates in Cost Contracts

If you want to avoid potential CPPC headaches in a cost environment, avoid predetermined overhead rates. Restricting the rates with ceilings or maximums may not cut the mustard at least with the Court of Appeals for the Federal Circuit.[322] If predetermined overhead rates must be

employed make sure they are provisional i.e., subject to audit and retroactive revision.

FOOTNOTES

[1] Graske, The Law of Government Defense Contracts, Chapter IV (1941).

[2] 324 U.S. 49, 65 S. Ct. 442 (1945).

[3] 324 U.S. 49, 61 (1945).

[4] Comp. Gen. Dec. B-196556, 80-2 CPD ¶ 87 (1980) at 3.

[5] GSBCA 5545, 1981 BCA ¶ 15,254 (1981).

[6] Id. at 75,509.

[7] Urban Data Systems, Inc. v. United States, 1 FPD ¶ 60 at 6, 699 F.2d 1147, 1153 (1983).

[8] Graske, supra, note 1.

[9] Hearings before the Select Committee on Expenditures in the War Department, 66th Cong., 1st Sess. Series I, pt. 5, p. 488.

[10] Id.

[11] The Vinson-Trammel Act of March 27, 1934, 48 Stat. 505; 34 U.S.C. § 446, (current version at 10 U.S.C. § 2382 & § 7300, was an example of a profit limitation provision relating to Government contracts).

[12] 10 U.S.C. § 2306(a); 41 U.S.C. § 254(b) see also 50 App. U.S.C. 1152.

[13] Reda, Anatomy of Cost-Plus-Percentage-of-Cost, 10 AF JAG L. Rev. (No. 5) 39, Sept-Oct 68.

[14] Annot., 2 A.L.R. 126 (1919).

[15] Hamilton v. Coogan, 7 Misc. 677, 28 N.Y. Supp 21 (1894), aff'd without opinion 148 N.Y. 753, 43 N.E. 987 (1896).

[16] 44 Atl. 1 (1899).

[17] 98 C.C.A. 174, 174 Fed. 140 (1909).

[18] 88 N.J. Eq. 33, 102 Atl. 151 (1917).

[19] 2 A.L.R. 122 (1919).

[20] 102 Atl. 151, 154 (1917).

[21] Id. at 155.

[22] 39 Stat. 166, ch. 134, 64th Cong., 1st Sess.

[23] Annual Report, Paymaster General of the Navy, 1918 at 24, 25.

[24] Editorial, Engineering News-Record, Vol. 78, No. 10, June 7, 1917 at 514.

[25] Corwell, Government War Contracts at 82 (1920).

[26] Uniform Contracts and Cost Accounting Definitions and Methods, at 5, Government Printing Office, 1917.

[27] Annual Report, Paymaster General of the Navy, 1918 at 24, 25.

[28] Housing Act of May 16, 1918, Pub. L. No. 164, 65th Cong. (H.R. 12,280).

[29] See House Bill Histories Volume 5, 65th Congress, Report of May 25, 1918 to accompany H.R. 12280 from the Committee on Appropriations.

[30] 59 Ct. Cl. 295 (1924).

[31] 26 Comp. Dec. 688, Feb. 26, 1920.

[32] 26 Comp. Dec. 401, Nov. 21, 1919.

[33] 58 Ct. Cl. 98 (1923).

[34] 60 Ct. Cl. 654 (1925).

[35] 60 Ct. Cl. 764 (1925).

[36] Graske, The Law of Government Defense Contracts, at 146 (1941).

[37] See testimony of Bernard Baruch before the War Policies Commission, House Doc. No. 163, 72nd Cong., 1st Sess. 30-72 (1931).

[38] S. Res. 206, 73rd Cong., 2d Sess., (April 12, 1934).

[39] Hensel and McClung, Profit Limitations Controls Prior to the Present War, X Law and Contemporary Problems at 119 (1943).

[40] 54 Stat. 676, 50 U.S.C.A. § 1152 (1940); 54 Stat. 712, 50 U.S.C.A. § 1171 (1940); 55 Stat. 148. 50 U.S.C.A. § 1261 (1941).

[41] 55 Stat. 839, 50 U.S.C.A. § 611 (1941).

[42] 56 Stat. 176, 50 U.S.C.A. § 633 (1942).

[43] On December 27, 1941, the President of the United States, by Executive Order No. 9061 delegated to the War Department, the Navy Department and the United States Maritime Commission, the authority conferred upon him by the First War Powers Act, with the limitation that "nothing herein shall be construed to authorize the cost-plus-a-percentage-of-cost system of contracting."

[44] See 13 Am. Jur. 2d Building and Construction Contracts § 20 (1968).

[45] 21 Comp. Gen. 858 (1942).

[46] Comp. Gen. Dec. B-155750 Feb. 9, 1965, Unpub.

[47] 45 F. Supp. 1016 (D.C. Mo., 1942).

[48] Id. at 1019.

[49] 324 U.S. 49, 70, 65 S.Ct. 442 (1945).

[50] Id.

[51] Id. at 61.

[52] Id. at 62.

[53] Id. at 63.

[54] Pub. L. No. 413, 10 U.S.C. § 2306(a). (1981).

[55] 41 U.S.C.§254(b)(1952).

[56] FAR 52.244-3(b); FAR 52.244-2(g).

[57] 10 U.S.C. § 2306(f)(1981).

[58] FAR 15.802 et. seq.

[59] 10 U.S.C. § 2306(a), and 41 U.S.C. § 254(b).

