newsletter

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1st quarter

Government Enforcement Litigation

Inside this issue

Repairing The Tucker Act Loophole So That All Government Customers Are Accountable For Their Contract Breaches

by David R. Moffitt and David L. Hackett

It is as much the duty of government to render prompt justice against itself, in favor of citizens, as it is to administer the same between private individuals.

– Abraham Lincoln

In keeping with Honest Abe's principles, most contractors expect that their contracts with United States government will be binding – on both the government and the contractor. When disputes arise and can't be settled, contractors expect that they can rely on the claim resolution process established by the Contract Disputes Act of 1978 for a just result. They expect access to a meaningful forum to decide their appeal of a contracting officer's adverse final decision. Unfortunately, this is not always the case.

The Non-appropriated Fund Instrumentalities Doctrine

For too long, the courts (and the boards of contract appeals) have refused to enforce procurement contracts awarded by government entities that are not funded by congressional appropriations (referred to as "Non-Appropriated Fund Instrumentalities" or "NAFIs"). Many contractors are unaware of this arcane doctrine that protects NAFI's from suit, even when they breach their contracts. No procurement regulation requires NAFI's to warn prospective contractors of their immunity from suit. Indeed, some NAFI's reinforce the opposite expectation. They issue contracts containing the standard FAR clauses, including the standard disputes clause, setting forth the contractors' right of appeal. Often, then, it is only after substantial investment in contract performance, and lengthy, expensive litigation, that some contractors learn that they have no remedy for their customer's breach.

The non-appropriated funds doctrine is based on the principle that the United States can be sued only if it consents to waive its sovereign immunity. The Tucker Act waives sovereign immunity for contract claims against the United States.[1] However, the Tucker Act is limited by the requirement that judgments must be paid out of funds appro-

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priated for that purpose.[2] Based on that requirement, courts have developed a doctrine precluding jurisdiction over contract actions against the United States if appropriated funds cannot be used to pay the resulting judgments.[3] This limitation means that contractors have no recourse for enforcing contracts with government programs or entities that do not receive appropriated funds from the U.S. Treasury.

What Government Entities Can Use the NAFI Doctrine to Avoid Suit?

The original NAFI's were military post exchanges created to improve morale and provide for the welfare and recreational needs of our servicemen and women. The exchanges were traditionally funded by their own activities rather than congressional appropriations and were deemed immune from suit in post-World War II Supreme Court decisions. Over time, however, the NAFI doctrine has been expanded to apply to *any* government instrumentality that cannot access congressional appropriations.

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Today, distinguishing between government entities that can be sued and those that cannot be sued is no easy task. Federal statutes provide for a variety of "independent establishments," wholly owned government corporations and "mixed ownership" corporations within the executive branch.[4] Some of these entities contract for goods and services as the United States but nevertheless enjoy immunity for their contractual breaches. Many more have asserted the NAFI defense unsuccessfully. The issue has been litigated repeatedly in recent years by agencies including Federal Prison Industries (UNICOR), the United States Mint, the Federal Retirement Thrift Investment Board, the Board of Governors of the Federal Reserve, the Federal Housing Finance Board, the FDIC, the Grape Crush Administrative Committee, the Office of the Comptroller of the Currency, and the Agency for International Development, to name a few.

Agencies That Have Invoked the NAFI Doctrine to Assert Immunity from Contract Suits

United States Mint
Office of Comptroller of the Currency
Agency for International Development (AID)
Federal Grain Inspection Service (FGIS) of the Department of Agriculture
U.S. Army Nonappropriated Fund Risk Management Program (RIMP)
Bolling Officers' Club
Eielson Air Force Base Central Base Fund (CBF)
Federal Prison Industries, Inc. (UNICOR)
Federal Retirement Thrift Investment Board
Board of Governors of the Federal Reserve
Federal Housing Finance Board
Morale, Welfare, and Recreational Entities *(not closely affiliated with a military post exchange)*
Federal Deposit Insurance Corporation (FDIC)
Army and Air Force Exchange Service (AAFES)
Grape Crush Administrative Committee
Raisin Administrative Committee
Navy Resale and Services Support Office (NAVRESSO)
Guest House Fund (Brook General Army Hospital, Fort Sam Houston, Texas)

