ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --	)	
	)	
Kellogg Brown & Root Services, Inc.	)	ASBCA No. 58081
	)	
Under Contract No. N62470-04-D-4017	)	

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OPINION BY ADMINISTRATIVE JUDGE D'ALESSANDRIS

This appeal arises under Contract No. N62470-04-D-4017, also known as the Emergency Construction Capabilities Contract Worldwide (CONCAP III or contract), between the Naval Facilities Engineering Command Atlantic (NAVFAC, Navy, or government) and Kellogg Brown & Root Services, Inc. (KBR or appellant). KBR appeals from a contracting officer's final decision disallowing $14,707,191 of subcontractor costs that it incurred under various task orders issued under the contract. We possess jurisdiction pursuant to the Contract Disputes Act, 41 U.S.C. §§ 7101-7109.

The government's claim consists of disallowed costs incurred under numerous master agreements, task orders, purchase orders, and subcontracts issued under the Contract. Accordingly, we consider each portion of the government's claim *seriatim* in the order presented in KBR's complaint. Only entitlement is before us.

FINDINGS OF FACT

I. The Emergency Construction Capabilities Contract Worldwide

1. On 26 July 2004, NAVFAC awarded Contract No. N62470-04-D-4017, the CONCAP III, to KBR. CONCAP III required KBR to provide the supervision, equipment, materials, labor, travel, and all means necessary to provide an immediate response for civilian construction contract capability in response to natural disasters or similar events. (R4, tab 1 at 1, 7) Although the contract work would predominately be construction, it also provided that the contractor may be required to provide operations and support functions, including providing galley services (*id.*).

2. CONCAP III was designed to respond to natural disasters, and other contingencies, by issuing task orders to modify the contract's broad scope of work (R4, tab 1 at 16-17; tr. 5/47-49).

3. In the event of a future natural disaster, NAVFAC would be able to issue a task order to KBR to rapidly provide labor, material, and equipment to provide emergency construction and engineering services (R4, tab 1 at 7). The task orders would be subject to modification to add funds and by technical direction to change the scope (R4, tab 1 at 16-17; tr. 5/48-49, 8/18-19).

4. Typical disaster-related tasks performed by KBR and its subcontractors included facility and infrastructure assessment, "dry-in" construction (repairing the building envelope to keep water out), "dry-out" (removing water damaged components and mold abatement), removal of storm debris, restoration of utilities, construction of temporary facilities, provision of temporary living facilities (housing, dining, laundry, and sanitary facilities) and general rebuild construction (tr. 6/25, 46-49).

5. CONCAP III provided that the contracting officer's representative could issue technical directions to approve contractor-proposed solutions, fill in the details, and define an emphasis for the tasks assigned within the scope of work defined by the task order (R4, tab 1 at 18).

6. The contingency environment in which CONCAP III task orders were issued, and the need for quick performance of work that often had a rapidly evolving and indefinite scope, required KBR to execute its tasks pursuant to extremely broad direction from the government, defined and modified on the fly through written technical directives and, more frequently, verbal directions and clarifications (R4, tab 1 at 7; tr. 5/47-49, 107-08, 117; supp. R4, tab 400). KBR's project manager, Mr. Scott Hayward testified that KBR would receive a telephone call instructing it to mobilize, followed by issuance of a broadly-worded task order that was later definitized through written technical directives and verbal instructions from the government (tr. 6/23-25, 31-33).

7. By way of example, the primary task order for Hurricane Katrina recovery efforts was issued the day that Katrina made landfall on the Gulf Coast, and was for $150,000 with no scope of work beyond the brief statement: "Initial Disaster Response for Hurricane...Katrina. Mobilization for initial responders." (R4, tab 57 at 298; tr. 8/12-13, 43) This task order was supplemented with 21 modifications, eventually totaling $84.96 million in work, 47 separate written technical directives, and many verbal directions and clarifications (R4, tabs 58-81; supp. R4, tab 512; tr. 6/57-58).

8. The CONCAP III contract language required "unbounded flexibility," with KBR working "very closely and in detail with Navy procurement, planning, and program officials" to develop goals and planned actions "through contractor and Navy iterative discussions" (R4, tab 1 at 7). These iterative discussions included daily meetings, daily reports, and

additional verbal discussions with the government contracting officers both on site and at NAVFAC headquarters (tr. 8/9-10, 28, 78; supp. R4, tab 683 at 6558). Due to the exigent circumstances, this verbal direction was not always memorialized in writing (tr. 8/75, 92-95, 5/118-19). Moreover, the precise nature of the work to be performed under the contract and the manner in which it was to be performed often fell to KBR's business judgment (tr. 8/37).

9. Because the nature of the work under CONCAP III was undefined, KBR was generally unable to issue firm-fixed-price subcontracts, negotiating instead fixed all-in labor rates for the majority of its subcontracts, an approach endorsed by NAVFAC (tr. 6/17-19, 66-67; supp. R4, tab 510 at 4123).

10. In awarding CONCAP III to KBR, the government evaluated KBR's ability to control and document its costs (tr. 5/54-55).

11. KBR had an approved purchasing system, meaning that KBR's subcontracting procedures were judged to have conformed to government procurement policies as provided under Part 44 of the Federal Acquisition Regulation (R4, tab 1 at 35 (FAR 52.244-2); tr. 5/50).

12. Because KBR had an approved purchasing system, it was not required to seek contracting officer approval before executing most types of subcontracts (R4, tab 1 at 35-37 (FAR 52.244-2); tr. 5/50-51).

13. CONCAP III was a Cost-Plus-Award-Fee, Indefinite-Delivery/Indefinite-Quantity (ID/IQ) contract, a type of cost reimbursement contract (R4, tab 1 at 7; tr. 5/47).

14. CONCAP III required the contractor to maintain records sufficient to reflect all the costs incurred in performance of the contract and the government had a right to audit those records (R4, tab 1 at 24 (FAR 52.215-2); tr. 2/16-18, 5/49).

15. CONCAP III required KBR to maintain payrolls during the course of the work and it was also responsible for the submission of copies of payrolls by all subcontractors (R4, tab 1 at 24 (FAR 52.222-8)).

16. Each payroll submitted was required to be accompanied by a "Statement of Compliance," signed by the subcontractor or its agent who paid or supervised the payment of the persons employed under the contract and also was to certify that the payroll was correct and complete, that each laborer had been paid, and that each laborer had been paid not less than the applicable wage rates and fringe benefits (R4, tab 1 at 24 (FAR 52.222-8)).

17. CONCAP III prohibited KBR from paying any subcontractor on a cost-plus-a-percentage-of-cost basis (R4, tab 1 at 37 (FAR 52.244-2(h)).

18. CONCAP III provided that the contractor shall give the contracting officer prompt notice of any claim made by any subcontractor that, in the opinion of the contractor, may result in litigation related in any way to the contract with respect to which the contractor may be entitled to reimbursement from the government (R4, tab 1 at 37 (FAR 52.244-2(i)).

19. On 8 September 2005, by executive order, President Bush suspended the Davis-Bacon Act for contracts in hurricane-damaged areas of Florida, Mississippi, and Louisiana. On 15 September 2005, task order 17 was modified to reflect the suspension of the Davis-Bacon Act. (R4, tab 96 at 463-64) On 27 October 2005, the task order was again modified to "clarify that Davis-Bacon Act wage determinations did apply to the entire performance period and will continue to apply to the entire performance period of this task order, notwithstanding the apparent suspension per Mod 3 (13 SEP 2005) and withdrawal of the suspension, Mod 10 (14 OCT 2005)" (R4, tab 103 at 487).

II. Relevant CONCAP III Task Orders

20. Hurricane Ivan hit Pensacola, Florida on 16 September 2004 (tr. 6/31).

21. NAVFAC issued Task Order 2 for the Hurricane Ivan response on 17 September 2004 (R4, tab 11).

22. Hurricane Katrina hit Louisiana and the Mississippi Gulf Coast on 29 August 2005 (tr. 6/19).

23. NAVFAC issued Task Order 16 for the Hurricane Katrina response on 29 August 2005 (R4, tab 57).

24. NAVFAC issued Task Order 17 on 30 August 2005 for the Hurricane Katrina response at Naval Air Station Pascagoula, Naval Air Station Gulfport, Stennis Space Center and other Navy installations in the Southeast Region (R4, tab 82).

25. Task Order 19 was issued on 8 September 2005 to work on temporary mortuary facilities in New Orleans in coordination with United States Army Corps of Engineers in response to Hurricane Katrina (R4, tab 104).

26. Task Order 20 was issued on 9 September 2005 for unwatering work in the New Orleans area (R4, tab 115).

27. Hurricane Rita hit the Texas/Louisiana border area about 25 September 2005 (tr. 6/44).

28. Task Order 21 was issued on 28 September 2005 for debris removal, roof repair and stabilization efforts at the Naval Reserve Center in Orange, Texas (R4, tab 124).