[60] Such contracts are most frequently used in the building and construction industries. See 13 Am Jur.2d Building and Construction Contracts § 20. Some of the more recent CPPC Construction contract cases include, inter alia:

D.C. Edwards & Co. v. Fisher (1980, Tex. Civ. App., 1st Dist.) 610 SW.2d 546; LaVelle v. DeLucca, 48 Wis.2d 464, 180 N.W 2d 710 (1970) and Pioneer Construction v. Symes, 77 Ariz. 107, 267 P.2d 740 (1954). Am. Jur. Legal Forms contains the following CPPC contract provisions: Compensation for extra work -- cost-plus percentage basis. 4 Am. Jur. Legal Forms 2d 47:216; Cost-plus percentage basis -- payment by owner for material and labor, 4 Am.Jur. Legal Forms 2d 41:224; Payment under cost-plus contract, 15 Am. Jur. Legal Forms 2d 216:242.

[61] Klein-Sieb Advertising and Public Relations, Comp. Gen. B-200399, 81-2 CPD ¶ 251 (1981) at 6.

[62] The Department of Labor -- Request for Advance Decisions, Comp. Gen. Dec. B-211213, 83-1 CPD 4 ¶ 429 (1983) at 2.

[63] Id.

[64] 1 FPD ¶ 60, 699 F.2d 1147 (1983).

[65] Id. at 1151.

[66] Id. at 1154. Ironically one of the most explicit examples of the application of a predetermined percentage rate to actual costs is a case in which the issue of CPPC was never discussed. In Sun Shipbuilding and Dry Dock Co. v. United States, 183 Ct. Cl. 358, 393 F.2d 807 (1968) the contract stated that the contractor was to be paid "110% of net cost increases." This payment clause obviously easily meets the GAO's four point test. In fact this is a clear example of an open invitation to increase costs for a government contractor. Sun Shipbuilding couldn't lose (a virtual carte blanche!) since greater costs guaranteed greater profits.

[67] FAR 16.306.

[68] ASBCA 21656, 78-1 BCA ¶ 12,867 (1978).

[69] Department of State-Method of Payment Provisions, Comp. Gen. Dec. B-196556, 80-2 CPD ¶ 87 (1980) at 2.

[70] Id.

[71] Id. at 3, 4.

[72] J. Cibinic & R. Nash, Cost Reimbursement Contracting, Government Contracts Program, George Washington University, 137 (1981).

[73] Id. at 138.

[74] Id.

[75] Urban Data Systems, Inc., GSBCA 5545, 81-2 BCA ¶ 15,254 (1981).

[76] 1 FPD ¶ 60 at 3, 699 F.2d 1147 at 1150.

[77] Id. at 7 and 1154. Compare Marketing Consultants International, Ltd., Comp. Gen. Dec. B-184825, 75-2 CPD ¶ 384 (1975) where the GAO held that use of a sliding matrix for percentage fee determination that had some points at which the fee falls as costs increase did not avoid the CPPC prohibition since the overall effect of payment procedure was that fee increases and incentive was to raise costs sufficiently to avoid profit depression.

[78] Id. at 8 and 1155.

[79] Id.

[80] Payne v. United States, 50 App. D.C. 219, 269 Fed. 871, 873 (1921).

[81] Kenicott v. Wayne County, 16 Wall (83 US) 452, 471 (1872).

[82] FAR 31.205.6(f).

[83] FAR 31.205.6(b).

[84] Bell Helicopter Co., ASBCA 9625, 65-1 BCA ¶ 23,015 (1965).

[85] Id. at ¶ 23,020.

[86] ASBCA 20094, 76-1 BCA ¶ 11,880 (1976).

[87] Id.

[88] FAR 31.205.6(b)(1).

[89] ASBCA 2909 & 3180, 57-1 BCA ¶ 1247 (1957).

[90] Id. at 3647.

[91] ASBCA 10288, 67-1 BCA ¶ 6115 (1967).

[92] Id. at 28,309.

[93] 582 F.2d 552 (1978).

[94] Id. at 554.

[95] Id. at 559.

[96] 35 Comp. Gen. 434 (1956); 35 Comp. Gen. 63 (1955).

[97] 35 Comp. Gen. 63, 69 (1955).

[98] 35 Comp. Gen. 434 (1956).

[99] Id. at 436.

[100] Id.

[101] 41 U.S.C. § 254a.

[102] 76 Stat. 437 (1962).

[103] DAR 3-704.2(b), NASA PR 3-704.2(b), FPR 1.3.703(c) and FAR 42.705-3(b).

[104] FAR 42.705-3(b).

[105] FAR 16.207-1.

[106] Hq. Air Force Audit Agency letter dated July 5, 1983, to Air Force General Counsel.

[107] Id.

[108] Memorandum by Daniel Rak, Assistant General Counsel Department of the Air Force (March 23, 1984) (addressing CPPC for Hq. Air Force Audit Agency).

[109] 324 U.S. 49, 70, 65 S. Ct. 442 (1945).

[110] Memorandum, supra note 108.

[111] FAR 16.601(a).

[112] FAR 16.602

[113] FAR 16.601(b)(1).

[114] 46 Comp. Gen. 612, 613 (1967).

[115] FAR 16.203-1(a); DAR 3-404(c)(1).

[116] DAR 3-404(c)(1).

[117] FAR 16.203-1(b); DAR 3-404.3(c)(2).

[118] FAR 16.203-1(c); DAR 3-404(c)(3).

[119] DAR 3-404(c)(3); similar language is found in FAR 16.203-1(c).

[120] FAR 16.203-4(c)(3)(ii) and DOD FAR Supp 16.203-4.

[121] Letter from Robert Sands, Chief, Contract Pricing and Financial Office Hq USAF to Air Force General Counsel (February 24, 1982) (requesting a legal opinion on whether payment of profit on escalation adjustments constitutes CPPC contracting).

[122] Id.

[123] Memorandum by Laurence Fedak, Office of the Air Force General Counsel (March 30, 1982) (addressing whether payment of profit on escalation adjustments constitutes CPPC contracting).