Even the courts do not always agree when an agency is a NAFI. For example, the Court of Federal Claims recently reached different conclusions when considering whether the United States Mint was a NAFI.[5] This uncertainty is due to the need to discern congressional intent from federal statutes and legislative history which are not always clear. Also, the NAFI doctrine has "developed unevenly, reflecting changes in both the functions of NAFI's in the appropriations process, and in the structure and source of funding of federal programs."[6]

Congress' Incomplete Attempt to Address the Problem in 1970

In 1970, Congress amended the Tucker Act to correct the "injustice and inequity worked by this Tucker Act 'loop-

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hole,'"[7] referring to a contractor's inability to enforce contracts made with U.S. government instrumentalities unless the claim rested on a contract which "in the contemplation of Congress could obligate public monies."[8] The amendment extended the waiver of sovereign immunity only to a handful of traditional NAFIs—the Army and Air Force Exchange Service, Navy Exchanges, Marine Corps Exchanges, Coast Guard Exchanges and Exchange Councils of the National Aeronautics and Space Administration.[9] Sovereign immunity was not waived for contract claims against any other NAFIs. Therefore, despite recognizing the injustice and inequity created by NAFIs, Congress solved the problem for only a select few NAFIs.

The limited outcome was very different from that contemplated in the original version of the legislation. The first Senate bill, S.980, waived immunity for implied or express contracts with all NAFIs. The bill added the caveat that if a NAFI was not financially able to pay a judgment, then funding for that judgment would come from the general treasury.[10] In support of the bill, the Department of Defense proclaimed, "there appear to be no policy grounds justifying non-appropriated fund instrumentalities in continuing to claim absolute immunity from suits on their contracts when Congress has waived such immunity in suits on contracts with the federal government itself."[11]

Ultimately, however, the House version of this legislation limited the waiver to military and NASA exchanges. The House subcommittee supporting the limitation stated that the military and NASA exchanges were solvent, implying that they would be able to support the costs associated with any claim against them.[12] But the House was concerned about NAFIs with insufficient assets to reimburse the U.S. Treasury for judgments it paid. Specifically, the House was concerned that the cost of judgments against such NAFIs might be imposed on taxpayers, "a result of which is inconsistent with the very concept of non-appropriated fund activities."[13]

Consequently, Congress in 1970 recognized the injustice caused by NAFI contractual immunity, but limited its solution to save taxpayers from liabilities to which the government would be exposed by fully addressing the problem. That was a shortsighted and politically expedient perspective.

The ABA Public Contract Law Section's Proposal to Solve the Problem

The NAFI doctrine has left many unsuspecting contractors with steep legal bills and no legal recourse for even blatant breaches of contract by government customers that meet the NAFI definition. The Court of Federal Claims has recognized not only the harshness of the doctrine, but its shortsightedness. Although viewed by Congress as a tax-saving devise, the NAFI doctrine creates a "powerful disincentive to contract with these NAFI agencies" that it creates.[14] In the long term, that disincentive will result in higher costs of goods and services to government institutions as contractors decline to compete for NAFI procurements, or pad their proposals with contingencies suitable to the enormous risks inherent in agreeing to perform an unenforceable contract.

Only Congress can legislate the waiver of sovereign immunity necessary to undo the NAFI doctrine. Recently, the Contract Claims and Dispute Resolution Committee of the American Bar Association's Public Contract Law Section has developed a set of proposed legislative amendments that would close this Tucker Act "loophole."

First, the proposal seeks to ensure that sovereign immunity is waived in all government contracting. The proposal would clarify that contracts with any executive agency, including non-appropriated fund instrumentalities thereof, are contracts with the United States, regardless of whether the instrumentality has access to general appropriations. The proposal accomplishes this goal by amending the Tucker Act to remove any distinction between executive agencies supported by appropriated versus non-appropriated funds. As a result, the Tucker Act's waiver of sovereign immunity would apply to all express or implied contracts with the United States. The proposed legislation would

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Dave Hackett Named Campaign Chairman for U.S. Representative Curt Weldon

Dave Hackett, a member of Saul Ewing's White Collar and Government Enforcement Practice Group, was recently named Campaign Chairman for U.S. Representative Curt Weldon. Congressman Weldon represents areas of Delaware, Chester, and Montgomery Counties in Pennsylvania. He is currently serving his ninth term and is the most senior Republican of the Pennsylvania delegation. Additionally, Congressman Weldon currently serves as Vice Chairman of the U.S. House Armed Services Committee, Chairman of the Tactical Air and Land Forces Subcommittee, and is a member of the House Select Committee on Homeland Security.

While attending Duke University, Dave Hackett interned for Congressman Weldon during the summers of 1989 and 1990, receiving the Lyndon Baines Johnson scholarship in 1990. He went on to serve as a Legislative Assistant to Congressman Weldon in Washington, D.C. from 1991 to 1994 before leaving to attend law school. Dave has continued to actively support Curt Weldon's efforts since leaving his office. Speaking on the appointment of Dave Hackett to campaign chairman, Curt Weldon noted, "David's contacts in the local community and his legal expertise make him the ideal choice to head up my re-election campaign. Having worked with David in the past, I have no doubt that he'll do an excellent job coordinating events, communicating with the press and public, and serving as a public face for my re-election campaign." ■

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also amend the Contract Disputes Act of 1978, which outlines the procedure for resolving contract claims against the U.S. government, so that non-appropriated fund instrumentalities are expressly within the Act's ambit.

Next, the proposal addresses payments of judgments against NAFIs, including Congress' concern over the liability exposure incurred by the government by permitting recovery against NAFIs. The proposal would require judgments against NAFIs to be paid by the responsible NAFI directly to contractor, rather than from the U.S. Department of Treasury's judgment fund. The responsible NAFI would

The NAFI doctrine has left many unsuspecting contractors with steep legal bills and no legal recourse for even blatant breaches of contract by government customers that meet the NAFI definition.

be required to use funds other than appropriated funds to satisfy the judgment. In the event the NAFI could not promptly pay the judgment, the NAFI would be barred from executing any further contracts until (a) payment is made in full, or (b) Congress receives a letter from the head of the agency with cognizance over the NAFI explaining when payment will be made. These amendments are intended to ensure that any judgments against NAFIs are financed by the NAFI's revenue stream rather than the taxpayers at large.

Conclusion

Government contractors currently have no forum to resolve contract disputes with government entities that are non-appropriated funds instrumentalities. A committee of the American Bar Association's Public Contract Section is developing a proposal that would correct this injustice in a way that places financial responsibility on the NAFI that breaches its contract rather than Congress. If the NAFI is insolvent, the burden is on the cognizant agency head to explain why, and to find a solution. Thus the concern regarding the assumption of unknown and potentially vast liabilities that faced Congress in 1970 has been addressed.

This time around, there should be no excuse for Congress failing to act decisively and comprehensively to right a fundamental wrong that has developed in the law of federal government contracts. ■

[1] 28 U.S.C. § 1491 (2003).
[2] 28 U.S.C. § 2517 (2003).
[3] *Kyer v. United States*, 369 F.2d 714 , 718 (Cl. Ct. 1966).
[4] *See* 5 U.S.C. § 104; 31 U.S.C. § 9101(2); 31 U.S.C. § 9101(2).
[5] *Compare MDB Communications v. United States*, 53 Fed. Cl. 245 (2002) *with AINS,Inc. v. United States,* 56 Fed. Cl. 522 (2002).
[6] *AINS,Inc.*, 56 Fed. Cl. at 527.
[7] S.Rep. No. 268, 91st Cong., 1st Sess. 2 (Statement of Sen. Tydings in introducing the bill)(June 24, 1969).
[8] *Kyer,* 369 F.2d at 718.
[9] 28 U.S.C. § 1491(a)(1) (2003).
[10] Under the original version of S. 980, judgments against the United States would have been paid by the Comptroller General of the United States and the NAFI would be required to reimburse the Treasury only up to the amount that Comptroller determines could be paid "without unduly jeopardizing the operation of such activity." H.R. Rep. No. 933, 91st Cong, 2d Sess. (March 23, 1970).
[11] Letter from Thomas Nielson to Hon. James Eastland (May 20, 1968), *reprinted* in S.Rep. No. 91-268.
[12] 116 Cong. Rec. H2681 (April 7, 1970).
[13] As ultimately adopted, the legislation required the military/NASA exchanges to reimburse the United States for any judgments paid on their behalf. 28 U.S.C. § 1304(c).
[14] *AINS, Inc.*, 56 Fed., Cir. at 543.

Mr. Moffitt is a partner in Saul Ewing's Litigation Practice Group, and focuses his practice on complex government enforcement disputes, including civil and criminal investigations, qui tam cases, government contract and subcontract disputes, and regulatory enforcement actions.

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Court Expands Contractors' Ability to Recover Unabsorbed Overhead Costs for Government Delay

by Nytasha W. Tobias

Traditionally, contractors have been required to look to the formula set forth in Appeal of Eichleay Corp.[1] to calculate claims for unabsorbed overhead due to government delay. Under the *Eichleay* formula, the contractor computes its claim by calculating a daily overhead dollar amount based on actual contract performance and billings, and multiplying that amount by the number of days of the delay.[2] The Federal Circuit Court of Appeals, however, recently held that the *Eichleay* formula is not the only way to calculate claims for unabsorbed overhead due to government delay. In *Nicon, Inc. v. United States*,[3] the court decided that a contractor can recover unabsorbed overhead costs as part of a termination for convenience settlement, even where contract performance was never commenced. In such cases, even though *Eichleay* will be inapplicable, a contractor can now recover if it can offer a reasonable method of allocation based on the facts of the case.

On March 30, 1998, the Department of the Army awarded Nicon a $1.4 million contract to repair a dorm at MacDill AFB. When a disappointed bidder filed a bid protest the government instructed Nicon to take no further action on the contract, but to remain on "stand by." The bid protest was dismissed but the Army never issued a notice to proceed. Rather, after a number of inquiries from Nicon, the government terminated the contract for convenience on January 12, 1999.

Nicon submitted a termination settlement proposal to the government. Nicon sought costs for the time period between the award of the contract and termination. Nicon was awarded $184,757 in direct costs, related overhead and profit; however, the contracting officer denied Nicon's claim for $387,513.00 in unabsorbed home office overhead for the 288 days it waited for the Army to direct Nicon to proceed. Nicon's appeal to the Court of Federal Claims to recover the unabsorbed overhead damages was denied.

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The fundamental problem Nicon faced was that the *Eichleay* formula, as traditionally applied, requires the contractor to have begun performance under the contract before the delay period. Because Nicon never commenced performance, the *Eichleay* formula was not applicable. Faced with this difficulty, Nicon had argued that the court should apply a modified version of the formula, substituting constructive figures instead of actual contract billings and actual days of performance as required by *Eichleay.* The COFC refused Nicon's request to modify the *Eichleay* formula as a means to calculate its damages. Nicon appealed, arguing that the COFC applied the *Eichleay* formula in a "overly mechanistic fashion."[4]

The Federal Circuit agreed with the COFC that constructive figures should not be substituted into the formula. The court also agreed that the *Eichleay* formula is the only means to calculate unabsorbed home office overhead when (1) contract performance has begun, (2) the government subsequently suspends performance, and (3) the suspension causes the contract performance to take longer than originally anticipated.[5]

The court nevertheless determined that a contractor that is required to remain on standby because of a government caused delay, but is never allowed to begin performance, should be allowed to recoup its unabsorbed home office overhead as part of a termination for convenience settlement, so long as a reasonable basis for allocation exists, and the contractor can prove that it was unable to take on other work during the delay period.

"It would be inappropriate in the termination for convenience setting, where fairness to the contractor is the touchstone, to rigidly apply a formula developed in different factual circumstances, and thereby deny the contractor fair compensation for unabsorbed home office overhead."[6] The court suggested that, rather than invoke *Eichleay,* a contractor could claim unabsorbed overhead as part of the contractor's "initial cost and preparatory expense allocable thereto," which is listed as a recoverable item in the termination for convenience clause at FAR 52.249.2(g)(2)(i). The court also suggested that unreasonable delay in issuing a notice to proceed could provide the basis for an equitable adjustment under the suspension of work clause at FAR 52.242-14. Additionally, the court appeared to endorse *any* reasonable method for allocating a portion of the contractor's overhead costs to the contract in question, so long as it is a fair method.

Nicon confirms that contractors may assert claims for unabsorbed overhead resulting from government delay, prior to beginning contract performance. It also counsels contractors that a calculation of damages for delay using constructive figures pursuant to a modified *Eichleay* formula will not be entertained. Instead, a contractor seeking to recapture unabsorbed overhead is entitled to utilize any other reasonable means to allocate such costs to the government caused delay. ■

[1] 1960 WL 538, 60-2 B.C.A. (CCH) ¶2688 (A.S.B.C.A. July 29, 1960).
[2] *Appeal of Eichleay Corp.,* 1960 WL 538 at*4.
[3] 331 F.3d 878 (Fed. Cir. 2003).
[4] *Nicon,* 331 F.3d at 883.
[5] *Id.* at 884.
[6] *Id.* at 886-87.

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Fourth Circuit Finds False OCI Certification Material Under FCA Even Though Contracting Agency Did Not

by Karissa Bridges and David Moffitt

Imagine this scenario: Your company is a prime contractor with a government agency. After reviewing your proposal, the government approves a subcontractor you selected to perform a portion of the work. After award, a whistleblower alleges fraud in the subcontractor's OCI (Organizational Conflicts of Interest) certification and the agency investigates. The agency concludes nothing improper occurred, and decides to continue funding the subcontract. Your company can proceed with the prime contract, using the same subcontractor, confident the issue is resolved, right?

Wrong. Almost ten years later a jury in a qui tam case reached a different conclusion than the agency's investigators and found the OCI certification was false. As a result, the contractor was held liable under the federal False Claims Act (FCA) for submitting 25 invoices for payment, *including 19 invoices submitted after the whistleblower's allegations were investigated and deemed meritless*. Under the FCA, a \$5,000-\$10,000 penalty attaches to each invoice. The case, *United States ex rel. Harrison v. Westinghouse Savannah River Co,* 352 F.3d 908 (4th Cir. 2003), illustrates the continuing risk facing a contractor that elects to continue performance—and to continue to submit claims for payment—under a contract tainted by an allegedly improper certification.

Westinghouse was developing a radioactive waste storage facility for the Department of Energy (DOE) and wanted to subcontract out a recovery plan to accelerate an employee training program that was a component of its prime contract. Westinghouse solicited subcontract proposals and General Physics Corp. (GPC) was one of four prospective subcontractors who bid.

The problem was that GPC had previously provided employees, under contract, in support of the training program being implemented by Westinghouse. One of these GPC employees then assisted in preparing GPC's proposal for the training program subcontract. GPC submitted a certification to Westinghouse attesting that it had no OCI with the potential award of the subcontract. Westinghouse recommended that the DOE approve the GPC subcontract proposal by submitting a package that included GPC's no-OCI certification.

After a jury found the certification was false, Westinghouse argued that it was not material to DOE. After all, the government had decided to accept performance and fund the contract after it learned about and investigated the alleged OCI. The court disagreed, finding the no-OCI certification had to be material because it was an essential prerequisite to subcontract award. The court did not care what *actually* motivated DOE's decision, as motivations are irrelevant to an "objective" determination of materiality (i.e., whether a false statement has a "natural tendency to affect agency action").

This reasoning is troubling because an agency's actual decision to proceed with a procurement with knowledge of the alleged OCI would seem to be the best evidence of materiality (or lack thereof) in the circumstances. If the advantages of proceeding with performance outweigh the alternative of termination and rebidding to ensure "procurement integrity," the materiality element would seem to be absent. *Harrison* suggests that *qui tam* relators, juries, and appellate courts are free to reach the contrary conclusion.

On a practical level, the decision invites agencies to demand continuing performance on contracts while retaining the ability to bring an FCA action and seek severe civil monetary penalties long after the fact.

The harsh result in *Harrison* is a warning to contractors to carefully consider the risk posed by *qui tam* relators notwithstanding apparent agency acquiescence in alleged procurement irregularities. That risk should be addressed as early as possible while options such as novation may still be practical. Otherwise, the risk increases with each additional claim for payment submitted under the contract. ■

Ms. Bridges is an associate in Saul Ewing's Litigation Practice Group and a member of the firm's White Collar / Government Enforcement Group.

What is Government Enforcement Litigation?

Government Enforcement Litigation comprises all phases of government investigations, enforcement proceedings, and litigation; and typically involves companies that contract with the government or are heavily regulated. Saul Ewing's White Collar and Government Enforcement Practice Group has extensive experience in "white collar" criminal defense, civil fraud proceedings, regulatory enforcement matters, and government contract disputes. Our government enforcement attorneys assist clients in the defense, health care, financial services, pharmaceutical, insurance and other heavily regulated industries.

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