

Regulatory/Contractual Update

January 23, 2006

Volume 11, Issue 1

Highlights:

- GAO Report on Award Fees
- Final/Proposed DFARS Rules
- GIDEP Alerts
- "PGI"
- FAC 2005-07
- "Another" unauthorized contract clause
- WAWF
- Price/Cost Guidance
- Berry Amendment
- Guide on Flowdowns

Contract Negotiation Comments. . .

Speaking Engagements

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Recent Regulatory/Contractual matters that may be of interest since the last Update include---

- On December 19, 2005, GAO Report 06-66, entitled, "DoD Has Paid billions in Award and Incentive Fees Regardless of Acquisition Outcome," was issued. The "official abstract" provides as follows:

Collectively, the Department of Defense (DOD) gives its contractors the opportunity to earn billions of dollars through monetary incentives--known as award fees and incentive fees. These fees are intended to motivate excellent contractor performance in areas deemed critical to an acquisition program's success, with award fees being appropriate when contracting and program officials cannot devise objective incentive fee targets related to cost, technical performance, or schedule. GAO was asked to determine whether award and incentive fees have been used effectively as a tool for achieving DOD's desired acquisition outcomes. To do this, GAO selected a probability sample of 93 contracts from the study population of 597 DOD award- and incentive-fee contracts that were active and had at least one contract action valued at \$10 million or more from fiscal year 1999 through 2003.

The power of monetary incentives to motivate excellent contractor performance and improve acquisition outcomes is diluted by the way DOD structures and implements incentives. While there were two examples in our sample in which the Missile Defense Agency attempted to link award fees directly to desired acquisition outcomes, such as demonstrating a capability within an established schedule, award fees are generally not linked to acquisition outcomes. As a result, DOD has paid out an estimated \$8 billion in award fees to date on the contracts in our study population, regardless of outcomes. The following selected programs show this disconnect. When DOD programs did not pay all of the available award fee, DOD gave contractors on an estimated 52 percent of award-fee contracts at least a second opportunity to earn an estimated \$669 million in initially unearned or deferred fees. GAO believes these practices, along with paying significant amounts of fee for "acceptable, average, expected, good, or satisfactory" performance, undermine the effectiveness of fees as a motivational tool and marginalize their use in holding contractors accountable for acquisition outcomes. They also serve to waste taxpayer funds. Incentive fees provide a clearer link to acquisition outcomes; however, a majority of the 27 contracts with cost incentives that GAO reviewed failed or are projected to fail to complete the acquisition at or below the target price. Despite paying billions in fees, DOD has little evidence to support its belief that these fees improve contractor performance and acquisition outcomes....

The report is located at <http://www.gao.gov/new.items/d0666.pdf>

COMMENT: Think the criteria for award fees may be revisited as well as the practice/policy on retention of funds (which were not awarded earlier) for possible future award fees?

Items summarized in these Updates are for general informational/discussion/educational purposes only and should not be relied upon in the course of representation or in the forming of decisions in legal matters— independent counsel should be obtained.

- On January 23, 2006, DoD noticed in the Federal Register DFARS final rules as part of the DoD Transformation Initiative. The proposed changes are effective January 23, 2006, and include:
 - Updating the text on Contracting by Negotiation.
 - DoD Pilot Mentor-Prot[acute]g[acute] Program for 5 additional years.
 - Update text addressing the use of simplified acquisition procedures.
 - Update text pertaining to the acquisition of mortuary and laundry and dry cleaning services
 - Update text pertaining to utility rates established by independent and nonindependent regulatory bodies.
 - Update text pertaining to the acquisition of utility services.
- On January 23, 2006, DoD noticed in the Federal Register proposed DFARS final rules with comments due March 24, 2006. Proposed items include
 - Update requirements for DoD contractors to establish and maintain earned value management systems (EVMS). The rule revises the dollar thresholds at which EVMS requirements are applied and eliminates requirements for contractors to submit cost/schedule status reports under DoD contracts.
 - Delete text addressing internal DoD procedures pertaining to foreign acquisitions. This text will be relocated to the new DFARS companion resource, Procedures, Guidance, and Information (PGI).
 - To adjust acquisition-related thresholds for inflation. Section 807 of the National Defense Authorization Act for Fiscal Year 2005 requires periodic adjustment of statutory acquisition-related dollar thresholds for inflation, except those established by the Davis-Bacon Act, the Service Contract Act, or trade agreements. This proposed rule also amends other acquisition-related thresholds that are based on policy rather than statute.
- It's reported that there is an increasing submittal of GIDEP alerts. Are there increasing quality issues or merely greater self-disclosure?
- As a reminder, the authority for issuance of DFARS Procedures, Guidance, and Information (PGI) is found in 201.301(a)(2) which provides that "Relevant procedures, guidance, and information that do not meet the criteria in paragraph 201.301(a)(1) ... are issued in the DFARS PGI." The PGI website is <http://www.acq.osd.mil/dpap/dars/pgi/index.htm>.