[124] Id.

[125] DAR 3-404.3(c)(2)(d).

[126] Fedak, supra note 123.

[127] Id.

[128] Ingrao, Types of Government Contracts, 18 A.F.L. Rev. 63 (Spring 1976).

[129] Mack, Cost-Plus-Percentage-of-Cost Contracting, 2 National Contract Management Journal 125, 134 (1968).

[130] FAR 16.603-2(c); DAR 3-408(c).

[131] DAR 3-408(c)(6).

[132] 33 Comp. Gen. 291, 292 (1954).

[133] B-110609 (1954).

[134] Id.

[135] Urban Data Systems v. United States, 1 FPD ¶ 60, 699 F.2d 1147 (1983); Department of Labor 83-1 CPD ¶ 429 (1983).

[136] 33 Comp. Gen. 291, 292 (1954).

[137] Mack, supra note 129.

[138] 296 F.2d 393 (1961).

[139] Id. at 396.

[140] FAR 16.603; DAR 3-408; FPR 3-408.

[141] R. Nash & J. Cibinic, Federal Procurement Law, Vol. II, 1359 (1980).

[142] 409 F.2d 246, 187 Ct. Cl. 477 (1969).

[143] Id. at 249.

[144] Mack, supra note 129 at 155.

[145] Modern Foods, Inc., ASBCA 2090, 57-1 BCA ¶ 1239 (1957); See also, Jack Picoult, VACAB 1221, 78-1 BCA ¶ 13,024 (1978); Celesco Industries Inc., ASBCA 22251, 79-1 BCA ¶ 13,604 (1978).

[146] United States v. Callahan Walker Construction Co., 317 U.S. 56, 61; Bennet v. United States, 371 F.2d 859 (1967); General Builders Supply Co. v. United States, 409 F.2d 246 (1969); Martin-Marietta Corp., ASBCA 10062, 65-2 BCA ¶ 4973 (1965).

[147] ASBCA 16164, 76-2 BCA ¶ 11,979 (1976).

[148] Id. at 57,427.

[149] Ed Goety Painting Co., DOT CAB 1168, 83-1 BCA ¶ 16,134 (1983).

[150] FAR 52.212-15; DAR 7-104.77(f).

[151] FAR 52.212-12; DAR 7-602.46; Drano Corp., ENGBCA 3915, 79-1 BCA ¶ 13,603 (1978).

[152] Reda, Anatomy of Cost-Plus-Percentage-of-Cost, 10 AF JAG L. Rev. (No.5) 39,42, Sept-Oct 68.

[153] ASBCA 15528, 72-1 BCA ¶ 9343 (1972).

[154] Id. at 43,382.

[155] 5 Government Contractor § 579 at 4.

[156] J. Cibinic & R. Nash, Administration of Government Contracts, Government Contracts Program, George Washington University, 335 (1981).

[157] 392 F.2d 807, 183 Ct. Cl. 358 (1968).

[158] Id. at 812.

[159] ASBCA 4611, 60-2 BCA ¶ 2769 (1960).

[160] Id. at 14,202.

[161] ASBCA 21656, 78-1 BCA ¶ 12,807 (1978).

[162] Id. at 12,867.

[163] Reda, Anatomy of Cost-Plus-Percentage-of-Cost, 10 AF JAG. L. Rev. (No.5) 39, 42, Sept-Oct 68.

[164] Id. at 43.

[165] Aerojet, General Corp., ASBCA 17171, 74-2 BCA ¶ 10,863 (1974).

[166] Fidelity Construction Company, Inc., DOT CAB 1113 & 1219 82-1 BCA ¶ 15633 at 77,226, (1982).

[167] Id.

[168] 179 Ct. Cl. 97, 374 F.2d 516 (1967).

[169] ASBCA 18730, 74-2 BCA ¶ 10,711 (1974).

[170] R.C. Hedreen Co., ASBCA 20004, 76-2 BCA ¶ 12,202 (1976).

[171] 41 C.F.R. 8-7.650-21.

[172] Id.

[173] GSBCA 1178, 66-1 BCA ¶ 5312 (1965) Mot. for reconsid. denied, 66-1 BCA ¶ 5702 (1966).

[174] Id. at 24,975.

[175] J. Cibinic & R. Nash, Administration of Government Contracts, Government Contracts Program, George Washington University, 335 (1981).

[176] Id. at 334.

[177] See Program Resources, Inc., ASBCA 21656, 78-1 BCA ¶ 12,807 (1978), where the board concluded that to allow the contractor an additional fee because it had experienced an increase in labor rates, but where there had been no "change" in the nature of the work, would violate the CPPC proscription.

[178] 163 Ct. Cl. 339, 353, 325 F.2d 451, 465 (1963).

[179] Cibinic & Nash, supra note 175, at 334.

[180] 5 Government Contractor § 579 at 4.

[181] Id.

[182] E.V. Lane Corp., ASBCA 9741, 65-2 BCA ¶ 5076 (1965); Kemmons-Wilson, Inc., ASBCA 16167, 72-2 BCA ¶ 9689 (1972).

[183] National Electronics Laboratories, Inc. v. United States, 180 F. Supp. 337, 148 Ct. Cl. 308 (1960); E.V. Lane Corp., ASBCA 9741, 65-2 BCA ¶ 5076 (1965). Kemmons-Wilson, Inc., ASBCA 16167, 72-2 BCA ¶ 9689 (1972).

[184] Reda, supra note 152 at 42.

[185] 180 F. Supp. 337, 148 Ct. Cl. 308 (1960).

[186] The contract stated: "In determining the extent of any estimated allowance for profit to be taken into account in fixing such revised price, consideration will be given to the extent to which the contractor has performed the contract with efficiency, economy and ingenuity. In no event shall revised price exceed . . ." 180 F. Supp. 337, 339 (1966).