29. Hurricane Wilma hit South Florida on 24 October 2005 (tr. 6/6, 45).

30. Task Order 23 was issued on 26 October 2005 for hurricane recovery efforts in Key West, Florida (R4, tab 130).

31. The Navy generally gave KBR high ratings and award fees for its performance on the CONCAP III contract. The Navy rated KBR's work "Outstanding" for its performance evaluations for task orders 02 (Hurricane Ivan response), 16 (Hurricane Katrina response), and 20 (Hurricane Rita response), and "Above Average" for task orders 17 (Katrina response at Pascagoula, Gulfport, and Stennis) and 21 (Hurricane Rita response). (App. supp. R4, tabs 524, 530-32, 534, 536-37) However, KBR experienced much lower ratings and fee awards for task orders 19 (mortuary facility) and 23 (Hurricane Wilma response at Key West) (app. supp. R4, tabs 533, 538 at 5027-28, 5030; supp. R4, tab 462).

III. KBR's Contracting under CONCAP III

32. On 12 September 2005, after task orders 2, 16, 17, 19, and 20 were issued, KBR issued an internal memorandum establishing contracting procedures for its Hurricane Katrina relief efforts under CONCAP III (supp. R4, tab 477; tr. 7/11-12).

33. The KBR memorandum states that, "[a]ll external commitments will be reduced to writing and may only be executed by duly authorized Procurement personnel acting within their respective delegation of commitment authority" (supp. R4, tab 477 at 69496).

34. The KBR memorandum states that the solicitation must provide instructions on how the subcontractor's pricing data should be presented (supp. R4, tab 477 at 69499).

35. The memorandum required solicitations to include the KBR Subcontract General Conditions, as well as Contract Specific Special Conditions that apply to the contemplated award (supp. R4, tab 477 at 69499).

36. The KBR Subcontract General Conditions are incorporated into the subcontracts with Commercial Marketing International, Inc., Blackmon Mooring Steamatic Catastrophe, Inc.'s subcontract S0015, and Kustom Industrial Fabricators (supp. R4, tab 1507 at 10227-34, tab 1206 at 56580-87, tab 2210 at 62678-85).

37. The memorandum states that a written solicitation was required on a service subcontract regardless of the dollar value (R4, tab 477 at 69500).

IV. The Audit of the CONCAP III Contract

38. Shortly after KBR began responding to the 2005 hurricanes, DCAA commenced an audit of KBR's subcontracting costs under the CONCAP III contract. In May 2007,

DCAA issued its first audit report, questioning $1.5 million under KBR's subcontract with Commercial Marketing International (app. supp. R4, tab 640).

39. Two years later, in June 2009, NAVFAC Deputy Acquisition Director Kimberly Kahler issued a letter to KBR notifying it that, based upon the significant costs to be questioned by DCAA in its overall subcontract audit, NAVFAC was suspending payment of all invoices and award fees under the contract (supp. R4, tab 479). NAVFAC has not made any payments to KBR under the CONCAP III contract since June 2009 (tr. 5/79-82).

40. In July 2009, DCAA issued a second audit report, questioning $24.3 million in subcontractor costs in addition to those previously questioned for Commercial Marketing International (app. supp. R4, tab 544). Shortly thereafter, in September 2009, DCAA issued a series of Form 1 notices disapproving $26 million in subcontract costs under CONCAP III (app. supp. R4, tab 546).

41. In April 2010, NAVFAC met with KBR to discuss the disallowed costs (tr. 5/82). During the negotiations, KBR and NAVFAC agreed to categorize the costs as allowable, unallowable, allowable pending verification, and tabled for further negotiations (R4, tab 331; tr. 5/62-63). After the negotiations, KBR provided additional documentation, which was reviewed by DCAA before issuing a revised audit report in August 2010 (R4, tab 325).

42. In September 2010, DCAA issued revised versions of the Form 1 notices (app. supp. R4, tabs 548-55). After receiving these Form 1 notices, KBR sent a letter to NAVFAC requesting disposition of the questioned costs discussed at the April 2010 negotiation (app. supp. R4, tab 724). Four months later, in January 2011, Ms. Kahler issued a letter confirming the amounts deemed allowable, unallowable, and tabled for further negotiation, and requesting that KBR provide an additional analysis and documentation supporting the approximately $19 million in costs classified by NAVAC as "Tabled for Further Negotiation" (app. supp. R4, tab 726).

43. In April 2011, KBR provided NAVFAC with additional supporting data for the questioned costs related to Blackmon Mooring Steamatic Catastrophe Inc. (BMS-CAT), LJC Defense Contracting, Environmental Chemical Corporation, BE&K, and Commercial Marketing International (supp. R4, tabs 2700-2829).

44. NAVFAC did not provide this information to DCAA (tr. 4/50-51, 175-76, 5/87). Instead, these materials were reviewed by Kendra McMahon, a NAVFAC claims contract specialist who was principally responsible for drafting the final decision (tr. 4/120, 162, 175-76).

45. The draft final decision was presented to Patricia Kellihan, the Chief of Contracts for NAVFAC Atlantic. Ms. Kellihan testified that she signed the document without any substantive changes, and that she had not read the DCAA audit reports, KBR's responses, or the subcontracts; and had no knowledge of the day-to-day management of the contract or the details of any technical direction given under the contract; and conducted no

independent investigation of the facts or law underlying the final decision (tr. 4/161-62, 5/68, 110, 116, 122, 132-34). By letter dated 27 February 2012, the contracting officer issued a final decision disallowing $14,707,191 of the questioned costs. KBR timely appealed to the Board on 16 April 2012, which was docketed as ASBCA No. 58081.

A. BMS-CAT Master Agreement HUR004

46. On 9 July 2005, KBR requested proposals for infrastructure dry-out stabilization work at various naval facilities. The request for proposals stated that proposals must be in accordance with the terms and conditions of the request for proposals and that it must strictly adhere to the proposal instructions to be considered for award. (Supp. R4, tab 1231 at 55728, 55730; tr. 1/49)

47. The request for proposals stated that the awardee would be required to remove and discard all mold infected surfaces, cut-out mold contaminated materials, and treat any mold growth that did not require removal (supp. R4, tab 1231 at 55734).

48. The request for proposals stated that labor "shall" include all burdens, benefits, overhead and profit (supp. R4, tab 1231 at 55736).

49. BMS-CAT responded to the request for proposals on 18 July 2005 (supp. R4, tab 1232).

50. BMS-CAT bid a fully burdened labor rate of $39.86/hour (supp. R4, tab 1235 at 58450-51; app. supp. R4, tab 103 at 739; tr. 6/87-88).

51. KBR also received proposals from two other offerors (supp. R4, tabs 1235, 2712). Based on an evaluation of BMS-CAT's labor and equipment pricing, as well as its technical proposal, KBR determined that BMS-CAT was the best value, and awarded it Master Agreement HUR004 on 23 August 2005, six days before Hurricane Katrina made landfall in Louisiana (supp. R4, tab 1240; app. supp. R4, tab 598).

52. The Master Agreement provided that any services to be furnished under the agreement should be ordered by issuance of work releases that were to be priced "based on firm fixed unit rates" (supp. R4, tab 1236 at 58401).

53. The Master Agreement did not identify a particular location where the work would be performed (supp. R4, tab 1236 at 58401; tr. 1/51-52). However, KBR's request for proposals and BMS-CAT's bid were both based upon an earlier solicitation for anticipated, but un-awarded, work at the Pensacola Naval Air Station (R4, tabs 1232, 2738; tr. 1/142, 6/84).

54. KBR contracted with BMS-CAT on a time-and-material basis (supp. R4, tab 1234 at 58441, tab 1239 at 55627, tab 1245 at 55634, tab 1251 at 55649, tab 1276 at 55931; tr. 1/164-69).

55. The CONCAP III Master Agreement HUR004 between BMS-CAT and KBR indicated that pricing would be provided in the work releases (app. supp. R4, tab 598 at 5688).

56. On 31 August 2005, two days after Hurricane Katrina made landfall, KBR issued Work Release 1 under the Master Agreement, for infrastructure dry-out stabilization at naval facilities in Mississippi & Louisiana (supp. R4, tab 1241 at 58418-22).

57. Work Release 1 provided that for labor rates "[a]ll burdens and benefits, supervision, other overhead costs and profit shall be accounted for within the hourly rates provided," and for equipment the rates "will include mobilization costs, maintenance and repair costs, overhead and profit" (supp. R4, tab 1241 at 58422). The work release provided that these costs should be specified on an attached pricing sheet (*id*).

58. The pricing sheet referenced in Work Release 1 provided a box with the instruction "provide markup rate to be applied to actual costs per reciept [sic]" and BMS-CAT indicated that the "Equipment & Material Mark Up Rate %" was "10% + 10%" (supp. R4, tab 2738 at 70162).

59. In response to Hurricane Katrina, KBR issued subcontract Change Order 1 to Work Release 1 on 13 September 2005 to increase the scope of work and increase the contract value by $1,000,000 (supp. R4, tabs 1246, 1259). On 13 October 2005, subcontract Change Order 2 increased the contract value by $12,500,000 (supp. R4, tab 1253).

60. Subcontract Change Order 3 to Work Release 01 was signed on 10 November 2005, and increased funding of Work Release 1 by $12,000,000 and added the State of Florida to the Master Agreement work location (supp. R4, tab 1259). Subcontract Change Order 4 to Work Release 01 was signed on 29 December 2005 and increased the contract value by $13,000,000 to $39,500,000 (supp. R4, tab 1264). Subcontract Change Order 5 to Work Release 01 was signed on 24 February 2006 and increased the value of the contract by $24,500,000 to $64,000,000 and extended the period of performance from 31 December 2005 to 31 March 2006 (supp. R4, tab 1270).

61. Subcontract Change Orders 3, 4, and 5 each contained a release clause stating:

> In consideration of the increased work and cost modifications referred to herein the Subcontractor (BMS) hereby releases Kellogg Brown & Root Services and the U.S. Government from all liability performed under this Master Agreement and subsequent work release for further equitable adjustments

attributable to such facts or circumstances associated with the increased costs and change in performance period.

(Supp. R4, tab 1259 at 58431, tab 1264 at 58434, tab 1270 at 56337)

62. BMS-CAT's invoices added a 21% markup to its labor and equipment costs. (supp. R4, tab 1276 at 55931; tr. 1/59-61).

63. BMS-CAT's labor rate of $39.86 per hour is a blended rate for skilled and non-skilled labor that includes $8.72 per hour for profit and overhead (supp. R4, tab 2703 at 69680; tr. 1/54-55, 58-59, 6/90).

64. Mr. Scott Hayward, KBR's program manager for CONCAP III, concluded that the 21% markup on BMS-CAT's invoices was more than was provided in its contracts with KBR (compl. ¶¶ 66-68, 71; tr. 6/90-91).

65. KBR paid BMS-CAT the 21% markup on labor based on an oral modification of the contract in late November or early December 2005. KBR agreed to the amendment because Mr. Hayward concluded that the 21% markup was less than BMS-CAT could have obtained if it had chosen to seek a contract modification (tr. 6/90-91).

66. The destruction of infrastructure, damage to roads and bridges, shortages of gasoline and unavailability of labor following Katrina was dramatically different than in other hurricane response efforts, a point conceded by several government employees (app. supp. R4, tab 158; tr. 6/34-35, 88-90, 8/15-17, 104-05, 109).

67. The Navy added build-back services to the project, requiring BMS-CAT to employ skilled tradesmen at wage rates in excess of those contemplated by the request for proposals and original scope of work (tr. 6/89, 7/160-61); and implemented a new mold specification requiring BMS-CAT to employ specialists at rates higher than those included in the subcontract (tr. 6/89-90). As the Navy recognized in an award fee evaluation "KBR was constantly redirected due to changing guidance relative to application of the mold specification" (app. supp. R4, tab 696 at 6656).

68. Even with the additional markup for overhead and profit, BMS-CAT's hourly labor rate was still lower than that of the other offerors in the initial solicitation (tr. 6/92-95; supp. R4, tab 1308).

69. KBR paid BMS-CAT $6,710,322 in additional markups on its labor costs and an additional markup of $3,739,040 on its equipment costs (supp. R4, tab 1330, tab E-06d, Questioned Cost; tr. 1/63-65).

70. Mr. Hayward did not memorialize the oral modification to pay BMS-CAT an additional 21% markup in writing because he:

> [D]id not see the need for various reasons. We had the agreement and, you know, we're operating within the context of verbal agreement and verbal direction from the Government, and if we went through a formal, you know, submitting a Request for Proposal, and I thought that, you know, after the fact that sort of documentation might result in the contractor, BMS-CAT coming back and trying to take a larger bite.
>
> And so we come to what I was extremely confident was a reasonable settlement to the issue and saw no need to memorialize it, just like the Government is not seeking the need to memorialize many changes that they've directed in the prime contract.

(Tr. 6/91-92) Additionally Mr. Hayward testified that BMS-CAT did not overtly threaten to walk off the job site without the oral modification to permit the 21% markup on labor. Instead, Mr. Hayward testified that he could "tell from body language" that KBR might lose BMS-CAT as a subcontractor on the project if KBR did not agree to pay the markup on labor. (Tr. 7/35)

71. On 15 March 2006, Mr. Hayward emailed other KBR employees regarding a disagreement with BMS-CAT related to mold remediation. Mr. Hayward stated that "mold remediation is clearly in the scope of the original contract and [personal protective equipment] was clearly to be part of the all-in labor rate." (Supp. R4, tab 1291 at 55696)

72. In these communications, Mr. Hayward did not mention the oral modification that he had entered to compensate BMS-CAT for any changed conditions, such as the mold specification (supp. R4, tab 1291).

73. DCAA issued a report on 10 July 2009 questioning, among other things, $10,449,362 of the costs claimed by KBR related to BMS-CAT. That amount represents the 21% markup that BMS-CAT applied to its labor and equipment rates. That total is comprised of the $6,710,322 markup on labor and the $3,739,040 markup on equipment. (Supp. R4, tab 2903 at 19214)

74. DCAA issued a supplemental audit report on 19 August 2010. DCAA again questioned the $10,449,362 paid to BMS-CAT for the additional markup on labor and equipment under the master agreement. (R4, tab 325 at 1208)

75. On 27 February 2012, the contracting officer issued her final decision disallowing the costs that were paid to BMS-CAT for the 21% markup upon its labor and equipment rates (R4, tab 149 at 655).

76. The contracting officer found that KBR had failed in its responsibility to properly support its costs (R4, tab 149 (FAR 31.201-2(d))).

77. Additionally, the contracting officer found that the markup created a prohibited cost plus percentage of cost contract (R4, tab 149 (FAR 52.244-2(g))).

CONTENTIONS OF THE PARTIES

The Navy asserts that KBR improperly paid BMS-CAT $10,449,362, representing a 21% markup for overhead and profit on BMS-CAT's labor and equipment rates under the master agreement (gov't br. at 52-58). The Navy asserts that the markup creates an improper cost-plus-percentage-of-cost subcontract, that the oral agreement asserted by KBR violates the terms of the CONCAP III contract, the FAR, and KBR's own procurement policies, and that there is no evidence of an oral modification. The Navy additionally asserts that the costs were not reasonable. KBR asserts that the markup on equipment was provided for in the subcontract and that the subcontract was orally modified to permit the markup on labor costs (app. br. at 17-28).

Standard of Review

The contracting officer's final decision disallowed many of the claimed costs based upon a purported failure to comply with a contract, subcontract or FAR provision. However, at the hearing, and in post-trial briefing, the Navy asserted that each of the costs also should be disallowed on the basis of reasonableness pursuant to FAR 31.201-3. This change in emphasis is significant because it shifts the burden of proof to KBR.

"The government has the burden of proof in establishing that a cost is unallowable by operation of a specific contract provision or regulation." *Kellogg Brown & Root Services, Inc.*, ASBCA No. 56358 *et al.*, 14-1 BCA ¶ 35,639 at 174,521 (citing *Space Gateway Support, LLC*, ASBCA No. 56592, 12-1 BCA ¶ 34,941 at 171,792; *Lockheed Martin Western Development Laboratories*, ASBCA No. 51452, 02-1 BCA ¶ 31,803 at 157,102). However, the Navy is not limited in defending its case to the logic asserted in the contracting officer's final decision. Rather, the Board considers the action *de novo*. *See* 41 U.S.C. § 7104(b)(4) (action brought before the Board proceeds *de novo*); *Wilner v. United States*, 24 F.3d 1397, 1401-02 (Fed. Cir. 1994) (appeal to board or court from contracting officer's final decision is *de novo*).

With regard to the Navy's cost-reasonableness challenge to KBR's invoiced amounts, KBR bears the burden of proof. The FAR explicitly provides that when a review of the facts "results in a challenge of a specific cost by the contracting officer or the contracting officer's representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable." FAR 31.201-3(a). The Federal Circuit has interpreted this provision as providing the "reviewing officer or court considerable flexibility in assessing the reasonableness of costs." *Kellogg, Brown & Root Services, Inc. v. United States*, 728 F.3d

1348, 1359 (Fed. Cir. 2013). The Federal Circuit additionally noted that cost reasonableness "is a question of fact." *Id.* at 1360 (citing *Gen. Dynamics Corp. v. United States*, 410 F.2d 404, 409 (Ct. Cl. 1969)). The "standard for assessing reasonableness is flexible, allowing [the Board] to consider many fact-intensive and context-specific factors." *Id.* (citing FAR 31.201-3). Moreover, "the reasonableness of specific costs 'must be examined with particular care' when the costs incurred 'may not be subject to effective competitive constraints.'" (*Id.* at 1359 (quoting FAR 31.201-3(a)).

DECISION

We first turn to the Navy's assertion that KBR's claimed subcontract costs are a violation of the prohibition against cost-plus-a-percentage-of-cost contracts contained in FAR 52.244-2. A contract is a cost-plus-a-percentage-of-cost contract when (1) payment is on a predetermined percentage rate; (2) the predetermined rate is applied to actual performance costs; (3) the contractor's entitlement is uncertain at the time of contracting; and (4) the contractor's entitlement increases directly with an increase in performance costs. *Urban Data Systems, Inc. v. United States*, 699 F.2d 1147, 1150 (Fed. Cir. 1983). Obviously, the BMS-CAT subcontract satisfies provisions one and four of the *Urban Data* test because the markup is a percentage added to the invoiced amounts of labor and materials (finding 62). Less clear is whether the predetermined rate is being applied to actual performance costs and whether the contractor's entitlement was uncertain at the time of contracting.

Here, KBR was performing a cost-plus-award-fee contract (finding 13). The master agreement with BMS-CAT was a time and materials contract (finding 54). Thus, the situation is similar to that in *Michael Weller, Inc. v. Office of Navajo and Hopi Indian Relocation*, GSBCA Nos. 10627-NHI, 11411-NHI, 94-2 BCA ¶ 26,849 at 133,612, where that board determined that there was not a cost-plus-a-percentage-of-cost contract where the appellant invoiced the government for subcontractor overhead and profit passed on to it by a subcontractor in a time and materials contract. Thus the contractual arrangement in *Michael Weller* differs from that in *Urban Data*, which provided for profit as a fixed percentage of cost. We interpret the holding in *Michael Weller* as finding that reimbursement of subcontractor costs on a time and materials subcontract does not satisfy the second prong of the *Urban Data* test, that a predetermined rate is applied to actual performance costs, because the fixed-rate, time-and-materials subcontract was not a cost-type contract.

KBR asserts that the BMS-CAT master agreement was not a cost-plus-a-percentage-of-cost contract because the overhead and profit percentages were not applied to actual costs but were adjustments to a fixed hourly rate. KBR's argument is essentially the same as the holding in *Tero Tek International, Inc.*, B-228548 (Comp. Gen. Feb. 10, 1988) 88-1 CPD ¶ 132, holding that a similar provision that applied profit as a percentage of travel reimbursement was not a cost-plus-a-percentage-of cost contract. In *Tero Tek*, the General Accounting Office (GAO) held that that the contract was not a cost-plus-a-percentage-of-cost contract

because it did not satisfy provision three of the *Urban Data* test, that entitlement was uncertain at the time of contracting.

Regardless of whether it is provision two or provision three of the *Urban Data* test that is not satisfied, the logic is the same. Taken together, *Michael Weller* and *Tero Tek* hold that a contract is not a cost-plus-percentage-of-cost contract where the profit percentage is being applied to a cost that does not vary with the performance of the contract. In *Michael Weller* it was a time and materials subcontract, while in *Tero Tek*, the GAO noted that the travel was billed at rates established with government approval. The BMS-CAT subcontract involved the reimbursement of subcontractor costs that increased with an increase in the level of performance – that is an increase in the number of labor hours – but where the hourly rate was fixed. Thus, we hold that the BMS-CAT subcontract was not an improper cost-plus-a-percentage-of-cost contract. Moreover, as KBR notes, if the 21% overhead and profit were simply included in a higher hourly labor rate, there would be no argument that it was a cost-plus-a-percentage-of-cost contract.

Having determined that BMS-CAT's claimed markup would not constitute an illegal cost-plus-percentage-of-cost contract, we turn to the question of whether the BMS-CAT master agreement provided for a 21% markup on labor and equipment. The Navy contends that the subcontract required that labor, material, and equipment prices include all overhead and markup costs. KBR contends that the master agreement provided for markup on equipment and materials and that the master agreement was modified to provide for markup on labor costs.

We first turn to the terms of the master agreement. The CONCAP III Master Agreement HUR004 between BMS-CAT and KBR indicated that pricing will be provided in the work releases (finding 55). The work release (WR01) provided that for labor rates "[a]ll burdens and benefits, supervision, other overhead costs and profit shall be accounted for within the hourly rates provided," and for equipment the rates "will include mobilization costs, maintenance and repair costs, overhead and profit" (finding 57). The work release provided that these costs should be specified on an attached pricing sheet, in which BMS-CAT indicated markups on equipment and material (*id.*). Specifically, the pricing sheet provided a box with the instruction "provide mark up rate to be applied to actual costs per [receipt]" and BMS-CAT indicated that the "Equipment & Material Mark Up Rate %" was "10% + 10%" (finding 58). The Navy relies instead upon language contained in KBR's request for proposals, stating that equipment and labor were to be quoted at fully-burdened rates (finding 48). However, the Navy did not provide any argument that the terms of the request for proposals were incorporated into the master agreement, and we see no such provision. As the terms of the master agreement provide for a markup on equipment, but not for labor, we find that KBR is entitled to prevail on the equipment markup claim under master agreement HUR004.

We next turn to KBR's assertion that master agreement HUR004 was orally modified to permit markup on labor costs. There is no dispute that BMS-CAT bid a

fully-burdened labor rate of $39.86 per hour (finding 50), and that the labor rate was a blended-rate for skilled and non-skilled labor (finding 63). In fact, Mr. Hayward concluded that the 21% markup was more than was provided for under the subcontract (finding 64). According to the Navy, the alleged oral modification was contrary to the CONCAP III master contract, the FAR, and KBR's own policies. Additionally, the Navy asserts that there is no evidence of an oral modification of the master agreement. As discussed in more detail below, KBR asserts that BMS-CAT experienced changed conditions in performing the Hurricane Katrina response work entitling BMS-CAT to additional compensation. KBR asserts that it acted to protect the Navy by orally agreeing to allow a 21% markup on labor rather than risking that BMS-CAT would walk-off the job, putting performance at risk, or seek an equitable adjustment that, in KBR's opinion, would be greater than the 21% markup agreed to in the oral modification.

At the hearing Mr. Hayward testified that he orally agreed with BMS-CAT to modify the master agreement to include the 21% markup (finding 65). Neither party presented testimony from BMS-CAT to confirm or refute Mr. Hayward's testimony. As Mr. Hayward testified, the oral agreement was never reduced to writing, so there are no contemporaneous documents in the record to support the existence of the oral agreement (finding 70).

We first turn to the Navy's argument that the master agreement was not orally modified because such a modification would be in violation of the CONCAP III contract, the FAR, and KBR's own policies (gov't br. at 55-57). The Navy argues that an oral modification would violate the CONCAP III contract and the FAR because it would create a cost-plus-percentage of cost contract. As discussed above, we hold that the payment of overhead and profit as a percentage of cost for a time-and-materials subcontract does not create an impermissible cost-plus-percentage-of-cost contract. The Navy next asserts that the oral modification would violate KBR's own internal contracting procedures which require that "[a]ll external commitments will be reduced to writing and may only be executed by duly authorized Procurement personnel acting within their respective delegation of commitment authority" (finding 33). However, this argument fails because the KBR contracting procedures for Hurricane Katrina relief efforts were not incorporated into master agreement HUR004 applicable to this portion of the dispute (finding 36). In fact, master agreement HUR004 was awarded nearly a week *before* Hurricane Katrina made landfall (finding 51). Thus, the Navy has not presented any evidence that the oral contract violated the terms of the master contract or KBR's policies.

The Navy additionally argues that "KBR has failed to offer sufficient evidence to prove that there was such an [oral] agreement" (gov't br. at 57). However, the Navy's argument ignores the direct testimony of Mr. Hayward. Instead the Navy cites the fact that KBR did not provide notice to the Navy of a claim related to the contract which might result in litigation (finding 18 (FAR 52.244-2(i)), and the fact that the release language in subsequent change orders would have expressly applied to a claim for an equitable adjustment. The Navy's argument is unpersuasive because it simply assumes that which it seeks to prove.

Based upon Mr. Hayward's uncontradicted testimony, KBR and BMS-CAT orally modified the master agreement when the first invoices were submitted (finding 65). In appropriate circumstances, the oral modification of a government contract is legally binding. *See, e.g., Raytheon Service Company*, ASBCA No. 21358, 81-2 BCA ¶ 15,453 at 76,563. Because the master agreement was modified to permit the payment of the mark-up on labor, there would be no threat of pending litigation for which KBR would need to notify the contracting officer (finding 18). Two of the three waiver clauses cited by the Navy were signed after the date of the oral agreement, and thus would not prohibit payment of the markup on labor (findings 60-61, 65). The remaining waiver clause was contained in a modification that was executed before the oral agreement and could potentially limit KBR's ability to recover for markup incurred before the date of the oral modification; however, the waiver by its terms, applies only to "further equitable adjustments attributable to such facts or circumstances associated with the increased costs and change in performance period" of the subcontract Change Order (finding 61). However, subcontract Change Order 3 simply added funds to the work release and added Florida as a work location for the master agreement (finding 60) and is not related to the payment of markup on labor. Thus, there is no basis for finding that the oral agreement was prohibited by these waivers.

The Navy's argument that KBR's action in disputing BMS-CAT's request for an adjustment for additional costs for personal protective gear shows that there was not an oral agreement to modify the master agreement for a markup on labor costs also fails (gov't post-hearing br. at 58). The fact that KBR rejected one proposed adjustment (the adjustment for personal protective gear (findings 71-72)) by informing BMS-CAT that it was required to submit a formal claim, but did not do so with regard to a different proposed adjustment (allowing markup on labor hours) is not sufficient evidence to refute the direct testimony of Mr. Hayward regarding the oral agreement.

Based upon the evidence of record, and recognizing that the burden of proof was on the Navy, the Board finds that KBR has demonstrated that the master agreement HUR004 was orally modified to permit the markup of 21%. The continued submission by BMS-CAT of invoices with the 21% markup, and the continued payment of those invoices by KBR is contemporaneous evidence of the oral modification to permit the markup on labor. (Findings 69, 73-74)

Pursuant to the record before us, and based on the fact that KBR had an approved purchasing system pursuant to FAR section 44[1] that did not require concurrence of a contracting officer (finding 11), we conclude that the subcontract was orally modified to permit the payment of a 21% markup on labor.

Next we turn to the question of whether KBR's costs in paying the markup on labor and material costs were reasonable, and whether KBR established entitlement to an

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[1] The Navy does not allege that the oral modification was an action that would require the contracting officer's consent pursuant to FAR 44.201-1(a) and we do not see such a requirement in our review of CONCAP III (R4, tab 1).

adjustment for BMS-CAT. As noted above, KBR has the burden of establishing that its costs were reasonable. KBR received three quotes for disaster relief work and determined that BMS-CAT presented the best value based on an evaluation of BMS-CAT's labor and equipment pricing, as well as its technical proposal (finding 51). Thus, we find that the equipment prices are reasonable. With regard to labor prices, the Navy asserts without any analysis that an equitable adjustment would have been less costly to the government than paying the 21% markup on labor. However, KBR asserts that the markup was justified based on the cost of performing in higher Davis-Bacon Act wage rate areas, the increased use of higher-priced labor due to increased build-out work, and the implementation of new mold remediation standards.

We hold that the price was reasonable. As noted above, the "standard for assessing reasonableness is flexible, allowing [the Board] to consider many fact-intensive and context-specific factors." *Kellogg, Brown & Root Services*, 728 F.3d at 1360. Here we agree with KBR that the destruction of infrastructure and unavailability of labor following Katrina was dramatically different from other hurricane response efforts (finding 66). Additionally, KBR presented testimony that the Navy added build-back services to the project, requiring BMS-CAT to employ skilled tradesmen at wage rates in excess of those contemplated by the request for proposals and original scope of work (finding 67); and implemented a new mold specification requiring BMS-CAT to employ costly specialists at rates higher than those included in the subcontract (*id.* ("KBR was constantly redirected due to changing guidance relative to application of the mold specification.")).

Moreover, even with the additional markup for overhead and profit, BMS-CAT's hourly labor rate was lower than that of other offerors in the initial solicitation (finding 68). We do not find persuasive KBR's argument that an equitable adjustment was warranted because BMS-CAT's proposal was based on labor rates in Escambia County, Florida, but that BMS-CAT was required to work in new locations, with higher Davis-Bacon Act wage rates and higher lodging and personnel support costs because the solicitation did not provide a location where the work was to be performed (finding 53). However, KBR's testimony that the labor market disruptions were greater after Katrina than after other hurricanes is credible (finding 66). Accordingly we find that the labor prices in the BMS-CAT master agreement HUR004 were reasonable.

B. Environmental Chemical Corporation Master Agreement

78. KBR issued a request for proposals on 9 July 2005 for infrastructure dry-out stabilization at various naval facilities stating that:

> [L]abor rates shall be based on staffing the work 12 hours per day, seven days per week. Rates shall be weighted to include any overtime. The rates are for personnel actually performing the work and do not include travel time to the jobsite. All

> burdens and benefits, supervision, other overhead costs and profit shall be accounted for within the hourly rates provided.

(Supp. R4, tab 1600 at 52414) It also stated that "[e]quipment rates shall be based on operating 12 hours per day and will include mobilization costs, maintenance and repair costs, overhead and profit" (*id.*).

79. Environmental Chemical Corporation (ECC) submitted a bid in response to KBR's request for proposals on 17 September 2005. ECC bid a rate of $68/hour and stated that the unit rate included "Laborer Rate, Fringe, Indirect markups; G&A; Profit; Perdiem No Lodging – Assumed to the [sic] Warehouse at the Base; Small Tools; PPE [personal protective equipment]– Level C-3 change outs/day; Vehicles – Vans/pickup trucks; Equipment – HepaVacs, NAMs [negative air machines][2], Air Movers, Management – Based on a labor force of 100 people or greater, and QA/QC" (supp. R4, tab 1601 at 52452).

80. In addition to the bid from ECC, KBR also received proposals from two other companies. ECC was the only bidder to submit a timely proposal, and was onsite and ready to begin work. (App. supp. R4, tab 231; supp. R4, tab 1823; tr. 6/132)

81. ECC's rates compared favorably to subcontractor rates already under contract and the rates from other bidders, when adjusted for the additional overhead items disclosed in those bids, were higher than ECC's rate or close to the ECC rate with other overhead items still not accounted for (tr. 4/84-87, 6/132-37; supp. R4, tab 1823).

82. On 16 September 2005, KBR awarded Master Agreement HUR015 to ECC (supp. R4, tab 1605).

83. KBR issued Work Release 01 under Master Agreement HUR015 on 17 September 2005 for rebuild construction services and mold remediation at buildings located at Construction Battalion Center Gulfport, Naval Station Pascagoula, and the John Stennis Space Center (app. supp. R4, tab 231).

84. On 25 September 2005, ECC sent a letter to KBR with new labor and equipment rates, as well as a request for a meal per diem of $17 for ECC personnel. KBR initially informed ECC that three meals a day would be provided on site at a charge of $26 per day per man. However, once ECC arrived on site, it was informed that BMS-CAT[3] was ending the meal plan and could not accept ECC personnel. As a result, ECC had to compensate its workers with a per diem and requested the difference between the continental United States

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[2] Witnesses at the hearing were unable to define the term, but from context it appears to be negative air machines (tr. 4/91, 6/132).

[3] Although this document indicates that BMS-CAT was providing the meals at Gulfport, other documents in the record indicate that Commercial Marketing International was responsible for the dining facility at Gulfport (*see* finding 204).

(CONUS) per diem rate of $43 per day and the $26 per day rate that it had accounted for in its bid. (Supp. R4, tab 1749)

85. ECC incurred lodging costs once they were denied use of the public works warehouse (app. supp. R4, tab 709 at 6713;[4] tr. 6/144-45). Despite these lodging costs, ECC billed, and the Navy, through KBR, compensated ECC at the fixed-hourly rate of $68 per hour (tr. 6/145).

86. ECC submitted Invoice No. 9 on 20 November 2005 for $299,142.13. KBR rejected $2,627.46 of this amount. The full amount of the markup on equipment ($1,808.46) was rejected by KBR because the equipment mark-up was already covered in unit rates. (Supp. R4, tab 1696 at 26118, 26123)

87. DCAA issued its initial Audit Report on 10 July 2009 and questioned $4,956,340 of the costs paid to ECC under Master Agreement HUR015 Work Release 01. DCAA questioned:

- $4,855,344 for labor costs paid using excessive labor rates (awarded to highest of three bidders without justification; also did not solicit bids from qualified competitors with lower rates) based on FAR 31.201-3, Determining reasonableness,
- $61,656 for unauthorized security guard costs based on FAR 31.201-2, Determining allowability, and
- $39,340 for 18 percent mark-up (or profit) already included in the equipment rates based on FAR 31.201-2, Determining allowability.

(Supp. R4, tab 2903 at 19218-19) The questioned costs were related to Task Orders 17 and 23 (*id.* at 19219).

88. DCAA continued to question $4,956,340 of the costs paid to ECC under Master Agreement HUR015 Work Release 01 in its supplemental report, issued on 19 August 2010 (R4, tab 325 at 1213).

89. On 14 April 2011, over a year-a-half after the initial DCAA audit report, ECC submitted a labor rate build-up to NAVFAC to justify the labor rates. The rate build-up

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[4] We note that app. supp. R4, tab 709 indicates that ECC received a $17 per day adjustment for lodging while supp. R4, tab 1749, indicates that ECC's request for $17 per day was an adjustment for meals and not lodging. The $17 per day was based on the difference between the CONUS meal per diem of $43 per day and the previously quoted $26 per day charge by KBR for dining at the BMS-CAT dining facility.

included $0.15 per hour for ECC management airfare and $1.45 per hour for lodging. (Supp. R4, tab 504; tr. 4/30-31)

90. In the final decision, the contracting officer allowed the costs paid to ECC for the security guards, but disapproved $155,028.80 for labor rates, as well as $7,336.99 related to the markup on equipment rentals. The contracting officer determined that ECC's labor rates were reasonable compared to its competitors but questioned $1.60 per hour ($0.15 + $1.45) of ECC's labor rate for management air fare costs and lodging. (R4, tab 149 at 656-57)

91. In negotiations, KBR agreed that the markup on equipment rental was incorrectly applied, and planned to issue a credit. KBR has compensated the government for $32,004.01 of the original $39,340.00 in questioned costs, but $7,336.99 remains at issue because NAVFAC has not processed KBR's invoices. (R4, tab 149 at 657; tr. 4/29-30)

92. At the hearing, DCAA auditor, Garrett Wilson, reviewed the contracting officer's final decision and the DCAA workpapers from the audit and disagreed with the number of labor hours used in the contracting officer's final decision to calculate the disallowed costs. Based on the DCAA workpapers, there were 155,287 hours invoiced related to Mold Laborers. Using 155,287 hours instead of the 96,893 hours questioned in the DCAA audit report and in the final decision would result in approximately $248,460 being disallowed. The total amount of hours invoiced by ECC is approximately 400,000 hours which would result in $640,000 in questioned costs attributable to unallowable labor costs of $1.60 per hour. (Supp. R4, tabs 1820, E10j-1c-1 through E10j-1c-10; tr. 4/31-34)

DECISION

As set forth in the findings of fact above, the only remaining issues are the allowability of $1.60 per hour of labor charges for management airfare and lodging, and $7,339.99 in markup on equipment rentals. Although the DCAA audit reports questioned other costs, the final decision did not support DCAA's findings and questioned only the costs listed above (finding 90). As part of the discussions between the Navy and KBR, KBR submitted to the contracting officer a build-up of ECC's $68 per hour fixed rate for mold remediation workers (findings 41, 89). As part of this rate build-up, ECC indicated that $0.15 per hour was for ECC management airfare, and $1.45 per hour was for lodging (finding 89).

The Navy asserts that management airfare is unallowable pursuant to FAR 31.205-46 (Travel Costs), and that the lodging costs are unallowable because the bid indicated that the $68 rate was fully burdened and included lodging costs (finding 79). However, as KBR correctly notes, FAR 31.205 pertains to the allowability of selected costs for cost-type contracts. FAR 31.204(b)(1) provides that costs in that FAR part are allowable for cost-reimbursement, fixed-price incentive, and price redeterminable contracts. As ECC had

a fixed-price, time-and-materials contract, these cost allowability provisions are inapplicable and we find for KBR with regard to the $0.15 per hour management airfare issue.

Our analysis is similar for the $1.45 lodging cost issue. When ECC submitted its bid, it proposed a fully-burdened labor rate of $68 per hour and noted that the rate included "Laborer Rate, Fringe, Indirect markups; G&A; Profit; Perdiem No Lodging – Assumed to the [sic] Warehouse at the Base; Small Tools; PPE – Level C-3 change outs/day; Vehicles – Vans/pickup trucks; Equipment – HepaVacs, NAMs, Air Movers, Management – Based on a labor force of 100 people or greater, and QA/QC" (finding 79). The Navy questions the inclusion of $1.45 per hour for lodging in the rate build-up submitted after performance (finding 89) because ECC's bid indicated that the fixed hourly rate would not contain a charge for lodging (gov't post-hearing br. at 71-72). The Navy's argument fails for two reasons. First, ECC actually incurred lodging costs once they were denied use of the public works warehouse (finding 85). Thus, the fact that an after-the-fact build-up to explain a fixed labor rate includes lodging costs does not demonstrate that ECC charged prohibited costs. Second, ECC submitted a fixed-price fully burdened bid, and the final decision does not question the fixed hourly rate. How ECC internally apportions that hourly rate is irrelevant to the Navy, as the Navy is reimbursing at a fixed hourly rate of $68 per hour. (Finding 89 (the $1.45 for lodging had nothing to do with ECC's actual billing)) Had ECC sought an equitable adjustment, seeking an increase in the fixed hourly rate due to higher lodging costs, then the statement in its bid regarding lodging costs would be relevant to our analysis, but because ECC honored its $68 per hour fixed rate (with the exception of the adjustment to the meals per diem (finding 84)) we find in favor of KBR with regard to the lodging charge for ECC. [5]

Additionally, the Navy challenges $1.60 per hour of ECC's labor rate on a cost reasonableness basis pursuant to FAR 31.201-3 (gov't reply br. at 2). ("All of KBR's costs at issue in this appeal have been challenged on the basis of reasonableness."). However, the Navy cites little if any evidence demonstrating that ECC's prices were not reasonable, beyond the conclusory statement that KBR did not document "the reasonableness of paying ECC based on labor rates including improper mark-ups of $1.45 for lodging and $0.15 for management airfare" (gov't br. at 72). KBR, on the other hand, presented direct evidence that ECC's bid of $68 per hour was the best value because the other two offerors did not submit fully burdened labor rates as requested by KBR, and also because the rates, when adjusted for the additional overhead items

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[5] At the hearing, the government presented testimony that the contracting officer's final decision contained an error, and that the disallowed travel and lodging charges should have been applied to 155,287 labor hours for mold remediation, rather than 96,893 hours (finding 92). In post-hearing briefing, the Navy asserted that the disallowed costs should have been questioned as to all of the roughly 400,000 labor hours billed by ECC (gov't reply br. at 28-29). Since we have determined that the Navy failed to carry its burden in questioning the $1.60 per hour in airfare and lodging costs, we need not determine the applicable number of labor hours.

disclosed in the bids by the other offerors, were higher than ECC's rate or close to the ECC rate with other overhead items still not accounted for. (Findings 80-81) Accordingly we find that ECC's costs were reasonable.

Finally, KBR acknowledges that it owes a credit of $7,336.99 to the Navy for disapproved costs on equipment rental (finding 91). The amount is not in dispute; however, the Navy has not processed KBR's invoices such that the credit can be accounted for (finding 39).

C. BE&K, Inc., Master Agreement

93. On 6 September 2005, KBR issued a request for proposals soliciting bids for disaster recovery efforts at U.S. Navy and Marine Corps facilities in Louisiana. The Statement of Work states that "materials shall be reimbursed in the amount of the actual cost to the subcontractor plus a proposed markup rate only" and "equipment shall be reimbursed at rental cost plus markup." (Supp. R4, tab 800 at 66195)

94. BE&K, Inc. (BE&K) responded to KBR's request for proposals on 7 September 2005 (supp. R4, tabs 802-09). BE&K bid a daily rate of $388.60 (or $32.38 per hour based on a 12 hour day) for a laborer and $544.29 (or $45.36 per hour based on a 12 hour day) for a carpenter (app. supp. R4, tab 2 at 52-53, 57). The subcontract did not contain predetermined labor rates for unanticipated labor not included in the pricing sheet but incidental to the scope of work (app. supp. R4, tab 2 at 52-53).

95. KBR determined that BE&K was the only offeror with the ability to provide the required labor for the anticipated project, and that the other offerors' prices were approximately 50% higher than BE&K's prices (app. supp. R4, tab 566; tr. 6/96-97).

96. On 8 September 2005, KBR awarded Master Agreement HUR012 to BE&K (supp. R4, tab 811).

97. KBR issued Work Release 01 under Master Agreement HUR012 to BE&K on 8 September 2005. The work release was to conduct disaster recovery efforts at U.S. Navy and Marine Corps facilities in Louisiana, Mississippi, and Alabama. BE&K bid a markup rate of 15% for materials. The Statement of Work indicates that "materials shall be reimbursed in the amount of the actual cost to the subcontractor plus a proposed markup rate only" and "equipment shall be reimbursed at rental cost plus markup." (App. supp. R4, tab 2 at 46-53)

98. Shortly after award, KBR determined that the base public work maintenance and repair work originally solicited was no longer needed, and shifted BE&K's workforce to construction of the tent camp at Joint Reserve Base New Orleans (tr. 6/95-96). The originally anticipated work would have been performed pursuant to the Service Contract Act; however, the construction of the tent camp was subject to the Davis-Bacon Act (tr. 6/99-100).

99. On 1 December 2005, Scott Hayward emailed Bill Rigby of BE&K about concerns he had with BE&K's submitted invoices. Mr. Hayward questioned the Other Direct Costs that BE&K invoiced for, and said that "[d]emobilization subcontractor invoices plus markup, including expenses, [other direct costs], will not be reimbursed as they are not reimbursable per the terms of the subcontract." (Supp. R4, tab 932; tr. 3/197-98) However, at the hearing Mr. Hayward explained that the letter pertained to BE&K's claim for other direct costs for items that were included in fixed rates in the subcontract and not other direct costs for which there was no provision in the contract (tr. 6/127).

100. KBR and BE&K negotiated new inclusive labor rates on 8 March 2006. The changes included a reduction in the daily per diem rate for meals and laundry provided by KBR, an increase in the daily per diem rate applied to billable man-days to address the cost impact of workers who did not work a full 12-hour day, and all changes associated with the implementation of Davis-Bacon Act rates, among other things. (Supp. R4, tabs 950, 952)

101. The revised rates were incorporated into the contract by Change Order 5 to Work Release 01 under Master Agreement HUR012, signed on 5 July 2006 (supp. R4, tab 852).

102. DCAA questioned $983,793 of costs paid to BE&K under Master Agreement HUR012 Work Release 01 in its initial audit report issued 10 July 2009. The questioned costs were related to Task Orders 16 and 23. DCAA questioned:

- $446,371 of math errors in [KBR's] reconciliation of subcontract invoices to the terms of the subcontract,
- $436,464 for daily living expenses already included in labor rates incurred for [Task Order] No. 16,
- $65,127 of unsupported labor cost for [Task Order] 23,
- $25,494 for subcontractor and equipment rental mark-up (or profit) incurred for [Task Order] 16, and
- $10,337 for other direct costs plus mark-up (or profit) incurred for [Task Order] 16.

(Supp. R4, tab 2903 at 19228)

103. On 19 August 2010, DCAA issued its supplemental audit report, and continued to question $496,723 in costs paid to BE&K. DCAA "originally questioned $446,371 for daily living expenses already included in labor rates incurred for [Task Order] 16. Based on additional documentation provided by [KBR] on April 22, 2010, [DCAA] reduced [its] questioned costs to $395,795." DCAA also approved $436,464 of daily living expenses it had previously questioned after KBR provided reconciliations during negotiations on 22 April 2010. DCAA continued to question "$65,127 of unsupported labor cost for [Task Order] 23, $25,494 for subcontractor and equipment rental mark-up (or profit) incurred for

[Task Order] 16, and $10,337 for other direct costs plus mark-up (or profit) incurred for [Task Order] 16." (R4, tab 325 at 1223)

104. DCAA approved some of the costs it had originally questioned in its first audit report after receiving documents from KBR during negotiations (tr. 3/191, 195-96).

105. DCAA questioned $4,827 for a 15% markup that BE&K applied to its own equipment (R4, tab 325 at 1225).

106. DCAA also questioned $20,667 relating to a markup applied to costs billed by BE&K for a second tier subcontractor, Schoel Godwin Barnett Landscape Architects (R4, tab 325 at 1225-26).

107. DCAA questioned approximately $395,000 in costs relating to math and reconciliation errors as a result of labor adjustments. BE&K originally proposed rates based on Service Contract Act wages, but after the Davis-Bacon Act wages were reinstated, BE&K had to re-propose its rates. BE&K had originally proposed "daily living expenses," and included these when the labor rates were renegotiated to include Davis-Bacon wages. (Supp. R4, tab 1034; tr. 3/203-05)

108. DCAA questioned $65,127 for unsupported labor costs. These costs related to work performed by a second-tier subcontractor, Riverside Electricians, at a cost of $56,632. BE&K added a 15% markup of $8,495 to these costs. KBR provided DCAA with two invoices from Riverside Electricians, however, DCAA continued to question the costs. (R4, tab 325 at 1227; tr. 4/25-27)

109. In the contracting officer's final decision, issued on 27 February 2012, the contracting officer asserted that: "DCAA reviewed a spreadsheet developed by KBR for the negotiations. DCAA questioned $395,765 for mathematical errors in the contractor's calculation of the new labor rates." (R4, tab 149 at 659)

110. DCAA received additional information from KBR regarding the Davis-Bacon Act adjustments made by BE&K and KBR in the course of the appeal. KBR and BE&K each proposed new daily rates and, with the exception of the rates for carpenters, the new rate was determined by adopting the lower of the two proposed rates, and then making adjustments to the rates (app. supp. R4, tab 586; tr. 6/113-14). When the lower daily rate was proposed by KBR, that rate was reduced by $36 for meals provided by KBR, $8 for laundry provided by KBR and then increased by $21.15 for the agreed adjustment to the per diem for conversion to man-days (app. supp. R4, tab 586; tr. 6/115). Because the rates proposed by BE&K already included the meal credit, when the lower daily rate was the rate proposed by BE&K, the proposed rates were only adjusted for laundry and the per diem to man-day adjustment (app. supp. R4, tab 586; tr. 6/113-15, 116-21).

111. On cross-examination, the DCAA auditor, Mr. Wilson, testified that he had not attempted to seek more information from KBR regarding the calculations in the spreadsheet (tr. 4/62-64, 70). He also conceded that if the explanation above were correct, then there were no math errors in the spreadsheet (tr. 4/74-75). Mr. Wilson further testified that if the rates used the in the spreadsheet were appropriate, there would be no basis for questioning BE&K's costs (tr. 4/111).

112. With regard to the carpenter labor rates, Mr. Hayward testified that there was a large difference of $170 per day between KBR's proposed rate and the BE&K proposed rate. For this rate, KBR and BE&K agreed to split the difference and then adjust the rate for laundry and per diem. (Tr. 6/117-18)

113. The final decision additionally disallowed $8,449.78[6] for other direct costs plus mark-up on those costs. These costs were comprised of $36.71 representing the 15% markup on a $244.70 warehouse manifest; $862.66 for a $750.14 purchase at Lowe's and the 15% markup on that purchase; and $7,549.75 representing $6,565 in legal fees, plus the 15% markup on that cost. (R4, tab 149 at 658-59) The final decision allowed payment of the warehouse receipt because it was a separate charge by the subcontractor, but rejected the markup on the warehouse receipt because the contracting officer determined that the subcontract provided for markup only to materials and equipment (*id.*). The Lowe's purchase was rejected due to a lack of supporting documentation, and the legal fees were rejected because "BE&K's contract is for hurricane recovery construction repair service, it is not clear how attorney fees would be allocable to this contract" (*id.*).

114. At the hearing, KBR introduced the Lowe's receipt as well as the testimony of Mr. Hayward that the Lowe's receipt was similar to the documentation provided by other subcontractors for material purchased on the project that was not questioned by DCAA or the Navy (tr. 6/128-29; app. supp. R4, tab 3).

115. KBR presented testimony that the attorney fees were for a compliance audit of BE&K's worker's I-9 Employment Eligibility Verification forms to ensure that they met the employment requirements of the contract (tr. 6/130). Mr. Hayward testified that it was reasonable for BE&K to perform the added verification of the workers' documentation given that the workers were performing on a military facility and due to the high-visibility of the Hurricane Katrina recovery work (*id.*).

116. The final decision disallowed $20,667 representing the 15% markup on services provided by Schoel Godwin Barnett Landscape Architects, a second-tier subcontractor to BE&K because the DCAA audit determined that the cost should have been billed as labor, and not material, and the subcontract does not provide for a markup on labor, and even if billed as material, KBR had not supported the markup as a material handling cost (R4, tab 149 at 659).

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[6] The individual numbers do not sum to the total amount listed in the final decision.

117. The final decision rejected $4,827 for a markup on equipment rental for subcontractor-owned equipment (R4, tab 149 at 659).

118. Mr. Hayward testified that that there was an internal rental rate for BE&K's owned equipment and that such internal rates are standard in the industry (tr. 6/130; app. supp. R4, tab 2 at 50).

119. The final decision also rejected $65,127 because BE&K did not have any backup to support the material costs incurred by Riverside Electricians (R4, tab 149 at 660).

120. At the hearing, KBR presented invoices from Riverside Electricians in the amount of $56,632 (app. supp. R4, tab 27).

DECISION

BE&K was initially retained to perform public works services at Joint Reserve Base New Orleans; however, after this anticipated work was no longer required, BE&K's workers were transferred to build the Joint Reserve Base tent camp (finding 98). As a result, BE&K was required to comply with the Davis-Bacon Act, and incurred higher costs in performing its work (*id.*). The final decision questioned five different categories of costs for the work performed by BE&K: (1) math reconciliation errors; (2) other direct costs, plus markups; (3) markup on subcontractor labor; (4) equipment rental; and (5) sub-tier labor charges not supported by invoices billed as labor. We address the Navy's specific challenges to these issues *seriatim*, and then, following these discussions, we address the Navy's price reasonableness allegations with regard to BE&K.

i. Math Reconciliation Errors Related to Change Order 5

The Navy first challenges the labor rate adjustment contained in Change Order 5. The final decision cryptically asserts that "DCAA reviewed a spreadsheet developed by KBR for the negotiations. DCAA questioned $395,765 for mathematical errors in the contractor's calculation of the new labor rates." (Finding 109) The dispute centers around adjustments to the BE&K labor rates to adjust for increased costs due to the application of Davis-Bacon Act wages, and also adjustments for fuel prices, meals, and laundry provided by KBR, and an adjustment to the per diem rate to account for the fact that some workers were required to be on site, but were not working 12-hour days.

It is not necessary to detail in depth how DCAA misinterpreted the spreadsheet, resulting in the audit questioning $397,765. At the hearing, KBR's project manager, Mr. Hayward, testified that he had created the spreadsheet relied upon by the DCAA auditors and he provided unrefuted testimony explaining the formulae in the spreadsheet. Specifically, Mr. Hayward testified that the final adjusted rates in the spreadsheet were the rates incorporated into Change Order 5 (findings 100-01) to the BE&K subcontract, and

that the rates, with the exception of the rates for carpenters, were determined by taking the lower of the daily rates proposed by BE&K or KBR and then making other adjustments to the rates. When the lower daily rate was proposed by KBR, that rate was reduced by $36 for meals provided by KBR, $8 for laundry provided by KBR and then increased by $21.15 for the agreed adjustment to the per diem for conversion to man-days (finding 110). Because the rates proposed by BE&K already included the meal credit, when the lower daily rate was the rate proposed by BE&K, the proposed rates were only adjusted for laundry and the per diem to man-day adjustment (*id.*). On cross-examination, the DCAA auditor, Mr. Wilson, conceded that if the explanation above were correct, then there were no math errors in the spreadsheet. Mr. Wilson further testified that if the rates used in the spreadsheet were appropriate, there would be no basis for questioning BE&K's costs (finding 111).

With regard to the carpenter labor rates, Mr. Hayward testified that there was a large difference of $170 per day between KBR's proposed rate and the BE&K proposed rate. For this rate, the parties agreed to split the difference and then adjust the rate for laundry and per diem. (Finding 112) We find the testimony of Mr. Hayward to be credible because it was based upon his first-hand knowledge of the negotiations between KBR and BE&K and his own creation of the spreadsheet. Conversely, the Navy's witnesses could not testify beyond their assumptions as to how the spreadsheet might have been prepared. Further the DCAA auditor testified that he had not attempted to seek more information from KBR regarding the calculations in the spreadsheet. (Finding 111) Accordingly, we find in favor of KBR on this issue.

ii. Other Direct Costs, Plus Markups

The contracting officer's final decision disallowed $8,449.78 in other direct costs, including claims relating to the markup on the other direct costs. Specifically, the final decision questioned $36.71 representing the 15% markup on a $244.70 warehouse manifest; $862.66 for a $750.14 purchase at Lowe's and the 15% markup on that purchase; and $7,549.75 representing $6,565 in legal fees, plus the 15% markup on that cost. (Finding 113) The Navy alleges that the other direct costs were not reimbursable pursuant to the terms of the subcontract (gov't br. ¶ 188). The Navy's position apparently stemmed from DCAA's interpretation of an email from Mr. Hayward of KBR to BE&K stating that "[d]emobilization subcontractor invoices plus markup, including expenses, [other direct costs], will not be reimbursed as they are not reimbursable per the terms of the subcontract" (finding 99). Additionally, the final decision indicated that the warehouse receipt costs were questioned because the subcontract provides for markup only to materials and equipment (finding 113).

KBR presented testimony from Mr. Hayward that the email relied upon by the Navy referred only to specific other direct costs that were already included in the BE&K rates (finding 99). Additionally, KBR noted that the subcontract with BE&K expressly provided for markup on materials and equipment (finding 97).

We find that the markup on the warehouse receipt is allowable pursuant to the terms of the subcontract. As the final decision notes, warehouse manifests are normally included in material markup. However, the final decision allowed the warehouse charge because it was a separate charge by the subcontractor. (Finding 113) The Navy, having determined that the warehouse manifest was an allowable cost, should have allowed the markup on that cost after recognizing that warehouse manifests were normally part of a materials cost. Moreover, as KBR notes, FAR 31.205-26 defines materials costs to include "such collateral items as inbound transportation and in-transit insurance."

With regard to the items purchased at a Lowe's home improvement store, the final decision disallowed this cost due to a lack of supporting documentation (finding 113). At the hearing, KBR introduced the Lowe's receipt as well as the testimony of Mr. Hayward that the Lowe's receipt was similar to the documentation provided by other subcontractors for material purchased on the project that was not questioned by DCAA or the Navy (finding 114). We find that the receipt provides sufficient documentation for the claimed costs and related markup and find in favor of KBR with regard to this cost.

With regard to the claim for legal services, the final decision denied these costs stating that "BE&K's contract is for hurricane recovery construction repair service, it is not clear how attorney fees would be allocable to this contract" (finding 113). KBR presented testimony that the attorney fees were for a compliance audit of BE&K's worker's I-9 Employment Eligibility Verification forms to ensure that they met the employment requirements of the contract (finding 115). Mr. Hayward testified that it was reasonable for BE&K to perform the added verification of the workers' documentation given that the workers were performing on a military facility and due to the high-visibility of the Hurricane Katrina recovery work (*id.*). We hold that the attorney fees for the I-9 compliance audit, plus mark-up are allowable costs pursuant to FAR 31.205-33 (Professional and consultant service costs).

iii. Markups on Subcontractor Labor

The Navy disallowed $20,667 representing the 15% markup on services provided by Schoel Godwin Barnett Landscape Architects, a second-tier subcontractor to BE&K that was billed as material under the subcontract. The final decision denied these costs because the DCAA audit determined that the cost should have been billed as labor, and not material, and the subcontract does not provide for a markup on labor, and even if billed as material, KBR had not supported the markup as a material handling cost. (Finding 116) KBR argues that the subcontract only has labor rates for anticipated labor categories, and that there was no predetermined labor rate for unanticipated labor not included in the pricing sheet but incidental to the scope of work (finding 94). KBR asserts that it is normal practice to bill such lower-tier subcontractor labor costs as material. KBR additionally cites to FAR 16.601(a)(2) that, while not applicable to KBR's prime contract, illustrates this practice, providing that "*Materials means*— ...(2) [s]ubcontracts for supplies and incidental services for which there is not a labor category specified in the contract." FAR 16.601(a)(2).

We find that the subcontract did not have a labor rate for landscape architects and that BE&K properly charged the landscape architect costs as material and therefore that BE&K is entitled to its 15% markup on these costs.

iv. Equipment Rental

The final decision disallowed $4,827 of markup on equipment rental costs for subcontractor-owned equipment, holding that the subcontract did not provide for markup on subcontractor-owned equipment (finding 117). KBR asserts that the subcontract provides that that "[e]quipment shall be reimbursed at rental cost plus markup" and provided testimony by Mr. Hayward that there was an internal rental rate for BE&K's owned equipment and that such internal rates are standard in the industry (findings 97, 118).

We agree with KBR that the subcontract does not distinguish between owned and rented equipment and the Navy did not present any evidence to contradict Mr. Hayward's testimony that it was normal practice in the construction industry to use rental rates for owned equipment. Accordingly, we hold that KBR is entitled to reimbursement for markup on BE&K-owned equipment.

v. Sub-Tier Labor Charges Not Supported By Invoices

The Navy additionally questioned $65,127 comprised of a $56,632 invoice by Riverside Electricians and the 15% markup thereon, because the charge was not supported by invoices showing the labor rate charged, or certified payrolls[7] (finding 119). At the hearing, KBR presented invoices from Riverside Electricians in the amount of $56,632 (finding 120). As KBR has placed on the hearing record documentation of the questioned costs, we find that the costs are supported and hold that KBR is entitled to payment for the disallowed costs.

vi. Price Reasonableness

In addition to the specific challenges presented by the Navy to the BE&K costs detailed above, the Navy also asserts that the disallowed costs are all improper on a price reasonableness basis. However, the Navy does not cite any specific evidence challenging the reasonableness of these costs, instead simply asserting that the costs are unreasonable. Based upon the evidence presented, including KBR's testimony that BE&K was the only offeror able to provide the required labor, and was the lowest bidder with the prices of the

[7] Although this invoice presents the same issue as the landscape architect invoice discussed in Part C. iii, that is, charging a material markup on lower-tier contractor labor costs charged as materials, the Navy did not present that argument with regard to this cost. As we rejected the Navy's argument with regard to the landscape architects, we reject it here to the extent the Navy's pleadings can be read to assert such an argument.

two other offerors being roughly 50% higher (finding 95), the Board finds that the cited costs were reasonable. Thus, in summary, we find that KBR has established entitlement to the disallowed costs on the BE&K subcontract.

D. LJC Defense Contracting, Inc., Master Agreement

121. KBR issued a request for proposals for emergency repair services at Navy and Marine Corps facilities in Florida (supp. R4, tab 2300 at 49860).

122. On 15 September 2005, KBR awarded Master Agreement HUR013 to LJC Defense Contracting, Inc. (LJC) in response to LJC's bid (supp. R4, tab 2306).

123. On 16 September 2005, KBR issued Work Release 01 under Master Agreement HUR013 for construction services at buildings located at the Navy Construction Battalion Center Gulfport, Naval Air Station Pascagoula and the John Stennis Space Center (supp. R4, tab 2313).

124. LJC submitted Invoice No. 1 on 18 October 2005 for $757,628.80 (supp. R4, tab 2359).

125. DCAA questioned $603,953 of LJC's costs because the invoiced labor costs didn't match the certified payroll records (R4, tab 325 at 1229; tr. 3/144).

126. Following discussions between KBR and the Navy, the final decision ultimately disallowed $603,953 in labor costs. KBR conceded that $289,935 was properly disallowed. The final decision also noted that the government had received a credit of $49,524. KBR ultimately conceded that $378,320 was properly disallowed, leaving $225,633 at issue. (R4, tab 149 at 661-62; supp. R4, tab 2715)

127. In preparation for her hearing testimony in this appeal, the DCAA auditor originally responsible for questioning LJC's costs, Linda Bettis, reviewed additional documentation provided by KBR and determined that "the total hours that were in the payroll that were submitted in 2011 [after the date of the DCAA Supplemental Audit] did, in fact, support that the difference between the LJC invoice[s] and the certified payroll was around [the amount claimed by KBR]" (tr. 3/152).

128. Following Ms. Bettis' testimony on this point, counsel for the Navy represented that the parties were "essentially...in agreement" and that the calculations were "close enough" that there was no longer any dispute (tr. 3/153).

DECISION

In its post-hearing brief, the Navy continued to question the payment made to LJC because KBR failed to submit certified payrolls (gov't br. ