

## 2006 GOVERNMENT CONTRACT DECISIONS OF THE FEDERAL CIRCUIT

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## INTRODUCTION

In 2006, the Federal Circuit issued over two hundred and fifty precedential opinions and orders. This article discusses sixteen precedent-setting opinions involving government contract law issues, setting forth the relevant facts, the Federal Circuit's analysis, and key points for practitioners to glean from each case.<sup>1</sup> This article also includes a discussion of the Federal Circuit's September 2006 opinion regarding the TRICARE Pharmacy Benefits Program ("TPBP") refund program, a case that the pharmaceutical industry watched closely. The decisions have been grouped into the following categories: jurisdiction, contract interpretation, costs, contract termination, bid protests, and patent rights.

## I. JURISDICTION

The jurisdiction cases involve the Federal Circuit's ability to hear and decide disputes involving government contract issues. *Board of Trustees of Bay Medical Center v. Humana Military Healthcare Services*<sup>2</sup> illustrates the difficulty of demonstrating that the United States is the proper defendant to a subcontractor's claims against a prime contractor. *Wesleyan Co. v. Harvey*<sup>3</sup> reiterates one key consideration that contractors should make when deciding between filing at Boards of Contract Appeals or the Court of Federal Claims ("COFC"). Finally, *PSEG Nuclear v. United States*<sup>4</sup> addresses whether a broad statutory conferral of jurisdiction to the U.S. Courts of Appeals over issues related to the Nuclear Waste Policy Act strips the COFC of Tucker Act subject matter jurisdiction.

## A. Board of Trustees of Bay Medical Center v. Humana

In *Humana II*, the Federal Circuit rejected a prime contractor's argument that the United States was the "real party in interest" to its subcontractor's claim and affirmed the district court's ruling that the COFC lacked jurisdiction over the subcontractor's claims.<sup>5</sup>

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1. This Article excludes the Federal Circuit's *Winstar*-related opinions, which are the subject of a separate article in this issue.

2. Bd. Of Trs. Of Bay Med. Ctr. V. Humana Military Healthcare Servs. (*Humana II*), 447 F.3d 1370 (Fed. Cir. 2006).

3. 454 F.3d 1375 (Fed. Cir. 2006).

4. 465 F.3d 1343 (Fed. Cir. 2006).

5. 447 F.3d at 1372.

In January 1996, Humana entered into a contract (the “prime contract”) with the Department of Defense (“DOD”) to provide managed care medical services to certain beneficiaries in a geographical region.<sup>6</sup> Humana then subcontracted with local hospitals to provide the health care services required under the prime contract. The prime contract was based on a fixed price and permitted Humana to negotiate rates of payment and payment methodologies with its subcontractor hospitals. Humana assumed the risk for the cost of healthcare (i.e., the government would not pay Humana for any amount above the maximum specified rate).<sup>7</sup> Humana paid the subcontractor hospitals’ rates agreed upon in the negotiated subcontracts.<sup>8</sup>

In October 1999, without notice, Humana reduced the amount of payments to its subcontractor hospitals for outpatient nonsurgical services by applying certain maximum rates.<sup>9</sup> The rates were based on a schedule of maximum rates issued by the DOD for outpatient nonsurgical services.<sup>10</sup> Although the DOD issued a policy statement in March 2000 that approved of the application of such maximum rates to subcontractor hospital providers,<sup>11</sup> Humana was still free to pay its subcontractors higher rates and absorb the difference.<sup>12</sup> Humana declined to pay its subcontractor hospitals the higher rate set forth in the subcontract. The subcontractor hospitals sued Humana in the Northern District of Florida and alleged breach of contract based on the reduced payments. Humana sought to transfer the case to the COFC under Tucker Act jurisdiction,<sup>13</sup> arguing that

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6. *Id.* This case concerned administrator-provider contracts for medical services under the DOD Civilian Health and Medical Program of the Uniformed Services (“CHAMPUS”), established in 1967. In 1995, the DOD established TRICARE, a managed health care program that involved the competitive selection of contractors to underwrite the delivery of health care services under CHAMPUS. *Bd. of Trs. of Bay Med. Ctr. v. Humana Military Healthcare Servs. (Humana I)*, 2004 WL 3314946, at \*1 (N.D. Fla. Mar. 16, 2004). The program was administered through the TRICARE Management Activity, which was previously the Office of CHAMPUS. *Id.* Under the TRICARE system, the DOD began using managed care support providers. Here, Humana was the managed care support provider.

7. *Id.* at \*2; *see, e.g.*, 32 C.F.R. § 199.14 (2006). Federal law prohibits the reimbursement of outpatient professional services billed by institutional providers in excess of the CHAMPUS/TRICARE Maximum Allowable Charge (“CMAC”). Thus, if Humana’s negotiated rates exceeded the government’s reimbursement limits, then Humana would have to pay for the overage out of its profit.

8. *Humana II*, 447 F.3d at 1372.

9. *Id.* This was the CMAC rate.

10. *Id.*

11. *Id.* at 1373.

12. *Humana I*, 2004 WL 3314946, at \*2.

13. The Tucker Act waived the federal government’s sovereign immunity but limited the jurisdiction of the COFC to hear claims “against the United States

the true nature of the subcontractor hospitals' claims were for money damages against the government, which stemmed from the DOD's approval of the application of maximum rates to the subcontractor hospitals.<sup>14</sup>

The Federal Circuit agreed with the subcontractor hospitals that Humana, not the government, was the proper defendant.<sup>15</sup> First, the subcontractor's complaint included both a breach of contract claim against Humana and a declaratory judgment claim against the government asserting that the DOD's March 2000 policy statement was invalid.<sup>16</sup> The complaint clearly alleged that, independent of the validity of the government's policy, the breach of contract claims against Humana remained intact: "[the DOD policy] did not change or otherwise affect the contracts entered into between Humana and [the subcontractor hospitals]."<sup>17</sup> Thus, the complaint unambiguously demonstrated that the subcontractor hospitals' contract claims were directed against Humana, not the government.<sup>18</sup>

Second, the subcontract was a private agreement between Humana and the subcontractor hospitals, the government was not a party to those subcontracts, and the subcontractor hospitals had no direct relationship with the government.<sup>19</sup> Moreover, Humana's reliance upon DOD policy as a defense to its liability did not transform the subcontractor hospitals' claims into claims against the government.

Third, although Humana argued that they would be allowed to seek reimbursement (i.e., indemnification) from the government if it were found liable, that alone would not make the government the "real party in interest."<sup>20</sup> In so reasoning, the Federal Circuit distinguished *Texas Peanut Farmers v. United States*<sup>21</sup> and *Consolidated Edison Co. of New York v. United States*.<sup>22</sup> In *Texas Peanut Farmers*, the contracts at issue had "plainly stat[ed]" that the defendant was the reinsurer and liable for money damages, but Humana's subcontracts

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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." 28 U.S.C. § 1491(a)(1) (2000); *United States v. Mitchell*, 463 U.S. 206, 212 (1983).

14. 447 F.3d at 1373.

15. *Id.*

16. *Id.* In its declaratory judgment claim against the government, the hospitals argued that the DOD policy conflicted with regulation, and that the policy set a substantive rule that should have been promulgated through notice-and-comment rulemaking.

17. *Id.* at 1375 (quoting the subcontractor hospital's complaint).

18. *Id.*

19. *Id.*

20. *Id.*

21. 409 F.3d 1370 (Fed. Cir. 2005).

22. 247 F.3d 1378 (Fed. Cir. 2001).

with the hospitals gave no indication that the government would act as a reinsurer or indemnifier, and thus the government was not a proper defendant.<sup>23</sup> In *Consolidated Edison*, the plaintiffs were in privity of contract with the government and directly sought monetary relief from the government, warranting transfer from district court to the COFC.<sup>24</sup> Therefore, neither case provided support for Humana.

To shift liability, a prime contractor will often attempt to recast its subcontractor's claims as claims against the government. The *Humana II* case illustrates the obstacles a prime contractor faces when arguing that the government is the "real party in interest" in a subcontractor claim. Prime contractors that can establish privity of contract between the subcontractor and the government are in a much better position to demonstrate that the government is the "real party in interest" in order to obtain a transfer to the COFC.

#### B. Wesleyan Co. v. Harvey

In *Wesleyan*,<sup>25</sup> the Federal Circuit addressed whether the Armed Services Board of Contract Appeals ("ASBCA") held subject matter jurisdiction over Wesleyan's \$21 million claim against the Army for allegedly disclosing proprietary data to nongovernmental third parties.

In 1983, Wesleyan submitted to the Army an unsolicited proposal for a mobile hydration system that allows a soldier to drink without removing his protective mask.<sup>26</sup> The proposal included Defense Acquisition Regulation ("DAR") 3-507.1(a), which prohibited the government from disclosing information in the proposal to third parties.<sup>27</sup> After determining that Wesleyan's system was feasible, the Army requested that Wesleyan lend a prototype to a manufacturer to incorporate into a soldier's protective suit. Wesleyan executed a bailment agreement with the manufacturer that was limited to this purpose.<sup>28</sup> Between 1984 and 1989, the Army continued testing the Wesleyan system and issued six purchase orders for the systems.<sup>29</sup> In 1992, the Army completed its testing of the system and terminated

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23. 447 F.3d at 1376.

24. *Id.*

25. *Wesleyan Co. v. Harvey*, 454 F.3d 1375 (Fed. Cir. 2006).

26. *Id.* at 1376.

27. *Id.* This proposal was the second proposal that Wesleyan submitted. The first proposal was substantially identical but rejected by the Army because it lacked provisions governing the government's use of unsolicited information.

28. *Id.*

29. *Id.* at 1377.

consideration of Wesleyan's proposal. By 1998, the Army had procured a different hydration system from a competitor of Wesleyan, which allegedly made use of Wesleyan's proprietary information.<sup>30</sup>

The sole issue on appeal was whether the ASBCA had subject matter jurisdiction under the Contract Disputes Act<sup>31</sup> ("CDA") to hear Wesleyan's claim for damages. Pursuant to the CDA, the ASBCA has subject matter jurisdiction over "any express or implied contract . . . entered into by an executive agency for—(1) the procurement of property, other than real property in being."<sup>32</sup> Procurement is "the acquisition by purchase, lease or barter, of property or services for the *direct benefit or use* of the Federal Government."<sup>33</sup> The main issue in *Wesleyan* was whether there was a procurement contract on which the claim could be founded.

The Federal Circuit found three types of agreements at issue: (1) Wesleyan's unsolicited proposals, (2) the bailment agreement, and (3) the Army's purchase orders.<sup>34</sup> Both the unsolicited proposals and the bailment agreement may have constituted a transfer of "property;" however, in the Federal Circuit's view, neither involved "acquisition" because Wesleyan did not receive anything in exchange.<sup>35</sup> As such, both the unsolicited proposal and the bailment agreement appeared "donative" in nature, were not procurement contracts, and could not be the bases for ASBCA subject matter jurisdiction under the CDA.<sup>36</sup>

In contrast, the Federal Circuit held the Army's purchase orders to be procurement contracts. The "procurement" element existed because there was an exchange of property for money.<sup>37</sup> The "contract" element existed because the purchase orders specified the parties involved, price, payment terms, transportation instructions, and delivery instructions.<sup>38</sup> Although Wesleyan had not signed the purchase orders, the delivery of the systems signaled acceptance, and resulted in a procurement contract.<sup>39</sup> Accordingly, the ASBCA would only possess subject matter jurisdiction over Wesleyan's claims that involved breach of the purchase orders. To succeed on its claim for

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30. *Id.* at 1378.

31. 41 U.S.C. §§ 601-613 (2000).

32. 41 U.S.C. § 602(a).

33. *New Era Constr. v. United States*, 890 F.2d 1152, 1157 (Fed. Cir. 1989).

34. *Wesleyan*, 454 F.3d at 1378.

35. *Id.*

36. *Id.*

37. *Id.* at 1378-79.

38. *Id.* at 1379.

39. *Id.*

disclosure of propriety information, “Wesleyan must prove that the Army obtained the confidential information that it later disclosed improperly not from the unsolicited proposals, nor from the bailment,” but exclusively from the purchase orders.<sup>40</sup>

Notably, the Federal Circuit took the extra step of commenting on Wesleyan’s litigation strategy. While Wesleyan chose to pursue its case at the ASBCA, nothing would have prevented suit in the COFC, where the court could have considered the nondisclosure provisions in both Wesleyan’s unsolicited proposals and the bailment agreement. Unlike the CDA, the Tucker Act<sup>41</sup> does not require that a contract with the United States relate to procurement; rather, any “express or implied contract with the United States” is sufficient for jurisdiction at the COFC.<sup>42</sup> Litigants would be wise to consider carefully whether all their legal theories may be based on procurement contracts before filing a complaint with the ASBCA or the Civilian Board of Contract Appeals.

### C. PSEG Nuclear v. United States

The Tucker Act generally vests in the COFC jurisdiction to render judgment in a government contracts dispute; however, that jurisdiction is supplanted when Congress vests exclusive jurisdiction over the dispute in another court through a specific jurisdictional statute.<sup>43</sup> In *PSEG*, the Federal Circuit examined one such jurisdictional statute but concluded that the COFC’s subject matter jurisdiction was still intact.<sup>44</sup>

The Nuclear Waste Policy Act of 1982 (“the NWPA”)<sup>45</sup> authorized the Department of Energy (“DOE”) to contract with companies that generate spent nuclear fuel (“SNF”).<sup>46</sup> Under the scheme set forth in the NWPA, entities with SNF (mainly utilities) would pay into a fund, and in return for the payment, the DOE would properly dispose of

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40. *Id.* at 1380. Judge Newman, dissenting in this case, rejected this reasoning and found no basis in the CDA for separating the various agreements involved. *Id.* at 1381 (Newman, J., dissenting). In his view, the CDA would not deny the ASBCA authority to consider the entirety of a claim, which here included nondisclosure provisions in both the unsolicited proposals and the bailment agreement. *Id.* (Newman, J., dissenting).

41. 28 U.S.C. §§ 1346(a)(2), 1491 (2000).

42. *See* 454 F.3d at 1380 (noting that Wesleyan severely limited the scope of relief available by failing to file suit under the Tucker Act).

43. 28 U.S.C. § 1491(a); *City of Burbank v. United States*, 273 F.3d 1370, 1377 (Fed. Cir. 2001).

44. *PSEG Nuclear v. United States*, 465 F.3d 1343, 1344 (Fed. Cir. 2006).

45. 42 U.S.C. §§ 10101-10270 (2000).

46. Spent Nuclear Fuel is a form of radioactive waste.

the SNF.<sup>47</sup> The DOE developed a contract (“Standard Contract”) through notice-and-comment rulemaking, and beginning in 1983, executed the Standard Contract with several utility companies. The Standard Contract stated that the DOE would begin collecting and disposing of the company’s SNF by January 31, 1998.<sup>48</sup> When it became clear that the DOE was not prepared to meet this date, PSEG and several companies filed breach of contract claims.<sup>49</sup>

The NWPA’s jurisdictional provision conferred exclusive and original jurisdiction in the U.S. Courts of Appeals over, *inter alia*, “any final decision or action of the Secretary, the President, or the Commission under this part; [or] alleging the failure of the Secretary, the President, or the Commission to make any decision, or take any action, required under this part . . . .”<sup>50</sup> The sole question on appeal was whether the COFC had subject matter jurisdiction over PSEG’s breach of contract claims, or whether the NWPA stripped the court of its Tucker Act jurisdiction in favor of the U.S. Courts of Appeals. The Federal Circuit held that the COFC retained jurisdiction.<sup>51</sup>

In the Federal Circuit’s view, the key question was not whether the breached contract provision (to begin collecting and disposing of the company’s SNF by January 31, 1998) was statutorily mandated by the NWPA, but whether PSEG’s claims involved the DOE’s authority under the NWPA.<sup>52</sup> The breached contract provision *was* statutorily mandated by the NWPA to appear in the Standard Contract with PSEG,<sup>53</sup> and therefore, the Courts of Appeals would have exclusive and original jurisdiction over “whether the DOE properly incorporated these obligations within its contracts . . . .”<sup>54</sup> However, the NWPA did not include any provision related to the DOE’s performance of these contractual obligations, or the damages, if any, for failure to meet these obligations.<sup>55</sup> PSEG’s claims related only to

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47. 42 U.S.C. § 10222 (2000).

48. *PSEG*, 465 F.3d at 1344.

49. *Id.* at 1345. Several other power companies initially filed their breach of contract claims against the DOE in the U.S. Court of Appeals. *See, e.g.*, *N. States Power Co. v. U.S. Dep’t of Energy*, No. 97-1064, 1998 WL 276581, at \*2 (D.C. Cir. May 5, 1998). When the D.C. Circuit rejected subject matter jurisdiction, the companies, including PSEG, filed their complaints in the COFC. *PSEG*, 465 F.3d at 1346. Judges at the COFC issued several conflicting opinions on the issue of jurisdiction. *Id.* at 1347-48. This case is on appeal from one such denial of jurisdiction.

50. 42 U.S.C. § 10139 (2000).

51. *PSEG*, 465 F.3d 1343.

52. *Id.* at 1350.

53. *Id.*

54. *Id.*

55. *Id.*

whether the DOE breached its contractual obligations, and whether PSEG was entitled to corresponding damages.<sup>56</sup> These were not within the DOE's statutory authority under the NWPA, and, therefore the NWPA's jurisdictional provision did not remove jurisdiction from the COFC.<sup>57</sup>

The Federal Circuit also addressed its holding in *City of Burbank v. United States*.<sup>58</sup> There, a jurisdictional statute conferred similar exclusive jurisdiction on the U.S. Courts of Appeals, and the Federal Circuit held that "where disputed contract provisions are statutorily mandated or are arrived at via an administrative hearing under the [Administrative Procedures Act] in which the pertinent facts are reflected in an administrative record, the [Court of Appeals] possesses exclusive jurisdiction" under the statute's jurisdiction provision.<sup>59</sup> In *PSEG*, the contract provisions at issue were statutorily mandated and the terms of the Standard Contract were developed through administrative rulemaking.<sup>60</sup> However, DOE was not statutorily required to use the administrative rulemaking process to develop the Standard Contract,<sup>61</sup> and DOE could not confer jurisdiction on the Court of Appeals by its choice of administrative rulemaking.<sup>62</sup> Moreover, in the Federal Circuit's view, the damages analysis in this case would require extensive factual inquiries outside the administrative record that the COFC was better equipped to adjudicate.<sup>63</sup> Thus, the COFC retained jurisdiction.

## II. CONTRACT INTERPRETATION

In 2006, the Federal Circuit cases reiterated long-standing principles of contract interpretation. *Applied Companies v. Harvey*<sup>64</sup> illustrates the importance of carefully drafting a value engineering change proposal. In *Lear Siegler Services, Inc. v. Rumsfeld*,<sup>65</sup> the court addresses the *addressed* events that trigger the Price Adjustment Clause. Moreover, in *Medlin Construction Group v. Harvey*,<sup>66</sup> the court reconciled seemingly conflicting contract provisions. In *TEG-*

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56. *Id.*

57. *Id.*

58. 273 F.3d 1370 (Fed. Cir. 2001).

59. *Id.* at 1380.

60. 465 F.3d at 1350.

61. *Id.* DOE did so because it preferred developing a contract with standard provisions that could be used with multiple plant operators to the extent practicable. 48 Fed. Reg. 5458, 5459 (Feb. 4, 1983).

62. 465 F.3d at 1350.

63. *Id.* at 1350-51.

*Paradigm Environmental Inc. v. United States*,<sup>67</sup> the court held that the contractor was required to decontaminate a building such that no asbestos remained in the pores and cracks. Lastly, the court held that a contractor is not entitled to retroactive repricing of work already performed where the task order modification did not expressly provide for retroactive repricing.<sup>68</sup>

#### A. Applied Companies v. Harvey

In *Applied Companies v. Harvey*<sup>69</sup> the issue was whether a value engineering change proposal (“VECP”) provided a reward for savings that might accrue by applying the concept to other companies’ products, as well as the contractor’s own products, and whether the proposal provided the plaintiff with a right to share in future savings.<sup>70</sup>

Applied Companies (“Applied”) entered into a fixed-price contract with the Army Troop Support Command to supply 36,000 BTU/HR horizontal air-conditioners.<sup>71</sup> The contract incorporated by reference Federal Acquisition Regulation 52.248-1, Value Engineering (“VE”),<sup>72</sup> which provided in pertinent part, “[t]he Contractor is encouraged to develop, prepare, and submit value engineering change proposals (VECP’s) voluntarily. The Contractor shall share in any net acquisition savings realized from accepted VECP’s, in accordance with the incentive sharing rates in paragraph (f) below.”<sup>73</sup>

Four years later, in 1989, Applied suggested to the government that it replace certain parts in the Applied air-conditioner with commercial parts.<sup>74</sup> Applied submitted a VECP, listing the specific commercial part substitutions for its air-conditioner. The government conditionally accepted the VECP, and a year later calculated Applied’s share of the savings to be \$1,540,181.<sup>75</sup>

In 1995, Applied submitted a claim to the Army, stating that it was entitled to half of the anticipated savings for the use of commercial

64. 456 F.3d 1380 (Fed. Cir. 2006).

65. 457 F.3d 1262 (Fed. Cir. 2006).

66. 449 F.3d 1195 (Fed. Cir. 2006).

67. 465 F.3d 1329 (Fed. Cir. 2006).

68. *Gardiner, Kamya & Associates, P.C. v. Jackson*, 467 F.3d 1348 (Fed. Cir. 2006).

69. 456 F.3d 1380 (Fed. Cir. 2006).

70. *Id.* at 1381-82.

71. *Id.* at 1381.

72. 48 C.F.R. 52.248-1 (1984).

73. 456 F.3d at 1381. Paragraph (f) entitled the contractor to “fifty percent of the net acquisition savings under the current contract and future contracts.” *Id.*

74. *Id.*

75. *Id.*

parts in all twenty three air-conditioning models covered by military specification MIL-A-52767.<sup>76</sup> Applied recognized that its VECP was limited to only the Applied air-conditioners, but argued that it was entitled to share in cost savings “for the concept proposed by Applied in the VECP.”<sup>77</sup>

In November 1996, the contracting officer denied Applied’s claim. In October 2001, the parties settled the issue of current savings, leaving only future savings in dispute.<sup>78</sup> The Armed Services Board of Contract Appeals (“ASBCA” or “the Board”) awarded one million dollars to Applied, which was fifty percent of the future savings relating to Applied’s air-conditioner, but denied the claim for future savings on models other than Applied’s.<sup>79</sup> Applied appealed the Board’s decision with respect to the future savings on other air-conditioner models.

On Appeal, the Federal Circuit held that the language of the VECP unambiguously lists only the contract for the Applied air-conditioner within the scope of the proposal.<sup>80</sup> While the VE clause would have allowed the parties to apply the VECP to the entire family of air-conditioners, the parties in this case did not do so.<sup>81</sup> Instead, the VECP and its modifications encompassed only the Applied air-conditioner.<sup>82</sup> The court additionally found that the clear language of modifications nine and fifteen to the VECP provided that Applied was not entitled to share in future savings.<sup>83</sup> Finally, the court rejected Applied’s assertion that it is entitled to share in the cost savings from the government’s implementation of its *idea* of commercialization: “the submission of a VECP does not confer any proprietary right in the ‘concept’ of the proposal.”<sup>84</sup> Thus, Applied’s entitlement is limited to the terms of its VECP.

Since the VECP agreement between the parties unambiguously stated that Applied was not entitled to future savings, the court affirmed the Board’s decision denying Applied’s claim for future savings on other air-conditioner models.<sup>85</sup>

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76. *Id.* at 1381-82.

77. *Id.* at 1382.

78. *Id.*

79. *Id.*

80. *Id.* at 1383.

81. *Id.*

82. *Id.*

83. *Id.* at 1384.

84. *Id.* (quoting *M. Bianchi of Cal. v. Perry*, 31 F.3d 1163, 1168 (Fed. Cir. 1994)).

85. *Id.* at 1385.

B. *Lear Siegler Services, Inc. v. Rumsfeld*

In *Lear Siegler Services, Inc. v. Rumsfeld*,<sup>86</sup> the Federal Circuit reversed a decision of the ASBCA and held that under the Price Adjustment Clause, the Air Force was required to compensate Lear Siegler Services, Inc. (“LSI”) for increased costs of providing its employees with a “defined-benefit health plan,” which was mandated by a collective bargaining agreement (“CBA”).<sup>87</sup>

LSI and the Air Force entered into a contract under which LSI would provide aircraft maintenance services at Sheppard Air Force Base in Texas.<sup>88</sup> The contract was subject to the Service Contract Act (“SCA”),<sup>89</sup> which protects wages and benefits of service workers.<sup>90</sup> Additionally, the contract incorporated an SCA wage/benefit determination set forth in the CBA between the Air Force and LSI’s predecessor, Lockheed Martin.<sup>91</sup> The contract also included a Price Adjustment Clause,<sup>92</sup> which required the government to pay LSI for “increase[s] . . . in applicable . . . fringe benefits . . . made to comply with . . . [the] wage determination.”<sup>93</sup>

Under the SCA, the Secretary of Labor issues “wage determinations” specifying prevailing wages for each class of service worker employed in a locality.<sup>94</sup> Contractors cannot pay less than the wage determinations.<sup>95</sup> A similar SCA provision applies to fringe benefits.<sup>96</sup> “[T]he SCA prevents contractors from underbidding each other . . . by cutting wages or fringe benefits to its service workers.”<sup>97</sup> Moreover, there is a “successor contractor rule” that requires a successor contractor to pay its employees at least as much as its predecessor paid under its CBA.<sup>98</sup> In the case at bar, LSI was a successor to Lockheed Martin during its base year and a successor to itself during the option year.<sup>99</sup>

LSI’s collective bargaining agreement required a defined benefit health plan, which obligated LSI to expend the resources necessary

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86. 457 F.3d 1262 (Fed. Cir. 2006).

87. *Id.* at 1264.

88. *Id.* at 1265.

89. Service Contract Act of 1965, Pub. L. No. 89-286, 79 Stat. 1034 (codified as amended at 41 U.S.C. § 351-358 (2000)).

90. *Lear Siegler Servs., Inc.*, 457 F.3d at 1265.

91. *Id.*

92. *Id.*

93. *Id.* (quoting 48 C.F.R. § 52.222-43(d)(1) (2006)).

94. 41 U.S.C. § 351(a)(1).

95. *Lear Siegler Servs., Inc.*, 457 F.3d at 1266 (citing 41 U.S.C. § 351(a)(1)).

96. *Id.* (citing 41 U.S.C. § 351(a)(2)).

97. *Id.*

98. *See id.* at 1267 (citing 41 U.S.C. § 353(c)).

99. *Id.*

to provide its employees with an agreed-upon level of benefits.<sup>100</sup> During the course of performance, LSI's costs of providing the agreed-upon level of benefits increased, and LSI submitted a request for a price adjustment pursuant to the SCA Price Adjustment Clause.<sup>101</sup> The Air Force denied the request, and LSI brought its claim to the ASBCA. The Board denied LSI's claim, distinguishing between increases in an employer's cost of providing the benefit and increases in the benefits themselves.<sup>102</sup> The ASBCA held that increases in the costs of providing the same level of benefits do not trigger the Price Adjustment Clause.<sup>103</sup>

On Appeal, the Federal Circuit held that the Price Adjustment Clause is triggered not only when the employee receives greater benefits, but also where the cost to the employer of providing the benefits increases.<sup>104</sup> The court explained that the Price Adjustment Clause states that "[t]he contract price or contract unit price labor rates will be adjusted to reflect the *Contractor's* actual increase or decrease in applicable wages and fringe benefits."<sup>105</sup> Thus, the plain language of the clause focuses on the cost to the contractor rather than the benefit to the employee.<sup>106</sup> Second, the court noted that this reading is consistent with other portions of the SCA scheme that measure benefits in terms of cost to the employer rather than value to the employee.<sup>107</sup> Furthermore, this outcome was consistent with prior Federal Circuit case law, which held that a contractor was entitled to a price adjustment under the contract where it had increased costs during the first option year because more of its employees were eligible for vacation benefits, even though the level of vacation benefits did not change.<sup>108</sup>

In sum, the court held that "the Price Adjustment Clause is triggered by changes in an employer's cost of compliance with the terms of a wage determination. The fact that there has been no nominal change in the mandated benefit . . . is simply irrelevant."<sup>109</sup>

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100. *Id.* at 1265.

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.* at 1268.

105. *Id.* (quoting 48 C.F.R. § 52.222-43(d) (2006)).

106. *Id.*

107. *Id.* (citing 29 C.F.R. § 4.177(a)(3) (2006) (measuring equivalency of fringe benefits in terms of the cost to the employer)).

108. *Id.* (citing *United States v. Serv. Ventures, Inc.*, 899 F.2d 1, 2-3 (Fed. Cir. 1990)).

109. *Id.* at 1269 (emphasis omitted).

## C. Medlin Construction Group, Ltd. v. Harvey

In *Medlin Construction Group, Ltd. v. Harvey*,<sup>110</sup> the Federal Circuit held that the contractor was “entitled to an equitable adjustment in the amount of the [increased] costs associated with supplying concrete” rather than polystyrene retainers in performance of a construction contract.<sup>111</sup>

In July 2002, the Army awarded Medlin a fixed-price contract for construction of a vehicle maintenance facility at Fort Hood, Texas.<sup>112</sup> The contract specifications allowed the contractor to choose between two types of retainers: polystyrene rigid insulation and precast concrete.<sup>113</sup> The contract drawings, however, show only precast concrete and not polystyrene retainers.<sup>114</sup> The contract incorporated Federal Acquisition Regulation 52.236-21, Specifications and Drawings for Construction, which provides, in pertinent part: “Anything mentioned in the specifications and not shown on the drawings, or shown on the drawings and not mentioned in the specifications, shall be of like effect as if shown or mentioned in both. In case of difference [sic] between drawings and specifications, the specifications shall govern.”<sup>115</sup>

During the course of the contract, the Army informed Medlin that Medlin was required to install concrete retainers at all grade beams.<sup>116</sup> Medlin responded that it interpreted the contract as giving it the option of supplying polystyrene *or* concrete retainers, and that in preparing its bid for the fixed-price contract, Medlin had assumed that it would provide the less expensive polystyrene retainers.<sup>117</sup> The Army replied that the drawing, which showed only the concrete retainer, limited Medlin’s choice and required it to use concrete.<sup>118</sup> Medlin was forced to supply the concrete retainers at an additional expense.<sup>119</sup>

On cross-motions for summary judgment, the ASBCA held that there was no conflict between the specifications and the drawings and

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110. 449 F.3d 1195 (Fed. Cir. 2006).

111. *Id.* at 1204.

112. *Id.* at 1196.

113. *Id.* at 1196–97.

114. *Id.* at 1197.

115. *Id.* at 1197 (quoting Federal Acquisition Regulation, 48 C.F.R. § 52.236–21(a) (1997)).

116. *Id.*

117. *Id.* at 1198.

118. *See id.* (basing its opinion on a lack of conflict between the drawings and specifications because “the drawings authorize[ed] the use of only one of the acceptable products”).

119. *Id.*

that the contract required Medlin to provide concrete retainers.<sup>120</sup> Medlin appealed the Board's ruling to the Federal Circuit.<sup>121</sup>

The Federal Circuit reversed and remanded the Board's summary judgment determination and found that Medlin was entitled to an equitable adjustment.<sup>122</sup> The parties agreed that the specifications gave the contractor the choice of concrete or polystyrene.<sup>123</sup> The issue was the effect of the drawings, which showed only the concrete retainer.<sup>124</sup> Because contract interpretation is a question of law, the court reviewed the Board's decision de novo.<sup>125</sup>

The court first noted that the general rules of contract interpretation apply to contracts with the government.<sup>126</sup> In order to prevail, a party's interpretation must be "reasonable." That is, it must "assure that no contract provision is made inconsistent, superfluous, or redundant."<sup>127</sup>

Medlin argued that the drawing and specifications were not in conflict because the drawing did not explicitly exclude the use of polystyrene retainers.<sup>128</sup> Rather, the drawing simply provided more detail in the event the contractor chose to use concrete retainers.<sup>129</sup> The government asserted that the drawing changed the dimensions listed in the specification for the concrete retainers and "narrowed" the contractor's choice of retainers by requiring it to use concrete.<sup>130</sup>

The court held that Medlin's interpretation was the only reasonable one, that is, it gave meaning to all provisions of the contract.<sup>131</sup> The court concluded that there was no inconsistency between the drawing and the specifications and that, read as a whole, the contract allowed Medlin to select which type of retainer to use.<sup>132</sup> Importantly to the court, the drawings did not expressly state that polystyrene retainers were unacceptable.<sup>133</sup> Moreover, FAR 52.236-21(a), which was incorporated in the contract, stated that if

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120. *Id.* at 1198-99. The Board found the essential facts were undisputed and considered "only the legal effect" of the specifications and drawings. *Id.* at 1198.

121. *Id.* at 1199.

122. *Id.* at 1204.

123. *Id.* at 1200.

124. *Id.*

125. *Id.*

126. *Id.* at 1200.

127. *Id.* (quoting *Lockheed Martin IR Imaging Sys., Inc. v. West*, 108 F.3d 319, 322 (1997)).

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

132. *Id.*

133. *Id.* at 1201.

information appears in either the specifications or the drawings it “shall be of like effect as if shown or mentioned in both.”<sup>134</sup> Thus, the fact that the polystyrene retainers were not included in the drawings was not dispositive. Because the Army should have permitted Medlin to supply polystyrene retainers, Medlin was entitled to an equitable adjustment for the increased cost of providing the concrete retainers.<sup>135</sup>

The court noted that even if it accepted the government’s argument, Medlin would still prevail. The government’s interpretation would place the specifications and drawings in direct conflict.<sup>136</sup> Under the contract’s Order of Precedence Clause, the specifications, which provided for the choice of retainer, would govern.<sup>137</sup>

#### D. TEG-Paradigm Environmental, Inc. v. United States

In *TEG-Paradigm Environmental, Inc. v. United States*,<sup>138</sup> the Federal Circuit held that under a contract to perform asbestos abatement work, the contractor was required to clean debris and residue from pores and cracks of the apartment complex buildings.<sup>139</sup>

TEG-Paradigm (“TEG”) entered into a fixed price contract with the Department of Housing and Urban Development (“HUD”) to perform asbestos abatement work at an apartment complex in San Francisco, California, so that the buildings could be imploded safely.<sup>140</sup> During performance of the contract, disputes arose between TEG and HUD regarding whether the contract required TEG to abate asbestos in the pores and cracks of the buildings’ surfaces and whether TEG’s performance was governed by the specifications or its work plan.

The case came before the Court of Federal Claims (“COFC”) on cross-motions for summary judgment.<sup>141</sup> The court was faced with three issues: (1) whether the contract required the removal of asbestos residue in pores and cracks, (2) whether TEG was required to follow the contract specifications rather than its work plan, and (3) whether TEG was entitled to an equitable adjustment for removing

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134. *Id.* (quoting Federal Acquisition Regulation, 48 C.F.R. § 52.236-21 (1997)).

135. *Id.* at 1204.

136. *Id.* at 1203.

137. *Id.* at 1203-04.

138. 465 F.3d 1329 (Fed. Cir. 2006).

139. *Id.*

140. *See id.* at 1332 (noting that TEG was awarded the contract on May 8, 2007, for a fixed price of \$5,153,625.00).

141. *Id.* at 1331.

what it contends were excessive amounts of asbestos.<sup>142</sup> The court first held that the asbestos did have to be removed from pores and cracks. The court next held that the contract specifications govern, not TEG's work plan. Lastly, the court ruled in favor of TEG on its "excess quantities" claim.<sup>143</sup> TEG appealed the court's adverse rulings to the Federal Circuit. The government did not appeal the court's determination on the "excess quantities" claim.<sup>144</sup>

The Federal Circuit first addressed whether TEG was required under the contract to abate asbestos in pores and cracks of the buildings' surfaces. The court set out the legal standard for contract interpretation, explaining that contract language must be given a reasonable meaning.<sup>145</sup> Contract terms are generally to be given their "plain and ordinary" meaning and the court may not use extrinsic evidence to interpret the terms of an unambiguous contract.<sup>146</sup> However, extrinsic evidence may be used to "confirm that the parties intended for the term to have its plain and ordinary meaning."<sup>147</sup> Furthermore, courts are permitted to use evidence of trade practice to interpret even an unambiguous term.<sup>148</sup> Trade practice, however, cannot be used to create an ambiguity where there otherwise was none.<sup>149</sup> Armed with these canons of construction, the court turned to its analysis of the contract.

The court first addressed what abatement standard the contract required. The original specifications contained two different abatement standards; friable materials<sup>150</sup> were to be cleaned so that no traces of debris or residue were visible, and nonfriable materials were to be cleaned until no residue is visible other than that embedded in pores, cracks, or other small voids below the surface.<sup>151</sup> Thus, there was originally a stricter standard for friable materials.

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142. *Id.* at 1334 (citing *TEG-Paradigm Envtl., Inc. v. United States*, No. 00-507C, slip op. at 10 (Fed. Cl. Aug. 30, 2002)).

143. *TEG-Environmental*, 465 F.3d at 1335-36.

144. *Id.* at 1336

145. *See id.* at 1338 (stating that when interpreting a contract, "the language of the contract must be given that meaning that would be derived from the contract by a reasonably intelligent person acquainted with the contemporaneous circumstances").

146. *Id.*

147. *Id.*

148. *Id.* (citing *Hunt Constr. Group, Inc. v. United States*, 281 F.3d 1369, 1373 (Fed. Cir. 2002)).

149. *Id.*

150. *See id.* at 1332 (stating that "friable materials, when dry, can be crumbled, pulverized, or reduced to powder by applying hand pressure").

151. *See id.* (quoting the original asbestos abatement standard set forth at section 2080, 4.3 of the disputed contract).

The specifications were later revised, deleting the more lenient standard for nonfriable material and adopting the more stringent standard for all asbestos-containing material.<sup>152</sup> The revision was in part spurred by questions from TEG's representatives in a pre-bid conference call in which TEG discussed the differences between the two standards contained in the original specifications.<sup>153</sup> Based on that discussion, the court found that TEG understood that the abatement standard in the revised specifications required that no asbestos remain in the pores and cracks.<sup>154</sup>

The next issue was whether any dust or powder found during inspection was assumed to be asbestos-containing debris or residue such that it had to be abated.<sup>155</sup> Relying on a trade practice in the asbestos-abatement field that debris and residue is "assumed" to contain asbestos,<sup>156</sup> the court held that TEG was required to clean all visible powder and dust found during inspection, including that found in cracks and pores.<sup>157</sup>

The court then addressed whether the contract specifications or TEG's work plan governed contract performance. The government had requested the work plan as part of the solicitation process so that it could assess TEG's ability to perform the contract.<sup>158</sup> While the work plan was physically attached to the contract, nowhere did the contract provide that the work plan would be incorporated into the contract or supersede the contract specifications.<sup>159</sup> Consequently, the court found that the work plan was extrinsic evidence that predated the formation of the contract.<sup>160</sup> Thus, under the parol evidence rule,<sup>161</sup> the work plan could not be used to contradict or modify the contract.<sup>162</sup>

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152. *See id.* at 1333, 1339 (noting that the original specifications expressly allowed for the contractor to leave non-friable asbestos in pores, cracks or other small voids below the surface of the material).

153. *See id.* at 1340 (citing TEG representatives who noted the significant difference between cleaning the asbestos to a degree where there is no trace or to a degree that material can still be embedded in pores, cracks, and voids).

154. *Id.*

155. *Id.*

156. *See id.* (relying on the ASTM standard).

157. *Id.* at 1341.

158. *Id.*

159. *Id.*

160. *Id.* at 1342.

161. *See* BLACK'S LAW DICTIONARY 1139 (7th ed. 1999) (defining parol evidence as the principle that "a writing intended by the parties to be a final embodiment of their agreement cannot be modified by evidence of earlier or contemporaneous agreements that might add to, vary, or contradict the writing").

162. *TEG-Environmental*, 465 F.3d at 1342 (ruling that work plans are not incorporated into government contracts).

Lastly, the court noted that its holding is consistent with the principle that the government is entitled to strict compliance with its specifications, which prevents contractors from submitting low bids and then supplying lower-cost materials than those required by the specifications.<sup>163</sup>

*E. Gardiner, Kamy & Associates, P.C. v. Jackson*

In *Gardiner, Kamy & Associates, P.C. v. Jackson*,<sup>164</sup> the Federal Circuit affirmed the decision of the Board of Contract Appeals (“BCA”) and held that a task order modification under which the contractor agreed to complete unfinished work did not provide for retroactive repricing of work already performed.<sup>165</sup>

In May 1993, Gardiner, Kamy & Associates (“GKA”) and HUD entered into an indefinite delivery/indefinite quantity contract for performance of assorted accounting services to “ensure the integrity of [HUD’s] Single Family Mortgage Insurance Program and to protect the insurance fund.”<sup>166</sup> The contract did not specify the work to be performed.<sup>167</sup> Instead, the details of specific tasks, including pricing, were set forth in separately negotiated task orders under the contract.<sup>168</sup>

In March 1996, the parties executed two task orders under which GKA would review 374 post-claims and conduct follow-up reviews to ensure that mortgagees complied with HUD’s requirements.<sup>169</sup> The contract provided for GKA to be paid a “fixed unit price” for each claim that it reviewed. GKA would be paid upon submission of an invoice.<sup>170</sup> The period of performance under the task orders was fifteen months.<sup>171</sup>

During negotiation of the task orders, there was disagreement over the unit prices that HUD proposed. The unit prices were computed by multiplying the estimated number of hours it would take to review a claim by the hourly rate of the employees who would perform the tasks.<sup>172</sup> HUD estimated the hours based on a prior contract with

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163. See *id.* (quoting *Granite Constr. Co. v. United States*, 962 F.2d 998, 1006-07 (Fed. Cir. 1992)).

164. 467 F.3d 1348 (Fed. Cir. 2006).

165. *Id.*

166. *Id.* at 1349.

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.* at 1349-50.

172. *Id.* at 1350.

another contractor.<sup>173</sup> GKA objected to the unit prices because it believed that the review would take longer than estimated and therefore GKA would incur higher costs.<sup>174</sup> However, HUD refused to change the unit price, and GKA eventually agreed to perform the work at the proposed price.<sup>175</sup>

Contract performance fell behind schedule and GKA did not complete the reviews in the fifteen months allotted.<sup>176</sup> Thus, the parties executed Modification 2, extending performance under the task orders for an additional six months.<sup>177</sup> Modification 2 also provided that the unit prices for the extended period would remain the same as the unit prices under the original task orders “pending results of [an] audit and subsequent negotiations.”<sup>178</sup> Thereafter, the Defense Contract Audit Agency conducted an audit and found that GKA’s actual hours worked were higher than the estimates that formed the basis of the unit prices.<sup>179</sup> HUD therefore agreed to adjust the prices for the extended period.<sup>180</sup>

The issue on appeal was whether Modification 2 permitted a retroactive price increase for the work completed prior to the execution of the modification.<sup>181</sup> The Board of Contract Appeals (“BCA”), interpreting the contract under the doctrine of *contra proferentum*, held that Modification 2 did not provide for a retroactive price adjustment.<sup>182</sup>

The Federal Circuit concurred with the BCA’s conclusion but disagreed with its analysis. The court explained that *contra proferentum* is an interpretive doctrine of last resort.<sup>183</sup> In interpreting a contract, the court must first determine whether the agreement is ambiguous.<sup>184</sup> Looking at the plain language of the contract, the court found that Modification 2 was not ambiguous.<sup>185</sup>

The fact that Modification 2 used the terms “continue service” and “extend performance” suggested to the court that the modification was “forward looking, not retroactive.”<sup>186</sup> Moreover, the language

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173. *Id.*

174. *Id.*

175. *Id.*

176. *Id.* at 1350.

177. *Id.* at 1351.

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.* at 1352.

183. *Id.* at 1353.

184. *Id.*

185. *Id.* at 1353.

186. *Id.*

relating to pricing addressed unit prices for the extended period but was silent regarding retroactive adjustments for work already completed.<sup>187</sup> The court noted that it could not interpret the modification's silence on retroactivity as an ambiguity in the agreement.<sup>188</sup> Rather, the fact that the modification did not address retroactivity was further evidence that it was not intended to provide such relief to GKA. The court also noted that the effective date of the modification, July 1, 1997 (rather than the March 1, 1996, effective date of the task orders), cut against GKA's argument that it was intended to provide for retroactive price adjustments.<sup>189</sup> The court concluded its analysis by noting that even if the contract was ambiguous, the negotiation history between the parties regarding the unit prices established that the modification was not intended to apply retroactively.<sup>190</sup>

### III. COSTS

The Federal Circuit decided four precedential cost cases in 2006. In *Richlin Security Service Co. v. Chertoff*,<sup>191</sup> the court considered the applicability of the interest provision of the Contract Disputes Act in denying a contractor's claim for interest on an award of back wages owed by the government to the contractor's former employees. In *Information Systems & Networks Corp. v. United States*,<sup>192</sup> the court considered whether state income taxes paid by the sole shareholder of a subchapter S Corporation were an allowable cost under 48 C.F.R. § 31.205-41. In *Wynne v. United Technologies Corp.*,<sup>193</sup> the court held that the government must demonstrate reliance on defective data submitted by a contractor in order to recover on a Truth in Negotiations Act claim. Finally, in *United Pacific Insurance Company v. United States*,<sup>194</sup> the court affirmed the dismissal of a Miller Act surety's claim to recover excess contract completion costs it incurred in completing a contract on a theory of quantum meruit, holding that the statutes on which the surety relied did not give rise to a private cause of action for contract invalidation.

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187. *Id.* at 1354.

188. *Id.* (citing *New Jersey v. New York*, 523 U.S. 767 (1998)).

189. *Id.*

190. *Id.*

192. 437 F.3d 1296 (Fed. Cir. 2006).

193. 437 F.3d 1173 (Fed. Cir. 2006).

194. 463 F.3d 1261 (Fed. Cir. 2006).

195. 464 F.3d 1325 (Fed. Cir. 2006).

## A. Richlin Security Service Co. v. Chertoff

In *Richlin Security Service Co. v. Chertoff*,<sup>195</sup> the Federal Circuit held that the interest provision of the Contract Disputes Act (“CDA”)<sup>196</sup> did not permit a contractor to recover interest on an award of back wages owed by the government to the contractor’s former employees where the contractor never actually paid any of those back wages.<sup>197</sup>

In 1990 and 1991, Richlin Security Service Company (“Richlin”) entered into two fixed-price contracts with the Immigration and Naturalization Service (“INS”)<sup>198</sup> to provide private security-guard services.<sup>199</sup> Due to a mutual mistake, the contract misclassified the Richlin security guards for purposes of the wage classification scheme under the Service Contract Act (“SCA”).<sup>200</sup> As a result, Richlin’s security guards were underpaid.<sup>201</sup>

In 1995, the Department of Labor (“DOL”) determined that Richlin’s security guards were eligible for back pay under the SCA.<sup>202</sup> In 1998, Richlin and the DOL entered into an agreement specifying how Richlin’s security guards would be compensated for the back wages owed.<sup>203</sup> Specifically, the agreement provided that: (1) Richlin’s security guards were owed \$638,818.72 in back wages, (2) the back wages would be paid into an escrow account to be administered by Richlin’s counsel and distributed to the security guards, (3) any excess funds would be remitted to the DOL, and (4) by virtue of the agreement, Richlin’s obligations to its former employees would be liquidated and satisfied.<sup>204</sup>

After a subsequent appeal and remand, the Department of Transportation Board of Contract Appeals (“the Board”) awarded Richlin the amount of back wages owed pursuant to the DOL-Richlin agreement.<sup>205</sup> The Board also found that Richlin was entitled to

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195. 437 F.3d 1296 (Fed. Cir. 2006).

196. 41 U.S.C. § 611 (2000).

197. *Richlin*, 437 F.3d at 1302.

198. See 1 CHARLES GORDON, STANLEY MAILMAN, AND STEPHEN YALE-LOEHR, IMMIGRATION LAW AND PROCEDURE, § 1.1 (Mathew Bender, Rev. Ed., Lexis Nexis 2006) (noting that the Homeland Security Act of 2002, Pub. L. No. 107-296, 116 Stat. 2135 (2002), abolished the INS and divided its functions into three bureaus: the Bureau of Citizenship and Immigration Services (“BCIS”); the Bureau of Immigration and Customs Enforcement (“BICE”); and the Bureau of Customs and Border Protection (“BCBP”).

199. *Richlin*, 437 F.3d at 1297.

200. 41 U.S.C. §§ 351-258 (2006).

201. *Richlin*, 437 F.3d at 1297.

202. *Id.*

203. *Id.* at 1298.

204. *Id.*

205. *Id.*

payroll taxes associated with the back wages.<sup>206</sup> Following distribution of the back wages and payment of the associated tax liability out of the escrow fund, Richlin petitioned the Board for interest pursuant to the CDA's interest provision, 41 U.S.C. § 611.<sup>207</sup> The Board denied Richlin's request on the ground that "there [was] nothing upon which interest could accrue" because the amounts awarded were not due to Richlin but instead, were amounts found due to Richlin's security guards and the tax authorities, and Richlin had not "advance[d] its own funds to pay" the back wages.<sup>208</sup> Richlin appealed the Board's denial of interest to the Federal Circuit.<sup>209</sup>

The Federal Circuit affirmed the Board's denial of interest.<sup>210</sup> The court first reviewed two prior Federal Circuit decisions considering the types of awards that could accrue interest under section 611 as "amounts found due contractors."<sup>211</sup> The court concluded that these decisions did not support the contention that section 611 "permits interest to accrue on costs . . . that were never actually incurred by the contractor."<sup>212</sup> The court thus rejected Richlin's argument that "the plain meaning of 'amounts found due contractors' in section 611 include[d] any amount (1) for which the contractor was liable and (2) that was 'awarded' to a contractor on a CDA claim."<sup>213</sup> The court explained that under both the legislative history of section 611 and the court's prior decisions, a "contractor can recover interest only on amounts it actually paid."<sup>214</sup> While the court agreed that Richlin's contract obligated it to pay its employees the amounts required by the SCA and to pay associated payroll taxes to the proper tax authorities, Richlin had not made those payments.<sup>215</sup> Instead, both the back wages and the associated payroll taxes had been paid by the government through its payments into the escrow account, which were then used to pay Richlin's security guards and the tax authorities.<sup>216</sup> Indeed, Richlin had acted "merely as a conduit" for the

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206. *Id.*

207. *Id.* at 1299.

208. *Id.*

209. *Id.*

210. *Id.* at 1302.

211. *Id.* at 1299-1300 (discussing the decisions in *Servidone Construction Corp. v. United States*, 931 F.2d 860 (Fed. Cir. 1991), and *Raytheon Co. v. White*, 305 F.3d 1354 (Fed. Cir. 2002)).

212. *Id.* at 1299 (quoting *Raytheon Co.*, 305 F.3d at 1365).

213. *Id.* at 1300.

214. *Id.* at 1301-02.

215. *Id.* at 1301.

216. *Id.*

disbursement of these funds<sup>217</sup> and “did not advance a penny of its own money” in support of these payments.<sup>218</sup> The court thus concluded that because the Board’s award “did not compensate Richlin for any past, present or future out-of-pocket expense,” Richlin was not entitled to receive interest under section 611.<sup>219</sup>

*B. Information Systems & Networks Corp. v. United States*

In *Information Systems & Networks Corp. v. United States*,<sup>220</sup> the Federal Circuit held that state income taxes paid by the sole shareholder of a subchapter S corporation were not an allowable cost under a cost-reimbursement contract between the subchapter S Corporation and the United States because the sole shareholder was not the contracting entity.<sup>221</sup>

Information Systems and Networks Corporation (“ISN”) was a Maryland subchapter S corporation that provided services to the United States under several cost-reimbursement contracts.<sup>222</sup> As a subchapter S corporation, ISN did not have to pay state income tax.<sup>223</sup> Instead, ISN’s sole shareholder, who received dividend income from ISN, paid state income tax on those dividends.<sup>224</sup> The issue under consideration was whether the state income taxes paid by the shareholder constituted allowable costs under ISN’s cost-reimbursement contracts pursuant to 48 C.F.R. § 31.205-41.<sup>225</sup>

ISN submitted claims for reimbursement under its cost-reimbursement contracts for costs associated with the shareholder state income tax payments.<sup>226</sup> The Defense Council Audit Agency denied ISN’s claims, finding that “because ISN was an S corporation and not subject to state income taxes, the state income taxes paid by [the shareholder] were not allowable costs for ISN.”<sup>227</sup> The contracting officer thus denied ISN’s claims for reimbursement.<sup>228</sup>

ISN filed suit in the Court of Federal Claims (“COFC”), alleging that it had reimbursed the shareholder for her state income tax

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217. *Id.* at 1302.

218. *Id.* at 1301.

219. *Id.* at 1302.

220. 437 F.3d 1173 (Fed. Cir. 2006).

221. *See id.* at 1177 (owing to the fact that the state tax liabilities were described as penalties and encumbrances).

222. *Id.* at 1174.

223. *Id.* at 1175 (noting that electing to be a subchapter corporation subjects the corporation only to one level of taxation, at the shareholder level).

224. *Id.*

225. *Id.*; 48 C.F.R. § 31.205-41 (2004).

226. *Info. Sys. & Networks Corp.*, 437 F.3d at 1175.

227. *Id.*

228. *Id.*

payments and that such costs should be allowable under its cost-reimbursement contracts.<sup>229</sup> The COFC agreed, holding that state income tax payments made by the sole shareholder of a subchapter S corporation were allowable costs under 48 C.F.R. § 1.205-41(a).<sup>230</sup>

The COFC concluded that under section 31.205-41(b), taxes were not allowable costs when they are subject to a reduction or an abatement.<sup>231</sup> Moreover, under section 31.205(a), state taxes are an allowable cost when they are required to be paid and are in fact paid.<sup>232</sup> The COFC thus concluded that, because “the state income taxes were required to be paid and were paid, and because the tax liability on the corporate income was not subject to abatement or reduction, the state income taxes claimed by the plaintiff for reimbursement [were] allowed.”<sup>233</sup>

The Federal Circuit reversed the COFC’s decision.<sup>234</sup> First, the court rejected the COFC’s interpretation of section 31.205-41(b), stating that the language of that section “makes it clear that the term exemption ‘means freedom from taxation in whole or in part’” and is not limited to tax abatements and reductions.<sup>235</sup>

Second, the court found that allowable taxes under 31.205-41(a) “apply to taxes paid by the contracting entity.”<sup>236</sup> ISN was the contracting entity and, as a subchapter S corporation, it never paid state income taxes.<sup>237</sup> The shareholder paid state income taxes on her ISN dividends, but because she was not the contracting entity under section 31.205-41(a), her state income tax payments were not an allowable cost for ISN under section 31.205-41(b).<sup>238</sup>

### C. Wynne v. United Technologies Corp.

In *Wynne v. United Technologies Corp.*,<sup>239</sup> the Federal Circuit affirmed the ASBCA’s decision denying the Air Force’s claim for a contract

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229. *Id.* at 1176.

230. *Id.*; 48 C.F.R. §1.205-41(a) (2004).

231. *Info. Sys. & Networks Corp.*, 437 F.3d at 1176.

232. *Id.*

233. *Id.* (quoting *Info. Sys. & Networks Corp. v. United States*, 48 Fed. Cl. 265, 270 (2000)).

234. *Id.* at 1177-78.

235. *Id.* at 1177 (quoting 48 C.F.R. § 31.205-41(b) (2004)).

236. *Id.*

237. *Id.*

238. *Id.*

239. 463 F.3d 1261 (Fed. Cir. 2006).

price reduction under the Truth in Negotiations Act (“TINA”),<sup>240</sup> holding that reliance on defective data is a necessary element of a TINA claim.<sup>241</sup>

In proceedings before the Board, the Air Force argued that it was entitled to a contract price reduction of approximately three-hundred million dollars on a six-year, multi-billion dollar contract because the contractor, United Technologies (“UTech”), had furnished defective cost or pricing data in connection with both its initial price proposal and its best-and-final offer (“BAFO”).<sup>242</sup> The Board concluded that UTech had furnished defective cost or pricing data on which the government had relied to its detriment.<sup>243</sup> However, the defective data caused an increase in the contract price in some instances, and a decrease in other instances, such that “the contract price reductions to which the Air Force was entitled were exceeded by the offsets to which UTech was entitled.”<sup>244</sup> The Board therefore concluded that the Air Force was not entitled to any recovery.<sup>245</sup>

UTech moved for reconsideration of the Board’s initial decision, arguing that the Board’s reliance analysis improperly focused on UTech’s cost and pricing data submitted with its initial price proposal, which the Air Force had not accepted.<sup>246</sup> Instead, the Air Force accepted UTech’s BAFO and subsequent revised offers.<sup>247</sup> Thus, the Board should have focused on “whether the [Air Force] relied on the defective BAFO cost or pricing data.”<sup>248</sup>

The Board agreed with UTech, finding that the contract price for the base year of the contract was based on UTech’s BAFO, not its initial price proposal.<sup>249</sup> The Board went on to explain that the Air Force “was entitled to a presumption that ‘the natural and probable consequence of defective cost or pricing data is to cause an overstated price.’”<sup>250</sup> The Board found that “UTech had rebutted this presumption by demonstrating that the Air Force did not rely upon

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240. 10 U.S.C. § 2306(f) (1983). The court analyzed the 1983 version of TINA because that was the version in effect at the time the contractor furnished its initial price proposal and best-and-final offer to the Air Force. *Wynne*, 463 F.3d at 1262 n.1.

241. *Id.* at 1265.

242. *Id.* at 1263.

243. *Id.*

244. *Id.*

245. *Id.*

246. *Id.*

247. *Id.*

248. *Id.* (quoting *In re United Techs. Corp.*, 05-1 B.C.A. 32,860 (A.S.B.C.A. 2005) (“*Reconsideration Decision*”).

249. *Id.*

250. *Id.* (quoting *Reconsideration Decision*, slip op. at 2-3).

the allegedly defective cost or pricing data in agreeing to any contract price.”<sup>251</sup>

Similarly, the Board found that for the five years beyond the base year of the contract, “competitive forces, rather than defective 1983 BAFO cost or pricing data were relied upon to make the awards and to exercise the options.”<sup>252</sup> Because the Air Force failed to show that anyone in the government reviewed—much less relied on—UTech’s BAFO cost or pricing data in making the awards to UTech, the Board held that the Air Force failed to meet its burden of proof that the defective cost or pricing data had caused an increase in the contract price.<sup>253</sup>

On appeal, the Air Force did not challenge the Board’s factual findings, but rather, argued that it was “never necessary to establish that [the government] relied upon the defective cost or pricing data to its detriment, as it is sufficient to establish that the contract price offered by UTech was calculated using the defective cost or pricing data.”<sup>254</sup>

The Federal Circuit disagreed.<sup>255</sup> Relying on *Singer Co., Librascope Division v. United States*,<sup>256</sup> the court found it well-settled that under TINA, the question is both whether the contractor furnished inaccurate, incomplete, or non-current cost or pricing data *and* whether the government *relied* on the inaccurate cost or pricing data to its detriment.<sup>257</sup> The court rejected the Air Force’s argument that the causation element of TINA can be established solely by demonstrating that the defective cost or pricing data influenced the final contract price.<sup>258</sup> The court explained that in both cases relied on by the government,<sup>259</sup> the contractor had failed to rebut the presumption that the government had relied on the inaccurate cost or pricing data to its detriment.<sup>260</sup> Here, in contrast, the contractor *had* rebutted the presumption of reliance, which the Air Force failed

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251. *Id.*

252. *Id.* at 1264 (quoting *Reconsideration Decision*, slip op. at 5).

253. *Id.*

254. *Id.* at 1265.

255. *Id.*

256. 576 F.2d 905 (Ct. Cl. 1978).

257. 463 F.3d at 1265.

258. *Id.*

259. *Id.* (citing to both *Sylvania Elec. Prods., Inc. v. United States*, 479 F.2d 1342 (Ct. Cl. 1973), and *Lockheed Aircraft Corp. v. United States*, 432 F.2d 801 (Ct. Cl. 1970) in support of its argument).

260. *Id.* at 1266.

to challenge with additional evidence or arguments in support of reliance.<sup>261</sup>

The court found additional support for its decision in the 1986 legislative history of TINA.<sup>262</sup> Congress had considered and rejected a proposed bill that would have eliminated the reliance requirement under TINA, which would have changed the rebuttable presumption of reliance into a conclusive presumption.<sup>263</sup> Notably, the court found the 1986 legislative history reflected Congress's recognition that, prior to 1986, the government could not recover on a TINA claim if it had not relied on the allegedly defective cost or pricing data.<sup>264</sup> In rejecting the proposed amendment, "Congress codified the [then existing] reliance requirement as a defense to a TINA claim."<sup>265</sup>

Finally, the court summarily rejected the Air Force's argument that the Board erred in finding that UTech had rebutted the presumption of reliance.<sup>266</sup> Specifically, the Air Force argued that the presumption of reliance could not be rebutted where the defective cost or pricing data had been used to calculate the contract price.<sup>267</sup> The court found that this argument was explicitly foreclosed by the court's decision in *Universal Restoration, Inc. v. United States*,<sup>268</sup> in which the court concluded that the contractor had successfully rebutted the presumption of reliance even where defective pricing data had been used to calculate the contract price.<sup>269</sup> Noting that the Air Force was not challenging the Board's factual findings, nor was it claiming it had relied on UTech's defective cost or pricing data in making the contract awards, the court affirmed the Board's decision rejecting the government's TINA claim.<sup>270</sup>

#### D. United Pacific Ins. Co. v. United States

In *United Pacific Insurance Co. v. United States*,<sup>271</sup> the Federal Circuit affirmed the dismissal of a Miller Act surety's claim to invalidate a contract and recover costs it incurred over and above the original

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261. *Id.* at 1267.

262. *Id.* at 1266.

263. *Id.*

264. *Id.*

265. *Id.* (citing the National Defense Authorization Act for Fiscal Year 1987, Pub. L. No. 99-661, § 952, 100 Stat. 3816, 3945-49 (1986) (codified at 10 U.S.C. § 2306a(d)(2) (2006))).

266. *Id.* at 1267.

267. *Id.*

268. 798 F.2d 1400 (Fed. Cir. 1986).

269. 463 F.3d at 1265 (citing *Universal Restoration*, 798 F.2d at 1402, 1406).

270. *Id.* at 1267.

271. 464 F.3d 1325 (Fed. Cir. 2006).

contract price on a theory of quantum meruit,<sup>272</sup> holding that the congressional oversight statutes that were allegedly violated did not give rise to a private cause of action to void the contract.<sup>273</sup> In October 1995, Castle Abatement Corporation (“Castle”) entered into a construction contract to renovate three buildings at an Air Force Base.<sup>274</sup> The government agreed to pay Castle \$3,152,174 under the contract.<sup>275</sup> In accordance with the Miller Act,<sup>276</sup> United Pacific Insurance Company (“United Pacific”) as surety, issued a performance bond in the amount of \$3,152,174 and a labor and material bond for \$1,576,087.<sup>277</sup>

In 1997, Castle defaulted and the government terminated its contract.<sup>278</sup> United Pacific then “entered into a written takeover agreement with the government in which it agreed to complete the contract work.”<sup>279</sup> United Pacific hired another contractor, who completed the contract for \$3,525,757.25.<sup>280</sup> United Pacific, however, only received \$661,512.31 from the government under the contract, which was the balance the government owed under its original contract with Castle.<sup>281</sup>

In April 2000, United Pacific filed a claim for equitable adjustment, asking the contracting officer to terminate the contract for convenience and for the government to pay United Pacific \$3,194,490.59, the amount United Pacific incurred completing the contract work minus the \$661,572.31 the government had already paid.<sup>282</sup> In support of its claim, United Pacific argued that “the contract between Castle and the government was void ab initio because it was illegal.”<sup>283</sup> The contracting officer denied United Pacific’s claim.<sup>284</sup>

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272. *Id.* at 1326. The court defined quantum meruit as “[a] claim or right of action for the reasonable value of services rendered.” *Id.* at 1329 (quoting BLACK’S LAW DICTIONARY 1276 (8th ed. 2004)).

273. *Id.* at 1333.

274. *Id.* at 1326.

275. *Id.*

276. 40 U.S.C. § 270a-d (1994) (current version at 40 U.S.C. §§ 3131-34 (2006)). Under the Miller Act, prime contractors are required to post performance bonds on all federal construction contracts as well as to post labor and material bonds to protect all persons supplying labor and materials. *United Pacific Ins. Co.*, 464 F.3d at 1326 n.2.

277. *United Pacific Ins. Co.*, 464 F.3d at 1326.

278. *Id.*

279. *Id.*

280. *Id.*

281. *Id.*

282. *Id.* at 1326-27.

283. *Id.* at 1327.

284. *Id.*

United Pacific appealed the contracting officer's decision to the ASBCA.<sup>285</sup> The Board dismissed United Pacific's claim, holding that United Pacific lacked standing "to assert Castle's pre-takeover claim that the contract was illegal."<sup>286</sup> Subsequently, the Federal Circuit decided *Fireman's Fund Insurance Co. v. England*,<sup>287</sup> in which it held that the Board did not have "jurisdiction over equitable subrogation claims based on events that took place before a takeover agreement."<sup>288</sup> In light of this decision, the Board issued a reconsideration decision in which it dismissed United Pacific's claim for lack of jurisdiction, holding that "United Pacific was not a 'contractor' within the meaning of the Contracts Disputes Act with respect to pre-takeover agreement events."<sup>289</sup> The Federal Circuit affirmed.<sup>290</sup>

In January 2005, "United Pacific filed suit in the COFC under the Tucker Act, alleging that the contract between Castle and the government was illegal and, thus, void ab initio, because it was in violation of 10 U.S.C. §§ 2805 and 2811."<sup>291</sup> United Pacific claimed that "as the completing surety, it was entitled to recover its excess costs of completion on a quantum meruit basis."<sup>292</sup> The COFC dismissed United Pacific's suit for failure to state a claim, relying on the Federal Circuit's decision in *American Telephone & Telegraph Co. v. United States* ("AT&T III").<sup>293</sup> United Pacific appealed the court's dismissal to the Federal Circuit.<sup>294</sup>

On appeal, United Pacific again argued that the contract was illegal and thus void because the government used operation and maintenance funds "in clear violation of 10 U.S.C. § 2805, which absolutely prohibited use of operation and maintenance funds ('O & M funds') for unspecified repairs exceeding \$300,000, and 10 U.S.C. § 2811, which prohibited use of O & M funds in any amount for any new construction."<sup>295</sup> United Pacific relied on *United States v.*

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285. *Id.*

286. *Id.*

287. 313 F.3d 1344 (Fed. Cir. 2002).

288. *United Pacific Ins. Co.*, 464 F.3d at 1327 (quoting *Fireman's Fund*, 313 F.3d at 1352).

289. *Id.* at 1327.

290. *Id.*

291. *Id.*

292. *Id.*

293. 177 F.3d 1368 (Fed. Cir. 1999) (en banc).

294. *United Pacific Ins. Co.*, 464 F.3d at 1327.

295. *Id.* at 1329 (quoting Brief of Plaintiffs-Appellants United Pacific Insurance Company, Reliance Insurance Company, and Reliance National at 10). The court evaluated sections 2805 and 2811 as they were in effect in 1995 when the contract between Castle and the government was formed. *Id.* at 1326 n.1.

*Amdahl*<sup>296</sup> and *Godley v. United States*<sup>297</sup> in support of its argument that “the [g]overnment must pay for the benefits it has received and accepted from the surety because . . . United Pacific completed the illegal/void [c]ontract in good faith without knowledge of the illegality, costs which would not have been incurred but for the illegal [c]ontract and violation of public policy.”<sup>298</sup> In contrast, the government argued that neither United Pacific nor Castle was entitled to have the contract declared void under section 2805 or 2811 and, further, that United Pacific’s suit was barred by the holding in *AT&T III*.<sup>299</sup>

The Federal Circuit first looked to the plain language of sections 2805 and 2811, noting that neither statute provided for the invalidation of a contract based on a violation of the statutes.<sup>300</sup> The court next looked to the legislative history, finding that the purpose of the statutes was not “to enable contractors to assert private causes of action to void contracts with the government that violate the statutes,” but rather, to provide for “agency flexibility through decentralization” and to “limit[] . . . spending and waste through Congressional oversight.”<sup>301</sup> Thus, the court concluded that its decision in *AT&T III* foreclosed United Pacific’s claim.<sup>302</sup>

The court explained that *AT&T III* held that invalidation of a contract was “not a necessary consequence when a statute or regulation [was violated], but must be considered in light of the statutory or regulatory purpose, with recognition of the strong policy of supporting the integrity of contracts made by and with the United States.”<sup>303</sup> More specifically, where the statute itself did not explicitly provide the remedy of invalidation, the underlying purpose of the statute must be considered in determining the appropriate remedy.<sup>304</sup> As noted above, the purposes of the statutes at issue here were not to

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296. 786 F.2d 387 (Fed. Cir. 1986).

297. 5 F.3d 1473 (Fed. Cir. 1993).

298. *United Pacific Ins. Co.*, 464 F.3d at 1329 (quoting Brief of Plaintiffs-Appellants United Pacific Insurance Company, Reliance Insurance Company, and Reliance National at 12).

299. *Id.*

300. *Id.* at 1330.

301. *Id.* at 1331.

302. *Id.* at 1333 (“In our view, *AT&T III* compels the conclusion that United Pacific is not entitled to the relief it seeks . . .”).

303. *Id.* at 1332 (quoting *AT&T III*, 177 F.3d 1368, 1374 (Fed. Circ. 1999)).

304. *Id.*

provide for a private cause of action for contract invalidation.<sup>305</sup> Thus, United Pacific failed to state a claim for relief.<sup>306</sup>

United Pacific argued that *AT&T III* was distinguishable in that the legislative history of the statute at issue in that case had “explicitly barred any private cause of action,” whereas the legislative history of sections 2805 and 2811 contained no similar prohibition.<sup>307</sup> The Federal Circuit rejected this argument, finding that precedent disfavored the invalidation of contracts that had been fully or substantially performed by both parties.<sup>308</sup>

Based on a similar rationale of full contract performance, the court also rejected United Pacific’s reliance on *United States v. Amdahl Corp.*<sup>309</sup> and *Godley v. United States.*<sup>310</sup> The court explained that in *Amdahl*, the government received the goods and services for which it had contracted and then sought to avoid payment by claiming that the contract it had entered into was illegal.<sup>311</sup> In contrast, here, the government had paid Castle and United Pacific the full amount owed under the contract for the construction performed.<sup>312</sup> The court explained that *Godley* was a breach of contract case, whereas here, “the government . . . paid in full the amount it agreed to pay Castle under the original contract,” and thus, there was no breach.<sup>313</sup>

Moreover, in *Godley*, the government had attempted to void the contract based on alleged fraud or wrongdoing by the contracting officer, which the Court refused to consider absent “some causal link between the [alleged] illegality and the contract provisions.”<sup>314</sup> Here, United Pacific had never asserted that the government’s contract with Castle was “tainted by fraud or wrongdoing.”<sup>315</sup> Thus, the Federal Circuit affirmed the COFC’s rule 12(b)(6) dismissal of United Pacific’s claim.<sup>316</sup>

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305. *Id.*; see also *supra* note 301 and accompanying text.

306. *United Pacific Ins. Co.*, 464 F.3d at 1333.

307. *Id.*

308. See *id.* (discussing the holdings in *AT&T III*, as well as *United States v. Miss. Valley Generating Co.*, 364 U.S. 520 (1961)).

309. 786 F.2d 387 (Fed. Cir. 1986).

310. 5 F.3d 1473 (Fed. Cir. 1993); see also *United Pacific*, 464 F.3d at 1333 (declining to find error in the lower court’s rejection of United Pacific’s argument).

311. *Id.*

312. See *id.* at 1334 (“[I]t is undisputed that the government paid Castle and United Pacific the full amount required by the contract for the construction performed . . .”).

313. *Id.* at 1334-35.

314. *Id.* at 1334 (quoting *Godley*, 5 F.3d at 1476).

315. *Id.*

316. *Id.* at 1335.

IV. CONTRACT TERMINATION: *JACOBS ENGINEERING GROUP, INC. V. UNITED STATES*

In *Jacobs Engineering Group, Inc. v. United States*,<sup>317</sup> the Federal Circuit held that upon a termination for convenience, a contractor was entitled to recover all of its costs rather than just eighty percent, even though the contract contained a cost-sharing provision that required the government to pay only eighty percent of the contractor's performance costs.<sup>318</sup>

Jacobs Engineering ("Jacobs") inherited a development and construction contract awarded to its predecessor to "develop, design, fabricate, construct, and install a gasification improvement facility."<sup>319</sup> The contractor would not receive a fee for its performance.<sup>320</sup> Instead, the contract contained a cost-sharing provision pursuant to which the government would pay eighty percent of the contractor's costs, and the contractor would be responsible for the remaining twenty percent of the total estimated cost of \$28,750,375.<sup>321</sup> The contract incorporated the Termination for Convenience Clause at Federal Acquisition Regulation 52.249-6, which provides that, upon a termination for convenience, the government must pay the contractor "[a]ll costs reimbursable under this contract, not previously paid, for the performance of this contract before the effective date of the termination . . . ."<sup>322</sup>

During contract performance, the government terminated the contract for convenience due to a shortage of funds.<sup>323</sup> Jacobs submitted a termination settlement proposal for reimbursement of one hundred percent of its costs.<sup>324</sup> The government rejected the proposal and Jacobs' subsequent claim, limiting recovery to eighty percent based on the cost-sharing provision.<sup>325</sup> Jacobs brought suit at the COFC, challenging the contracting officer's decision.<sup>326</sup>

On cross-motions for summary judgment, the COFC granted the government's motion, holding that the Termination for Convenience clause did not invalidate the cost-sharing provision, but, rather, must

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317. 434 F.3d 1378 (Fed. Cir. 2006).

318. *Id.* at 1379 (reversing the opinion of the COFC).

319. *Id.*

320. *Id.*

321. *Id.*

322. *Id.* at 1380 (quoting Federal Acquisition Regulations, 51 Fed. Reg. 19,717 (May 30, 1986) (codified at 48 C.F.R. § 52.249-6(g)(1))).

323. *Id.* at 1380.

324. *Id.*

325. *Id.*

326. *Id.*

be read in accordance with it.<sup>327</sup> Accordingly, the COFC held that only those costs reimbursable under the contract, the eighty percent, were to be paid to the contractor upon termination for convenience.<sup>328</sup> Jacobs appealed that decision to the Federal Circuit.<sup>329</sup>

On appeal, the Federal Circuit reversed and remanded.<sup>330</sup> Without citing legal support, the court held that “the term ‘all costs reimbursable’ defines the type or kind of costs for which the contract provides reimbursement and not the amount of such costs.”<sup>331</sup> The court reasoned that, had the parties intended for the cost-sharing provision to apply in the event of a Termination for Convenience, the contract would have so stated.<sup>332</sup> Furthermore, the court held that, to the extent that the phrase “all costs reimbursable” is ambiguous, it must be construed against the government as the drafter of the contract.<sup>333</sup>

The court’s decision was apparently driven by its view of the equities. Jacobs maintained that it had entered into this “seemingly unattractive venture [in] anticipation [of] . . . obtain[ing] valuable patent rights” upon the contract’s completion.<sup>334</sup> Since the contract was terminated prior to completion, Jacobs never received those rights.<sup>335</sup> Relying on a decision of the Department of Transportation Board of Contract Appeals,<sup>336</sup> the court concluded that “[i]n these circumstances it seems unfair to Jacobs to deny it full reimbursement for the costs of its performance up to the government’s contract termination, which thwarted its possibility of obtaining the patent rights.”<sup>337</sup>

## V. BID PROTESTS

The Federal Circuit’s decision in *Rex Service Corp. v. United States*<sup>338</sup> involved the Tucker Act’s interested-party requirement for purposes of the COFC’s bid protest jurisdiction. In *Rex Service Corp. v. United*

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327. *See id.* (discussing the COFC opinion).

328. *Id.*

329. *Id.*

330. *Id.* at 1381.

331. *Id.* at 1380.

332. *Id.* at 1381.

333. *Id.*

334. *Id.*

335. *Id.*

336. *In re Kasler Elec. Co.*, 84-2 B.C.A. 17,374 (D.O.T.C.A.B. 1984).

337. *Jacobs Engineering*, 434 F.3d at 1381.

339. 448 F.3d 1305 (Fed. Cir. 2006).

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*States*,<sup>339</sup> the Federal Circuit affirmed the COFC's dismissal of a protest by Rex Service Corporation ("Rex") for lack of standing.<sup>340</sup> Because Rex could have bid on the contract award but chose not to,<sup>341</sup> it was not an interested party under the Tucker Act<sup>342</sup> for purposes of the COFC's bid protest jurisdiction.

In July 2003, a subagency of the DOD "issued a request for proposals ('2003 RFP') to supply 'thumbwheel switches,' a component in aviation control transponders."<sup>343</sup> Rex filed an agency protest arguing that the RFP had disclosed some of its proprietary data.<sup>344</sup> The DOD cancelled the RFP even though it concluded that no proprietary data had been disclosed.<sup>345</sup>

In September 2004, the DOD issued a second RFP to supply thumbwheel switches.<sup>346</sup> One day before the close of bidding, Rex again filed an agency protest.<sup>347</sup> Rex argued that the DOD's violations of the Procurement Integrity Act ("PIA")<sup>348</sup> had prejudiced Rex and further argued that any bidder that used information from the prior RFP should be disqualified from the bidding.<sup>349</sup> Rex did not, however, submit a bid in response to the 2004 RFP, nor did it argue that the DOD's violations prevented it from doing so.<sup>350</sup> Rex's protest was denied, and "Rex did not pursue the matter further."<sup>351</sup>

In February 2005, the DOD awarded the contract to Associated Aircraft Manufacturing and Sales, Inc. ("Associated Aircraft").<sup>352</sup> In March 2005, Rex filed a protest at the COFC under the Tucker Act,<sup>353</sup> protesting the award to Associated Aircraft and arguing that the DOD "had deviated from the process specified in the 2004 RFP."<sup>354</sup> The COFC dismissed the protest, finding that Rex was not an "interested party" within the meaning of the Tucker Act, and thus, the court

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339. *Id.*

340. *Id.* at 1308.

341. *Id.* at 1306-08.

342. 28 U.S.C. § 1491(b)(1) (2000).

343. *Rex Service Corp.*, 448 F.3d at 1306.

344. *Id.*

345. *Id.* at 1306-07.

346. *Id.* at 1307.

347. *Id.*

348. Procurement Integrity Act of 1988, 41 U.S.C. § 423 (2000) (as amended by the National Defense Authorization Act for Fiscal Year 1996, 10 U.S.C. § 7420 (1996)).

349. *Rex Service Corp.*, 448 F.3d at 1307.

350. *Id.* at 1307.

351. *Id.*

352. *Id.*

353. *Id.*

354. *Id.*

lacked jurisdiction to hear the case.<sup>355</sup> Rex appealed the COFC's dismissal to the Federal Circuit.<sup>356</sup>

In deciding whether Rex was an "interested party" within the meaning of the Tucker Act, the Federal Circuit first noted that the term was construed in accordance with the Competition in Contracting Act ("CICA"),<sup>357</sup> which requires that the party be an "actual or prospective bidder[] . . . whose direct economic interest would be affected by the award of the contract or by failure to award the contract."<sup>358</sup>

Thus, the court found that in order for Rex to have standing to protest the award, Rex had to demonstrate: (1) that it was an actual or prospective bidder, and (2) that it had a direct economic interest in the award of the contract.<sup>359</sup> The court easily concluded that Rex was not an "actual bidder" as it had not bid on the contract.<sup>360</sup> Nevertheless, Rex argued that it was a prospective bidder "because . . . it filed an agency protest prior to the close of bidding, and it was prejudiced, but not prevented from bidding, by alleged violations in the department's solicitation."<sup>361</sup>

The Federal Circuit disagreed.<sup>362</sup> Relying on *MCI Telecommunications Corp. v. United States*,<sup>363</sup> the court explained that, in order to have standing to protest an award, a party that was not an actual bidder must demonstrate that it was "expecting to submit an offer prior to the closing date of the solicitation."<sup>364</sup> The court further noted that "the opportunity to qualify . . . as . . . a prospective bidder ends when the proposal period ends."<sup>365</sup>

Because Rex could have, but did not, submit a bid prior to the closing date of the solicitation, it could not qualify as a prospective bidder.<sup>366</sup> Specifically, Rex had not alleged "that it expected to bid prior to the close of the solicitation period, but was *prevented* from

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355. *Id.*

356. *Id.*

357. 31 U.S.C. §§ 3551-56 (2000).

358. *Rex Service Corp.*, 448 F.3d at 1307 (quoting *Am. Fed'n of Gov't Employees v. United States*, 258 F.3d 1294, 1302 (Fed. Cir. 2001)).

359. *Id.* at 1307.

360. *Id.*

361. *Id.* at 1307-08.

362. *Id.* at 1308 (rejecting Rex's arguments).

363. 878 F.2d 362, 364 (Fed. Cir. 1989) (construing "interested party" under the Brooks Automatic Data Processing Act, 40 U.S.C. § 759 (repealed 1996)).

364. *Rex Service Corp.*, 448 F.3d at 1308 (quoting *MCI*, 878 F.2d at 365, and further holding that the *MCI* construction of "interested party" "applies to the Tucker Act with equal force," 448 F.3d at 1307).

365. *Id.* at 1308 (quoting *MCI*, 878 F.2d at 365).

366. *Id.*

doing so on the basis of improper agency action.”<sup>367</sup> The fact that Rex had filed a pre-award agency protest or that alleged violations by the DOD *prejudiced* Rex’s ability to bid were irrelevant to the court’s determination of Rex’s standing.<sup>368</sup>

The court further held that Rex did not possess a direct economic interest in the award of the contract.<sup>369</sup> The court explained that, in order to have the requisite direct economic interest, a prospective bidder must demonstrate that it had a “substantial chance” of receiving the contract.<sup>370</sup> Here, Rex did not bid on the contract, nor did it argue that the DOD would have had to reopen the solicitation if its protest was sustained.<sup>371</sup> Thus, Rex had no chance of receiving the contract award.<sup>372</sup> Accordingly, the court affirmed the COFC’s dismissal of Rex’s protest for lack of jurisdiction.<sup>373</sup>

## VI. PATENT RIGHTS

One patent case this term involved government contract issues. *Zoltek Corp. v. United States*<sup>374</sup> concerned the government’s liability for a government contractor’s alleged intrusion on a third party’s intellectual property.

A patent owner’s sole remedy for a third party’s unlicensed use of the patented subject matter in performing a federal contract is a suit against the government for reasonable compensation under 28 U.S.C. § 1498<sup>375</sup> (implemented in FAR § 27.201-1<sup>376</sup>). In *Zoltek Corp. v. United States*,<sup>377</sup> the Federal Circuit discussed what constitutes “infringement” for purposes of the government’s liability, and clarified the applicability of the Fifth Amendment’s Just Compensation Clause with respect to such a claim.<sup>378</sup>

In *Zoltek*, the United States government entered into contract with Lockheed Martin Corporation (“Lockheed”) “to design and build the F-22 fighter.”<sup>379</sup> Lockheed subcontracted with other companies to

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367. *Id.* (emphasis added).

368. *Id.*

369. *Id.* (analyzing the second standing requirement).

370. *Id.* (quoting *Myers Investigative & Sec. Servs., Inc. v. United States*, 275 F.3d 1366, 1370 (Fed. Cir. 2002)).

371. *Id.*

372. *Id.*

373. *Id.*

374. 442 F.3d 1345 (Fed. Cir. 2006).

375. 28 U.S.C. § 1498 (2000).

376. 48 C.F.R. 27.201-1 (2006).

377. 442 F.3d 1345.

378. *Id.* at 1349-53.

379. *Id.* at 1349.

provide two types of silicide fiber sheet products for the aircraft.<sup>380</sup> The fibers for the first type of product were partially carbonized and developed into sheets in Japan, then imported into the United States.<sup>381</sup> The fibers for the second type of product were manufactured in Japan and sent to the United States for processing.<sup>382</sup> Zoltek alleged that Lockheed's subcontractors made the fiber products using Zoltek's patented methods.<sup>383</sup>

Section 1498(a) of title 28 of the United States Code provides that whenever a patented invention is used or manufactured by or for the United States without a license from the patent owner, the owner's only remedy is an action against the COFC for the recovery of reasonable compensation for such use or manufacture (e.g., reasonable royalties).<sup>384</sup> Section 1498(c), on the other hand, provides that even where a plaintiff meets all of the requirements that establish a claim for compensation under section 1498(a), the right to reasonable compensation will not apply to claims arising in a foreign country.<sup>385</sup>

The Federal Circuit affirmed the COFC's conclusion that Zoltek's claims against the government were barred under section 1498 because the patented steps allegedly used by Lockheed's subcontractors were not performed in the United States, but in Japan.<sup>386</sup> Thus, even where a patented process is used to manufacture goods for the government without a license from the patent holder, government liability for infringement does not persist under section 1498 when "not all steps of a patented process have been performed in the United States."<sup>387</sup>

More interesting is the Federal Circuit's response to the COFC's suggestion that the unlicensed use of Zoltek's patented process to manufacture goods for the government may constitute a taking

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380. *Id.*

381. *Id.*

382. *Id.*

383. *Id.* The relevant patent is U.S. Reissue Patent No. 34,162 (reissued Jan. 19, 1993) to "Controlled Surface Electrical Resistance Carbon Fiber Sheet Product." 442 F.3d at 1347.

384. 28 U.S.C. § 1498(a) (2000); *Bath Iron Works Corp. v. Parmatic Filter Corp.*, 736 F. Supp. 1175, 1176 (D. Me. 1990). Reasonable compensation includes the owner's reasonable fees for expert witnesses and attorneys in pursuing the action, but only if the owner is an independent inventor, a nonprofit organization, or an entity that had no more than five hundred employees at any time during the five year period preceding the use of the patented invention by or for the United States. 28 U.S.C. § 1498(a).

385. 28 U.S.C. § 1498(c).

386. *Zoltek*, 442 F.3d at 1350.

387. *Id.* (citing *NTP, Inc. v. Research in Motion, Ltd.*, 418 F.3d 1282, 1318 (Fed. Cir. 2005)).

under the Fifth Amendment.<sup>388</sup> Zoltek asked the lower court to apply the rationale of *Porter v. United States*,<sup>389</sup> which acknowledged that the United States can be obligated to pay just compensation under a theory of eminent domain when there is a taking of United States property overseas by foreign nationals or foreign governments, provided that “the United States carried out the alleged taking of property.”<sup>390</sup> The COFC agreed that the infringement constituted a taking of private property for public use under the Fifth Amendment and maintained jurisdiction under the Tucker Act.<sup>391</sup>

The Federal Circuit politely scolded the COFC for recognizing patent infringement as a Fifth Amendment taking. In a per curiam opinion, the Federal Circuit reasoned that applying takings jurisprudence to patent infringement claims against the government would effectively read section 1498 “out of existence.”<sup>392</sup> Moreover, the Supreme Court had rejected an argument in *Schillinger v. United States*<sup>393</sup> that a patentee could sue the government for patent infringement as a Fifth Amendment taking under the Tucker Act. The Federal Circuit’s per curiam opinion rejected Judge Plager’s dissenting view that the Supreme Court had implicitly overruled *Schillinger* in subsequent rulings.<sup>394</sup>

Congress created section 1498 to compensate patentees for the use of patented subject matter by or for the federal government, in lieu of the customary private suit for infringement in federal district court.<sup>395</sup> In effect, section 1498 allows the government to purchase goods and services for performance of governmental functions without the threat that work will be stopped because the contractor is enjoined for patent infringement. *Zoltek* reinforces the view that section 1498 is the patent owner’s *sole* remedy for the unauthorized practice of patented inventions for the government’s benefit, to the

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388. See *Zoltek Corp. v. United States*, 58 Fed. Cl. 688, 706 (2003) (discussing elements Zoltek would need to show to properly allege a taking). The Fifth Amendment’s Just Compensation Clause provides that the government shall not take private property without compensating its owners. U.S. CONST. amend. V (“[N]or shall private property be taken for public use, without just compensation.”).

389. 496 F.2d 583 (Ct. Cl. 1974).

390. *Id.* at 591.

391. See *Zoltek*, 442 F.3d at 1350 (noting the COFC’s decision). Under the Tucker Act a claimant may bring a claim for money damages against the United States if the claim is “founded . . . upon the Constitution.” 28 U.S.C. § 1491(a)(1) (2000).

392. *Zoltek*, 442 F.3d at 1352.

393. 155 U.S. 163 (1894).

394. *Zoltek*, 442 F.3d at 1352-53. A panel majority again rejected a vigorous dissent, this time from Judge Newman, in denying Zoltek’s petition for rehearing. See *Zoltek v. United States*, 464 F.3d 1335, 1336 (Fed. Cir. 2006).

395. See *Zoltek*, 442 F.3d at 1353 (discussing the purpose of § 1498).

exclusion of all others including constitutional theories of just compensation.

## VII. OTHER

In *Coalition for Common Sense in Government Procurement v. Secretary of Veterans Affairs*,<sup>396</sup> the Federal Circuit struck down the TRICARE Pharmacy Benefits Program (“TPBP”),<sup>397</sup> because the Secretary of Veterans Affairs (“VA”) did not follow the Administrative Procedures Act (“APA”) notice-and-comment rulemaking procedures in establishing the program.<sup>398</sup>

The Veterans Health Care Act of 1992 (“VHCA”)<sup>399</sup> was enacted to reduce the cost of prescription drugs purchased by the VA and the DOD.<sup>400</sup> The VHCA states that in order to receive federal Medicaid funds for their products, pharmaceutical manufacturers are required to enter into a Master Agreement and Pharmaceutical Pricing Agreement whereby the manufacturers agree to offer their “covered drugs” on the Federal Supply Schedule (“FSS”).<sup>401</sup> Moreover, under the VHCA and the Master Agreement, when certain agencies, including the VA and the DOD, purchase “covered drugs” off the FSS contract or through a “depot contracting system,” they are to be charged a price no higher than the calculated Federal Ceiling Price (“FCP”), which is approximately seventy-six percent of the “non-Federal average manufacturer price.”<sup>402</sup>

The DOD provides health care benefits to “active duty service members, retired service members, and their dependents” through a system called TRICARE.<sup>403</sup> As part of the TRICARE benefit, the DOD reimburses retail pharmacies when its beneficiaries purchase drugs.<sup>404</sup> Prior to fall 2004, the DOD paid wholesaler prices without regard to the FCP, because such reimbursements were not considered

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396. 464 F.3d 1306 (Fed. Cir. 2006).

398. This program is known in the industry as the Tricare Retail Pharmacy Benefit Plan (“TRRx”).

398. *Id.* at 1318-19.

399. 38 U.S.C. § 8126 (2000).

400. *Coal. for Common Sense*, 464 F.3d at 1310.

401. 38 U.S.C. § 8126(a).

402. *Id.* In the first year of the FSS contract, the Federal Ceiling Price is calculated as seventy-six percent of Non-FAMP minus an additional CPI-U based discount. In the second and subsequent years of the FSS contract, the FCP is calculated as the lower of seventy-six percent of Non-FAMP minus an additional CPI-U based discount and the FSS price on September 30 increased by the CPI-U percentage. 38 U.S.C. § 8126(c).

403. *Coal. for Common Sense*, 464 F.3d at 1309.

404. *Id.* 1309-10. TRICARE beneficiaries pay a co-payment for the drug and the DOD pays the remainder of the cost. *See id.* (describing the payment system for the TRICARE health care benefits program).

purchases through FSS or a depot contracting system. The DOD restructured the TPBP in 2004 with the intention of obtaining refunds from the manufacturers on retail pharmacy sales based on the difference between wholesaler pricing and FCP.<sup>405</sup> The TPBP refund requirement was announced to manufacturers in an October 2004 “Dear Manufacturer letter” issued by the VA.<sup>406</sup> In the letter, the VA concluded that the TPBP program qualified as a “depot contracting system” under the VHCA and that refunds would accrue on TPBP sales starting October 1, 2004.<sup>407</sup>

The plaintiff in this case, Coalition for Common Sense in Government Procurement, is a trade association whose members include pharmaceutical manufacturers that were required to pay rebates pursuant to the October 2004 letter.<sup>408</sup> The Coalition’s principal arguments were that the VA erred in concluding that TPBP was a “depot contracting system” and that the VA’s Dear Manufacturer letter was procedurally deficient because it was not issued pursuant to the APA’s notice-and-comment rulemaking procedures.<sup>409</sup>

The court’s analysis focused principally on whether the VA’s letter should be considered a substantive rule or an interpretive one.<sup>410</sup> This distinction was important because only substantive rules require formal APA notice-and-comment procedures.<sup>411</sup> The government argued that the letter merely interpreted the VHCA’s requirement to extend FCPs to depot contracting systems.<sup>412</sup> But the court found otherwise, and held that the letter established a substantive rule.<sup>413</sup>

The court noted that the letter created a new refund system under which manufacturers were “required to pay refunds . . . for covered drugs purchased at network pharmacies”—something that previously had not been required.<sup>414</sup> The court also emphasized that the program would require manufacturers “to change sales data for

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405. *Id.* at 1311-12.

406. *Id.*

407. *Id.* at 1312.

408. *Id.* at 1308. Note that the VA agreed to stay enforcement of the refunds pending the outcome of this case. *Id.* at 1312.

409. *Id.* at 1315.

410. *Id.* at 1316-18.

411. *See id.* at 1316 (“The determination of whether the letter is a substantive rule or an interpretive rule will determine whether the agency was required to comply with . . . the notice and comment procedures of section 553.”).

412. *Id.* at 1315.

413. *Id.* at 1319.

414. *Id.* at 1317-18.

purposes of calculating non-FAMPs,”<sup>415</sup> meaning that manufacturers would be required to exclude the TPBP transactions from the Non-Federal Average Manufacturer Price calculations as “Federal sales” under the VHCA.<sup>416</sup> The court bolstered its holding that the letter was a substantive rule by finding that the VA created the refund system with the intention of binding itself as well as tribunals faced with disputes under the program in the future.<sup>417</sup>

Based on its determination that the letter is a substantive rule, the court concluded that it had jurisdiction to review the letter under 38 U.S.C. § 502 (2000).<sup>418</sup> Since the VA had not complied with the notice-and-comment procedures of section 553 of the APA before issuing the letter in October 2004, the court set aside the letter as “procedurally defective.”<sup>419</sup>

The court then remanded the matter to the VA for compliance with the APA’s notice-and-comment requirements, including 5 U.S.C. §§ 552(a)(1) and 553.<sup>420</sup> Having found for plaintiff on the procedural issue, the court did not reach the question of whether the TPBP constitutes a “depot contracting system” within the meaning of the VHCA.

In the aftermath of the Federal Circuit’s decision in this case, the DOD agreed to return all the rebates paid under the TPBP.<sup>421</sup> Moreover, the VA has issued guidance requiring the manufacturers who paid refunds and excluded TPBP utilization from their Non-FAMP calculations as “Federal sales” to recalculate their Non-FAMPs for the affected time periods because TPBP transactions are no longer considered “Federal sales” under the VHCA.<sup>422</sup>

#### CONCLUSION

In 2006, *Zoltek*<sup>423</sup> and *Coalition for Common Sense in Government Procurement*<sup>424</sup> were the two most noteworthy decisions due to their

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415. *Id.* at 1318.

416. *Id.* (explaining the new refund system as stated under the Dear Manufacturer letter).

417. *Id.*

418. *Id.*; 38 U.S.C. § 502 (2000).

419. *Coal. for Common Sense*, 464 F.3d at 1318-19.

420. *Id.* at 1319.

421. See Letter from Melbourne A. Noel, Jr., Senior Contract Attorney, Office of General Counsel, Department of Veteran Affairs to Manufacturer of Covered Drugs (Oct. 18, 2006) (on file with author), available at [http://www1.va.gov/oamm/\\_bf/oa/20061018ManfCvrDrugs.pdf](http://www1.va.gov/oamm/_bf/oa/20061018ManfCvrDrugs.pdf).

422. See Letter from Department of Veteran Affairs to Refund-Paying Manufacturers (Nov. 9, 2006) (on file with author).

423. 442 F.3d 1345 (Fed. Cir. 2006).

424. 464 F.3d 1306.

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precedential and economic impacts. *Zoltek* dealt with the scope and exclusivity of the section 1498 patent remedy,<sup>425</sup> and *Coalition for Common Sense in Government Procurement* invalidated the VA's attempt to impose federal ceiling prices on TRICARE retail pharmacy sales.<sup>426</sup> The Federal Circuit did not issue any particularly surprising or innovative rulings on government contracts, although there were a number of instances in which the court reached different conclusions than the COFC or Boards of Contract Appeals. While the Federal Circuit faces far fewer government contract cases than do the tribunals whose decisions it reviews, it does not hesitate to assert its independent judgment on questions of law in that realm, any more than in fields such as patent law, that comprise a greater part of its own docket. This should encourage practitioners who are unsuccessful in the first instance to consider appeal in cases not clearly governed by Federal Circuit precedent.

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425. See 442 F.3d 1347.

426. See 464 F.3d 1306.