[187] Id. at 340.

[188] ASBCA 9454, 1964 BCA ¶ 4171.

[189] ASBCA 9741, 65-2 BCA ¶ 5076 (1965).

[190] 1 FPD ¶ 60, 699 F.2d 1147 (1983).

[191] Id. at 1157.

[192] Comp. Gen. Dec. B-211213, 83-1 CPD ¶ 429 (1983).

[193] See previous discussion under Fixed Rate of entitlement in Chapter III.

[194] Comp. Gen. Dec. B-211213, 83-1 CPD ¶ 429 at 3 (1983).

[195] Comp. Gen. Dec. B-195173, 79-2 CPD ¶ 34 (1979).

[196] Id. at 2.

[197] Id.

[198] 38 Comp. Gen. 38 (1958).

[199] Id. at 39.

[200] Id. at 40.

[201] Id.

[202] Id.

[203] Element two of the GAO formula is the application of a predetermined rate "to actual performance costs."

[204] Comp. Gen. Dec. B-184825, 76-1 CPD ¶ 325 (1976).

[205] Id.

[206] 21 Comp. Gen. 800 (1942); 22 Comp. Gen. 695 (1943); 20 Comp. Gen. 632 (1941); 46 Comp. Gen. 183 (1966).

[207] 10 U.S.C. 2306(a) (1981).

[208] George Washington University, ASBCA 4725, 59-2 BCA ¶ 2376 (1959).

[209] 35 Comp. Gen. 434 (1956).

[210] FAR 16.202-1.

[211] Id.

[212] DOD FAR Supp. 16.101(b).

[213] FAR 16.102(c).

[214] Comp. Gen. Dec. B-169217, Jan. 12, 1978, Unpub.

[215] Id. at 3.

[216] Id. at 4.

[217] Id.

[218] Id. at 5.

[219] Id. at 6.

[220] David P. Andross, Office of the Air Force General Counsel, Memorandum for AF/LGPP dated February 23, 1978.

[221] Comp. Gen. Dec. B-169217, August 22, 1978, Unpub.

[222] Id. at 2.

[223] Id. citing Comp. Gen. Dec. B-175237, November 7, 1977; 38 Comp. Gen. 38 (1958).

[224] Id.

[225] The GAO cited 46 Comp. Gen. 612 (1967) as illustrative.

[226] Comp. Gen. Dec. B-169217, August 22, 1978, Unpub. at 2.

[227] Id. at 3.

[228] Id.

[229] Letter from James E. Williams Jr., Acting Deputy Assistant Secretary (Programs and Acquisition) Department of the Air Force, to the GAO (Dec. 29, 1978).

[230] Id.

[231] Memorandum by John A. Cucci, Lt. Col. USAF for JA (General Lowery) (Oct. 19, 1978) at ¶ 90.

[232] Id. at 2b.

[233] For example, see ACME Process Equipment Co., v. United States, 347 F.2d 509 (1965); and Jersey Central Power and Light Co. v. Local 327, 508 F.2d 687 (1975).

[234] DAR 3-401(a)(2).

[235] Supra note 231 attachment 1.

[236] Informal SAF/GC memorandum attached to Staff Summary Sheet (August 28, 1978).

[237] Talking Paper on GAO Report (undated) (discussing CPPC contracting).

[238] Restatement of Contracts § 598 (1932). Comment, Restitutionary Relief Under Illegal Contracts in California, 19 Hastings L.J. 1143 (1968). It does not appear that CPPC contracts are void, in and of themselves, as contrary to public policy in absence of an applicable statute prohibiting them. The GAO has recognized CPPC contracts where no statute specifically prohibited their issuance. Application of District of Columbia Redevelopment Act of 1945. Comp. Gen. B-105344, Sept. 12, 1951; flood control program, 39 Comp. Gen. 535 (1960).

[239] Id.

[240] White Water Val. Canal Co. v. Vallette 62 U.S. 414, 21 How. 414, 16 L.Ed. 154 (1858); Coppell v. Hall 74 U.S. 542, 7 Wall.542, 19 L.Ed. 244 (1868); Trust v. Child 88 U.S.441, 21 Wall. 441, 22 L.Ed. 623 (1874); Gibbs v. Consolidated Gas Co. 130 U.S. 396, 32 L.Ed. 979, 9 S. Ct.553 (1889).

[241] Whitefield v. United States 92 U.S. 165, 167, 51 How. Prac. 418 (1875).

[242] 40 Comp. Gen. 447, 450 (1961).

[243] 347 F.2d 509 (Ct. Cl. 1965), rev'd 385 U.S. 138 (1966).

[244] Id.

[245] 28 U.S.C. § 1346(a)(1976).

[246] See Jankowitz v. United States, 533 F.2d 538 (Ct. Cl. 1976). See also Alabama v. United States, 282 U.S. 502 (1931).

[247] E.g., J.C. Pittman & Sons v. United States, 317 F.2d 366, 368 (Ct. Cl. 1963).

[248] See Mewett, The Quasi-Contractual Liability of Governments, 13 Toronto 56 (1957); Note, Government Contracts Quasi-Contractual Recovery Against the Government, 42 Cornell L.Q. 278 (1957).

[249] Id.

[250] Halvorson v. United States, 126 F.Supp. 898, 901 (E.D. Wash. 1954).

[251] Case Note, Government Contracts -- Illegal Contracts -- Jurisdiction of Court of Claims to Grant a Quantum Merit Recovery - Yosemite Park & Curry Co. v. United States, 582 F.2d 552 (Ct. Cl. 1978), 1979 Brigham Young University Law Review 419 (1979).

[252] E.g., 21 Comp. Gen. 800 (1942); 22 Comp. Gen. 784 (1943); 33 Comp. Gen. 533 (1954), and authorities therein cited; 40 Comp. Gen 407 (1961); B-167790, Unpub. April 12, 1973; 58 Comp. Gen. 654 (1979).

[253] 21 Comp. Gen. 800 (1942).

[254] 22 Comp. Gen. 784 (1943).

[255] The 21 Comp. Gen. 800 decision denying any CPPC quantum meruit relief for subcontractors has been interpreted by one commentator to apply to prime contracts as well. See Reda, Anatomy of Cost-Plus-Percentage-of-Cost, 10 AF JAG L. Rev. (No.5) 39, Sept-Oct 68.

[256] 21 Comp. Gen. 784 (1942).

[257] 22 Comp. Gen. 784 (1943).

[258] Dickson, Restitutionary Concepts and Terminology in Government Contracts Decisions of the Comptroller General, 6 Public Contract Law Journal 29 (1973).

[259] Id.

[260] 22 Comp. Gen. 784 (1943).

[261] 21 Comp. Gen. 858 (1942).

[262] Id. at 863.

[263] 33 Comp. Gen. 533 (1954).

[264] 123 Ct. Cl. 667 (1952).

[265] Id. at 675.

[266] E.g., 33 Comp. Gen. 533 (1954); 38 Comp. Gen. 38 (1958). Quantum meruit has been defined as how much a contractor deserves for labor or other intangible benefits and quantum valebat as how much the contractor's property is worth.

[267] 139 Ct. Cl. 751, 154 F.Supp. 271 (1957), cert. denied, 355 U.S. 904 (1957).

[268] Id. at 759, F.Supp. at 276.

[269] See e.g., Byrne Organization, Inc. v. United States, 152 Ct. Cl. 578, 287 F.2d 582 (1961).

[270] Prestex, Inc. v. United States, 162 Ct. Cl. 620, 320 F.2d 367 (1963).

[271] 320 F.2d 367 at 373.

[272] 171 Ct. Cl. 324, 347 F.2d 509 (1965).

[273] 171 Ct. Cl. 324 at 357, 347 F.2d 509 at 529.

[274] Comp. Gen. Dec. B-137471, August 26, 1959 at 2, Unpub.

[275] United States v. Mississippi Valley Generating Co., 364 U.S. 520 (1961).

[276] Id. at 566.

[277] Yosemite Park & Curry Co. v. United States, Ct. Cl. 582 F.2d 552 (1978).

[278] Id. at 554.

[279] Id. at 561.

[280] Id. at 560.

[281] Id. at 561.

[282] Footnote 14 of YPC cites New York Mail.

[283] Case note, Government Contracts -- Illegal Contracts --Jurisdiction of Court of Claims to Grant a Quantum Meruit Recovery -- Yosemite Park & Curry Co. v. United States 582 F.2d 552 (Ct. Cl. 1978). 197 Brigham Young University Law Review 419 (1979).

[284] Id. at 431.

[285] Essentially, the Federal Courts Improvement Act divides the former Court of Claims into two parts. The seven Article III judges of the Court of Claims and the five judges of the former Court of Customs and Patent Appeals have become judges of the new Court of Appeals for the Federal Circuit (CA-FC). The sixteen former Trial Judges of the Court of Claims constitute the new Claims Court. Cf. Section 105 of the Federal Courts Improvement Act. The Jurisdiction of the former Court of Claims found at former 28 U.S.C. § 1491 is transferred to the new Claims Court in new 28 U.S.C. § 1491.

[286] American Science and Engineering, Inc. v. United States, 663 F.2d 82 (1981).

[287] Trilon Educational Corp. v. United States, 578 F.2d 1356, 1360 (1978).

[288] Id.

[289] Augusta Aviation, Inc. v. United States, 671 F.2d 445 (1982).

[290] Schweiker v. Hansen, 450 U.S. 785 (1981).

[291] Dresser Industries, Inc. v. United States, 596 F.2d 1231, 1237 (1979).

[292] Sims v. Fox, 505 F.2d 857, 862 (1974).

[293] United States v. Mississippi Valley Generating Co., 364 U.S. 520 (1961).

[294] Augusta Aviation, Inc. v. United States 671 F.2d

445, 450 (1982).

[295] E.g., Comp. Gen. Dec. B-167790, April 12, 1973, Unpub.; Federal Aviation Administration, Comp. Gen. Dec. B-195173, 79-2 CPD ¶ 34 (1979); B.& A. Electric Co., Comp. Gen. Dec. B-197437, 81-1 CPD ¶ 147 (1981); Ft. Devens, Mass. in re Boston Water and Sewer Commission, Comp. Gen. Dec. B-200824, 81-1 CPD ¶ 244 (1981); Wheeler Industries, Comp. Gen. Dec. B-199792, 81-1 CPD ¶ 306 (1981); Y. W.& T. Metal Corp., Comp. Gen. Dec. B-193727, 82-1 CPD ¶ 281 (1982).

[296] Most decisions don't detail what a contractor is entitled to for quantum meruit relief other than the stock phrase "fair and reasonable" compensation. What is "fair and reasonable" is often left to the discretion of the contracting officer. Selective Service System - Yankelovich, Skelly & White, Inc., Comp Gen. Dec. B-205415, 82-1 CPD ¶ 259 (1982). However, in at least one unpublished decision, the GAO specifically listed profit and overhead as elements of recovery constituting "fair and reasonable value of services and supplies accepted by the Government." Comp. Gen. Dec. B-167790, April 12, 1973, Unpub.

[297] Gilbert Construction Co., Comp. Gen. Dec. B-200372, 80-2 CPD ¶ 370 (1980); Wheeler Industries, Inc., Comp. Gen. Dec. B-199792, 81-1 CPD ¶ 306 (1981); ACTION -- Compensation for Unauthorized Services Provided Government, Comp. Gen. Dec. B-202744, 81-1 CPD ¶ 339 (1981); Selective Service System - Yankelovich, Skelly & White, Inc., Comp. Gen. Dec. B-205415, 82-1 CPD ¶ 259 (1982).

[298] Comp. Gen. Dec. B-202744, 81-1 CPD ¶ 339 (1981).

[299] Id. at 2.

[300] Comp. Gen. Dec. B-196556, 80-2 CPD ¶ 87 (1980).

[301] In Department of State as discussed supra in Chapter III, two AID contracts violated the prohibition against cost-plus-a-percentage-of-cost system of contracting of 41 U.S.C. § 254 (b)(1976).

[302] Comp. Gen. Dec. B-205415, 82-1 CPD ¶ 259 (1982).

[303] Checker Van Lines, Comp. Gen. Dec. B-206542, 82-2 CPD ¶ 219 (1982).

[304] Id.

[305] Comp. Gen. Dec. B-211213, 83-1 CPD ¶ 429 (1983).

[306] Id. at 3.

[307] 6A Corbin on Contracts § 1528 (1962).

[308] Glazer v. Glaser, 378 F.2d 390, 411 (1967).

[309] Kelly v. Kosuga, 79 S. Ct. 429, 358 U.S. 516, 519, (1959).

[310] 1 FPD ¶ 60, 699 F.2d 1147 (1983).

[311] Id. at 16 & 1163.

[312] Id.

[313] Id. at 17 & 1164.

[314] Id. at 18 & 1165.

[315] Id.

[316] Nash and Cibinic, Federal Procurement Law, Volume II 2242 (1980).

[317] 72 Stat. 972 codified as amended at 50 U.S.C. §§ 1431-1435 (1973).

[318] This was in response to rulings by the Comptroller General that predetermined overhead rates were a violation of the CPPC proscription, 35 Comp. Gen. 434.(1956); 35 Comp. Gen. 63 (1955).

[319] Westinghouse Electric Corp., AFCAB 109, 1 ECR ¶ 52 (1960), ACAB 1010, 1 ECR ¶ 55 (1961), NCAB 1 ECR ¶ 94 (1961); Texas Instruments, Inc., NCAB 15-59, 1 ECR ¶ 67 (1961); AFCAB 115, 1 ECR ¶ 69 (1961), ACAB 1013, 1 ECR ¶ 71 (1961); Western Electric Co., AFCAB 119, 1 ECR ¶ 73 (1961), ACAB 1015, 1 ECR ¶ 77 (1961), NCAB 3-60, 1 ECR ¶ 86 (1961); Hughes Aircraft Co., ACAB 1029, 1 ECR ¶ 92 (1961), NCAB, 1 ECR ¶ 147 (1962); Avco Corp., ACAB 1048, 1 ECR ¶ 131 (1962), AFCAB 160, 1 ECR ¶ 168 (1963); Raytheon Co., NCAB, 1 ECR ¶ 149 (1962). NCAB, 1 ECR 161 (1963); General Electric Co., NCAB, 1 ECR ¶ 179 (1964), ACAB 1014, 1 ECR ¶ 195 (1964); Northrop Corp., AFCAB 169, 1 ECR ¶ 189 (1964).

[320] 324 U.S. 49, 63 (1945).

[321] Reda, Anatomy of Cost-Plus-Percentage-of-Cost, 10 AF JAG L. Rev. (No.5) 39, Sept-Oct 68.

[322] Urban Data Systems, Inc. v. United States, 1 FPD ¶ 69, 699 F.2d 1147 (1983).

SOURCES CONSULTED

Table of Cases and Reports

Court Decisions

Acme Process Equipment Co. v. United States, 347 F.2d 509 (1965).

Alabama v. United States, 282 U.S. 502 (1931).

American Science and Engineering, Inc. v. United States, 663 F.2d 82 (1981).

Appeal of Giller & Associates, 535 F.2d 37 (1976).

Augusta Aviation, Inc. v. United States, 671 F.2d 445, 450 (1982).

Austin Company v. United States, 58 Ct. Cl. 98 (1923).

Bennet v. United States, 371 F.2d 859 (1967).

Blake Construction Co., Inc. v. United States, 296 F.2d 393 (1961).

Byrne Organization, Inc. v. United States, 152 Ct. Cl. 578, 287 F.2d 582 (1961).

Dalehite v. United States, 346 U.S. 15 (1953).

Dresser Industries, Inc. v. United States, 596 F.2d 1231, 1237 (1979).

Fred T. Ley & Co. v. United States, 60 Ct. Cl. 654 (1925).

General Builders Supply Co. v. United States, 409 F.2d 246 (1969).

Glazer v. Glazer, 378 F.2d 390 (1967).

Halvorson v. United States, 126 F. Supp. 898, 901 (E.D. Wash. 1954).

Hamilton v. Coogan, 7 misc. 677, 28 N.Y. Supp. 21 (1894).

Isaacs v. Reeve, 44 Atl.1 (1899).

Jankowitz v. United States, 533 F.2d 538 (Ct. Cl. 1976).

Kelly v. Kosuga, 79 S.Ct. 429, 358 U.S. 516 (1959).

Kennicott v. Wayne County 16 Wall (83 U.S.) 452, (1872).

J.C. Pittman & Sons v. United States, 317 F.2d 366, 368 (Ct. Cl. 1963).

Muschany v. United States, 324 U.S. 49, 65 S.Ct. 442 (1945).

National Electronic Labortories, Inc. v. United States, 180 F. Supp 337, 148 Ct. Cl. 308 (1960).

Newport News Shipbuilding and Dry Dock Co. v. United States, 179 Ct. Cl. 97, 374 F.2d 516 (1967).

New York Mail and Newspaper Transportation Co. v. United States, 139 Ct. Cl. 751 (1957).

Payne v. United States, 50 App. D.C. 219, 269 Fed. 871 (1921).

Prestex, Inc. v. United States, 162 Ct. Cl. 620, 320 F. 2d 367 (1963).

Savannah A.& N.R. Co. v. Oliver, 174 Fed 140 (1909).

Shaw v. Beaumount Company 88 N.J. Eq. 333, 102 Atl. 151 (1917).

Sims v. Fox, 505 F.2d 857, 862 (1974).

Sun Shipbuilding & Dry Dock Co. v. United States, 183 Ct. Cl. 358, 393 F.2d 807 (1968).

Trilon Educational Corp. v. United States, 578 F.2d 1356, 1360 (1978).

United States v. Callahan Walker Construction Co., 317 U.S. 56, 61 (1941).

United States v. Mississippi Valley Generating Co., 364 U.S. 520, (1961).

United States v. Nickel, 243 F.2d 924 10th Cir. (1957).

United States v. 94.68 Acres of Land etc., 45 F. Supp. 1016 (D.C. Mo., 1942).

United States v. Shaw, 309 U.S. 495 (1940).

Urban Data Systems, Inc., v. United States, 1 FPD ¶ 69, 699 F.2d 1147 (1983).

Yosemite Park & Curry Co. v. United States, Ct. Cl. 582 F.2d 552 (1978).

Administrative Boards of Contract Appeal Decisions

Aerojet, General Corp., ASBCA 17171; 74-2 BCA ¶ 10,863 (1974).

Allison Div. General Motors Corp., ASBCA 15528, 72-1 BCA ¶ 9343 (1972).

American Pipe & Steel Corp., ASBCA 4611 60-2 BCA ¶ 2769 (1960).

Ball State University, ASBCA 16344, 1971 BCA ¶ 9246 (1971).

Celesco Industries, Inc., ASBCA 22251, 79-1 BCA ¶ 13,604 (1978).

Drano Corp., ENGBCA 3915, 79-1 BCA ¶ 13,603 (1978).

Ed Goety Painting Co., DOT CAB 1168, 83-1 BCA ¶ 16,134 (1983).

E.V. Lane Corp., ASBCA 9741, 65-2 BCA ¶ 5076 (1965).

Fidelity Construction Company, Inc., DOT CAB 82-1 BCA ¶ 15633 at 77,226 (1982).

George Washington University, ASBCA 4725, 59-2 BCA ¶ 2376 (1959).

Giller & Associates, ASBCA 14696, 73-1 BCA ¶ 100016 (1973).

International Space Corp., ASBCA 13883, 70-2 BCA ¶ 8519 (1970).

Jack Picoult, VACAB 1221, 78-1 BCA ¶ 12024 (1978).

Keco Industries, Inc., ASBCA 18730, 74-2 BCA ¶ 10,711 (1974).

Kemmons-Wilson, Inc., ASBCA 16167, 72-2 BCA ¶ 9689 (1972).

Martin-Marietta Corp., ASBCA 10062, 65-2 BCA ¶ 4973 (1965).

Modern Foods, Inc., ASBCA 2090, 57-1 BCA ¶ 1239 (1957).

New York Shipbuilding, ASBCA 16164, 76-2 BCA ¶ 11979 (1976).

Program Resources, Inc., ASBCA 21656, 78-1 BCA ¶ 12,807 (1978).

R. C. Hedreen Co., ASBCA 20004, 76-2 BCA ¶ 12,202 (1976).

Systems Engineering Associated Corp., ASBCA 21,846, 77-2 BCA ¶ 12,740.

Urban Data Systems, GSBCA 5545, 1981 BCA ¶ 15,254 (1981).

Administrative Decisions and Opinions

20 Comp. Gen. 632 (1941).

21 Comp. Gen. 784 (1942).

21 Comp. Gen. 800 (1942).

21 Comp. Gen. 858 (1942).

22 Comp. Gen. 784 (1943).

23 Comp. Gen. 410 (1943).

33 Comp. Gen. 533 (1954).

35 Comp. Gen. 63 (1955).

35 Comp. Gen. 291 (1954).

35 Comp. Gen. 434 (1956).

35 Comp. Gen. 590 (1956).

38 Comp. Gen. 38 (1958).

39 Comp. Gen. 535 (1960).

40 Comp. Gen. 407 (1961).

43 Comp. Gen. 166 (1963).

46 Comp. Gen. 183 (1966).

46 Comp. Gen. 612 (1967).

Comp. Gen. Dec. B-105344, September 12, 1951, Unpub.

Comp. Gen. Dec. B-137471, August 26, 1959, Unpub.

Comp. Gen. Dec. B-155750, February 9, 1965, Unpub.

Comp. Gen. Dec. B-176445, February 22, 1973, Unpub.

Comp. Gen. Dec. B-167790, April 12, 1973, Unpub.

Comp. Gen. Dec. B-169217, January 12, 1978, Unpub.

Marketing Consultants International Limited, Comp. Gen. Dec. B-183705, 75-2 CPD ¶ 384 (1975).

Grey Advertising, Inc., Comp. Gen. Dec. B-184825, 76-1 CPD ¶ 325 (1976).

Federal Aviation Administration--Request for Advance Decision, Comp. Gen. Dec. B-195173, 79-2 CPD ¶ 34 (1979).

Department of State--Method of Payment Provisions, Comp. Gen. Dec. B-196556, 80-2 CPD ¶ 87 (1980).

Gilbert Construction Company, Comp. Gen. Dec. B-200372, 80-2 CPD ¶ 370 (1980),

B.& A. Electric Co., Comp. Gen. Dec. B-197437, 81-1 CPD ¶ 147 (1981).

Fort Devens, Mass, in re Boston Water and Sewer Commission, Comp. Gen. Dec. B-200824, 81-1 CPD ¶ 244 (1981).

Wheeler Industries, Inc., Comp. Gen. Dec. B-199792, 81-1 CPD ¶ 306 (1981).

ACTION--Compensation for unauthorized Services Provided Government, Comp. Gen. Dec. B-202744, 81-1 CPD ¶ 339 (1981).

G.E. Webb, Comp. Gen. Dec. B-204436, 81-2 CPD ¶ 234 (1981)

Klein-Sieb Advertising and Public Relations, Comp. Gen. Dec. B-200399, 81-2 CPD ¶ 251 (1981).

Selective Service System-- Yankelovich, Skelly & White, Inc., Comp. Gen. Dec. B-205415, 82-1 CPD ¶ 259 (1982).

Martin Manufacturing Co., Inc., Comp. Gen. Dec. B-207068.2, 82-2 CPD ¶ 281 (1982).

Checker Van Lines, Comp. Gen. Dec. B-206542, 82-2 CPD ¶ 219 (1982).

The Department of Labor--Request for Advance Decision, Comp. Gen. Dec. B-211213, 83-1 CPD ¶ 429 (1983).

Books, Manuals, and Pamphlets

13 Am. Jur. 2d Building and Construction Contracts § 20, 1968).

Bid Protests at GAO, a Descriptive Guide, United States General Accounting Office, Washington, D.C. undated.

Cibinic & Nash, Administration of Government Contracts, Government Contracts Program, George Washington University, (1981).

6A Corbin on Contracts § 1528 (1962).

Corwell, Government War Contracts (1920).

Cuneo, Government Contracts Handbook, Machinery and Allied Products Institute and Council for Technological Advancement (1962).

Graske, The Law of Government Defense Contracts, (1941).

Government Contract Principles, Third Edition, Compiled in the office of the General Counsel, United States General Accounting Office (November, 1980).

Miller, Pricing of Military Procurements, (1949).

Nash, Cibinic, Federal Procurement Law, Volume II., (1980).

Restatement of Contracts (1932).

Uniform Contracts and Cost Accounting Definitions and Methods, Government Printing Office, 1917.

Articles, Papers, Letters and Memos

Air Force Audit Agency letter, July 5, 1983.

Andross, D.P. Memorandum Feb 23, 1978.

Annual Report, Paymaster General of the Navy, 1918.

Baruch, Bernard, testimony before the War Policies Commission, Jpise Doc. No. 163, 172nd Cong., 1st Sess. (1931).

Case Note, Government Contracts--Illegal Contracts--Jurisdiction of Court of Claims to Grant a Quantum Meruit Recovery--Yosemite Park & Curry Co. v. United States, 582 F.2d 552 (Ct. Cl. 1978). 1979 Brigham Young University Law Review 419 (1979).

Ciucci, J.A. Memorandum, October 19, 1983.

Comment, Restitutionary Relief Under Illegal Contracts in California, 19 Hastings L.J. 1143 (1968).

Dickson, Restitutionary Concepts and Terminology in Government Contracts Decisions of the Comptroller General, 6 Public Contract Law Journal, May 1973.

Editorial Note, George Washington Law Review, 994 (1962).

Editorial, Engineering News-Record, Vol. 78, No. 10, June 7, 1917.

Fedak, L., Memorandum, March 30, 1982.

Fedak, L., Memorandum, July 19, 1983.

Hensel and McClung, Profit Limitation Controls Prior to the Present War, X Law and Contemporary Problems (1943).

Ingrao, Types of Government Contracts, Air Force Law Review, Spring (1976).

Mack, Cost-Plus-Percentage-of-Cost-Contracting, 2 National Contract Management Journal 125 (1968).

Mewett, The Quasi-Contractual Liability of Governments, 13 Toronto 56 (1959).

Note, Government Contracts: Quasi-Contractual Recovery Against the Government, 42 Cornell L.Q. 278 (1957).

Rak, D., Memorandum, March 23, 1984.

Reda, Anatomy of Cost-Plus-Percentage-of-Cost, 10 A.F. JAG Rev., September - October (1968).

Sands, R., letter, February 29, 1982.

Secretary of the Air Force, General Counsel, Informal Memorandum, August 28, 1968.

Talking Paper on GAO Report RE Cost-Plus-a-Percentage-of-Cost Contracting. Undated.

Williams, J.E., letter, December 29, 1978.

Public Laws, Statutes, and Congressional Resolutions

10 U.S.C. § 2306(a).

10 U.S.C. § 284(a).

41 U.S.C. § 254 (b).

50 App. U.S.C. § 1152.

28 U.S.C. § 1346(a).

28 U.S.C. § 1491.

31 U.S.C. § 71, 74.

31 U.S.C. § 74.

50 U.S.C. § 1431-1435.

10 U.S.C. § 2306(f).

10 U.S.C. § 2382.

Public Law No. 164, 65th Congress (H.R. 12,280) amending sec. 7 of Housing Act of May 16, 1918.

Public Law No. 671, 76th Cong. 3d Sess., June 28, 1940 (54 Stat. 676); Military Establishment Appropriation Act of 1941, June 3, 1940 (54 Stat. 352); National Defense Supplemental Appropriations Act, June 26, 1940, Title II (54 Stat. 603); Public Law No. 730, 76th Cong., 3d Sess., July 2, 1940 (54 Stat. 712).

Public Law No. 354, 77th Cong. 1st Sess.

Public Law No. 413, 80th Cong. 2d Sess., Sec. 2c.

Senate Res. No. 206, 73d. Cong., 2nd Sess. (April 12, 1934).

Federal Administrative Regulations

Defense Acquisition Regulations

Federal Procurement Regulations

Federal Acquisition Regulations

DOD FAR Supplements