DFARS 201.301(a)(1) provides as follows:

(a)(1) DoD implementation and supplementation of the FAR is issued in the Defense Federal Acquisition Regulation Supplement (DFARS) under authorization and subject to the authority, direction, and control of the Secretary of Defense. The DFARS contains—

 - (i) Requirements of law;
 - (ii) DoD-wide policies;
 - (iii) Delegations of FAR authorities;
 - (iv) Deviations from FAR requirements; and
 - (v) Policies/procedures that have a significant effect beyond the internal operating procedures of DoD or a significant cost or administrative impact on contractors or offerors.

- On January 3, 2006, Federal Acquisition Circular (FAC) 2005-07 was issued and amends the FAR in several respects including the following:
 - Transportation: Standard Industry Practices (FAR Case 2002-005). This final rule amends FAR Parts 1, 42, 46, 47, 52, and 53 to clarify and update the FAR coverage to reflect the latest changes to the Federal Management Regulation and statutes that require use of commercial bills of lading for domestic shipments. Effective February 2, 2006.
 - Common Identification Standard for Contractors (FAR Case 2005-015). This interim rule amends the FAR by addressing the contractor personal identification requirements in Homeland Security Presidential Directive (HSPD-12), “Policy for a Common Identification Standard for Federal Employees and Contractors,” and Federal Information Processing Standards Publication (FIPS PUB) Number 201, “Personal Identity Verification (PIV) of Federal Employees and Contractors.” Effective January 3, 2006.
 - Change to Performance-based Acquisition (FAR Case 2003-018). This final rule amends the FAR by changing the terms “performance-based contracting (PBC)” and “performance-based service contracting (PBSC)” to “performance-based acquisition (PBA)” throughout the FAR; adding applicable PBA definitions of “Performance Work Statement (PWS)” and “Statement of Objectives (SOO)”, and describing their uses; clarifying the order of precedence for requirements; eliminating redundancy where found; modifying the regulation to broaden the scope of PBA and give agencies more flexibility in applying PBA methods to contracts and orders of varying complexity; and reducing the burden of force-fitting contracts and orders into PBA, when it is not appropriate. Effective February 2, 2006.
 - Deletion of the Very Small Business Pilot Program (FAR Case 2005-013). This final rule amends the FAR to delete the Very Small Business Pilot Program. Under the pilot program, contracting officers were required to set-aside for very small business concerns certain acquisitions with an anticipated dollar value between \$2,500 and \$50,000. The Councils are removing the FAR coverage because the legislative authority for the program terminated on September 30, 2003. Acquisitions previously set aside for pilot program vendors will now be open to other small businesses. Effective January 3, 2006.
 - Purchases From Federal Prison Industries-Requirement for Market Research (FAR Case 2003-023). Effective January 3, 2006.
 - Exception from Buy American Act for Commercial Information Technology (FAR Case 2005-022). This interim rule amends FAR 25.103 and FAR Subpart 25.11 to implement Section 517 of Division H, Title V of the Consolidated Appropriations Act, 2005 (Pub. L. 108-447). Section 517 authorizes exemption from the Buy American Act for acquisitions of information technology that are commercial items. This applies only to the use of FY 2005 funds. Effective January 3, 2006.
 - Elimination of Certain Subcontract Notification Requirements (FAR Case 2003-024). This final rule impacts contractors with DoD, NASA, or Coast Guard cost-reimbursement contracts and Government personnel who award and administer those contracts. The interim rule amended FAR 44.201-2, Advance Notification Requirements, and 52.244-2, Subcontracts, to remove the requirement under cost-reimbursement contracts with DoD, Coast Guard, and NASA for contractors to notify the agency before the award of any cost-plus-fixed-fee subcontract or any fixed-price subcontract that exceeds the greater of the simplified acquisition threshold or 5 percent of the total estimated cost of the contract if the contractor maintains a purchasing system approved by the contracting officer for the contract. Effective January 3, 2006.

➤ Annual Representations and Certifications--NAICS Code/Size (FAR Case 2005-006). This final rule amends the FAR provision at 52.204-8 to provide a place for contracting officers to inform prospective offerors of the NAICS code and small business size standard applicable to the procurement. Effective January 3, 2006.

- On January 12, 2006, the ABA Public Contract Law Section (PCLS) sent a letter to the DoD National Reconnaissance Office (NRO) over the “NRO Acquisition Manual Clause 52.244-002 (Draft) Subcontract Reporting, Monitoring, and Consent.” According to the PCLS this clause imposes new deliverables of quarterly reporting on subcontractor (defined as encompassing interorganizational transfers) information and a “comprehensive monitoring aspect,” i.e. “NRO is to take an active role in monitoring subcontractor source selection and performance.” Several “objections” are noted in the letter including inconsistency with the FAR Part 42 and 44, requiring 13 types of data that has not be approved by OFPP, on-going monitoring of subcontract performance, NRO approval of subcontracts over \$50M or 10% of the contract’s value, and flowdown to subcontractors at all levels.
- The Navy has posted some excellent powerpoint slides on the Wide Area Work Flow (WAWF) initiative at <https://e-commerce.spawar.navy.mil/command/02/acq/navgenint.nsf/policydocs/2278B7F190D783B2882570ED005291F1?opendocument>
- And, the Navy as posted some “policy/guidance” memos with additional questions on price/cost data, etc. in view of recent DoDIG audit reports. Memos are posted at [https://e-commerce.spawar.navy.mil/command/02/acq/navgenint.nsf/policydocs/466302337F48E205882570FF005D88DE/\\$file/Final+Guidance+Info.doc](https://e-commerce.spawar.navy.mil/command/02/acq/navgenint.nsf/policydocs/466302337F48E205882570FF005D88DE/$file/Final+Guidance+Info.doc)
- The Congressional Research Service has published a 20 page report to Congress on “The Berry Amendment: Requiring Defense Procurement to Come from Domestic Sources” covering history, application, and options.
- OMB announced that the next public meeting of the Services Acquisition Advisory Panel is January 31, 2006.
- NDIA announced the publication of a revised "Study of the Applicability of Federal Acquisition Regulation (FAR) Clauses to Subcontracts under Prime Defense and NASA Contracts." This version, dated November 2005, includes FAR clauses (March 2005 edition) as amended through Federal Acquisition Circular (FAC) 2005-04, Department of Defense FAR Supplement (DFARS) clauses (1998 edition) as amended through Change Notice 20051011 (10/11/2005), and NASA FAR Supplement clauses (Version 04.0 dated 11/01/2004), as amended through Procurement Notice 04-08. Contact Meredith Kytte at mkyttle@ndia.org for purchase info.

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Comments on items that may be of potential interest in contract negotiation and drafting/management—

- Two very interesting articles in recent issues of the ABA “Business Law Today” magazine published by the ABA Business Law Section are must reading on use of the “representations and warranties” in contracts. Are you using them—correctly? And, do you know what each “really” means? These articles provide some useful insight into the meaning of each. Specifically the Nov/Dec 2005 issue kicked off the topic and the recent Jan/Feb 2006 issue offered “another view” on it. As noted in the articles “reps and warranties” appear in numerous agreements including sales contracts, acquisitions, joint ventures, loan, employment agreements, etc.

The latter article was “more persuasive” to this writer. Briefly, some highlights from this latter article follow.

It starts with some background on “reps” as relating to present or past facts—not the future. The future is an opinion. If the “reps” are false the remedies may include an action in tort for fraudulent misrepresentation with “knowledge or conscious ignorance of the statement’s falsity” and whether the plaintiff knew the statement was false (and therefore could not have justifiably relied on it) being important factors in the author’s opinion on the issue of liability of the alleged wrongdoer. The choice of remedies is also interesting in looking at the differences, under “reps,” the plaintiff could perhaps rescind or affirm the contract and sue for damages. However, the option of rescission is not available if one is suing for a breach of a warranty. And, if it is a “rep” the possibility of punitive damages surfaces.

Looking at warranties, the author cites the case of CBS Inc. v. Ziff-Davis Publishing Co., 75 NY2d 496 (1990) wherein Ziff “represented and warranted” the financial condition of a division being spun off to CBS. CBS prior to the close and as part of its due diligence determined that that condition was not as represented and warranted. The deal closed and thereafter CBS sued for breach of warranty. Ziff argued before New York’s highest court that CBS could not sue for same since it knew about the problems and could not “have justifiably relied on the warranties.” According to the court as provided in this article, a “warranty is a promise.” Knowledge of the falsity will not defeat a warranty claim where it would for a “rep” claim!

Further, the remedies for breach of warranty are different, e.g. where the measure of the damages may be for the benefit of the bargain, etc. The author goes on to state that several States subsequently followed the rule in CBS v. Ziff-Davis.

Talk to counsel.

- Under the heading “read those indemnification clauses/articles,” is the recent 8th Circuit Court of Appeals decision in Angelo Cremona, S.p.A v. R.S. Bacon Veneer Co. (01/06/06 - No. 05-2369) wherein “summary judgment for plaintiff-seller in a contract dispute is affirmed where the parties’ (international) sales contract unambiguously expressed their intent that the buyer of a machine was obligated to indemnify the seller for damages from either party’s negligent acts, thus obligating defendant to indemnify plaintiff for any damages awarded in a products liability suit against the seller.” The clause/article in question read as follows:

The Seller shall deliver to the Buyer the goods in compliance with the laws in force in Italy. The Buyer shall check that the goods comply with the laws of the country of destination and shall properly inform the Seller, in any case prior to shipment of the goods, of any changes to be made; in

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which case the Seller shall be free to refuse the order or to charge a higher price. *It is agreed that whatever liability may derive from the goods, due to events occurring after the passage of risks to the buyer, including any damage to person or to property (even when such property includes parts or accessories of the machine), shall be borne solely by the Buyer, who shall indemnify the Seller and further undertakes to take out adequate insurance against all relative risks without being entitled to make recourse to the Seller.* The Buyer henceforth agrees to be cited in any instance of legal proceedings taken against the Seller in pursuance of the liability for herein. (emphasis added).

The case has an interesting discussion of “contracts (that) purport to relieve the indemnitee from liability for its own negligence.” And, the Buyer also attempted to argue that “the ‘event’ giving rise to its liability was not the... accident (subsequent to the sale that gave rise to the claim herein), but the Seller’s defective design of the machine before the passage of risks when Buyer took possession.” And, therefore the “event” was not covered by the indemnification provision. This latter argument was rejected by the courts. Case is located at <http://caselaw.lp.findlaw.com/data2/circs/8th/052369p.pdf>

Talk to counsel.

- From the U.S. Court of Appeals for the Federal Circuit *Jacobs Engineering Group, Inc. v. US* (01/19/06 - No. 05-5052). “A development and construction contract required the government to reimburse the contractor for 80 percent of its cost of performing the contract (or an 80/20 share contract). The contract’s termination-for-the-convenience-of-the-government clause required the government upon such termination to pay the contractor ‘[a]ll costs reimbursable’ under the contract.... The question is whether, when the government so terminated the contract, it was required to reimburse the contractor for all of the costs the contractor incurred up to that point or only for 80 percent of them. Reversing the United States Court of Federal Claims, (the court held) that the contractor may recover all of its cost, rather than 80 percent.”

All costs are reimbursable under the T for C clause of FAR 52.249-6. The court had to interpret the meaning of “all” and concluded, in part, that “to the extent there is an ambiguity on the point, it must be resolved in favor of Jacobs, the non-drafter of the contract.” Irreconcilable differences! Good case to read on drafting of contract terms and conditions, reconciling different clauses of a contract, etc. Case is located at <http://caselaw.lp.findlaw.com/data2/circs/fed/055052p.pdf>.

Talk to counsel.

- The Air Force was entitled to require a contractor to recertify its size as of the offer date specified in a request for proposals for a small business set-aside task order, even though the contractor had qualified as a small business at the time it was selected for the underlying indefinite delivery/indefinite quantity contract, the U.S. Court of Federal Claims ruled (*LB&B Associates Inc. v. United States*, Fed. Cl., No. 05-1066L, 12/8/05). With this ruling one may have to reconsider when the final terms are conditions are established under the contract—at time of award of the ID/IQ contract or release of task orders thereunder. If the terms change in other areas—is the price next? Will primes have to revisit the status of long-term small businesses under some of their agreements—to the detriment of small businesses? Review your ADR clause!

Talk to counsel.

Future Speaking Topics Include—

- Southern Nevada NCMA Chapter and Las Vegas ISM Affiliate, "Big Changes to UCC Rules on Contract Formation and Terms of the Deal are Around the Corner—Are You Ready?"
- ISM Arizona Affiliate, "Big Changes to UCC Rules on Contract Formation and Terms of the Deal are Around the Corner—Are You Ready?"
- US Naval Postgraduate School, Monterey, School of International Graduate Studies, "Request for Tender Offers."
- NCMA Atlanta, Georgia, National Educational Seminar, "Contract Negotiations."
- Tampa Bay Suncoast NCMA Chapter, "Baseball Arbitration."
- NCMA World Congress, Atlanta, Georgia, "Drafting the Ultimate ADR Clause for Government Subcontracts."
- Central Connecticut NCMA Chapter, National Educational Seminar, "Best Contracting Practices for Businesses."
- California State Bar Annual Meeting, "Thinking Again For The First Time About Advocacy In Arbitrations."

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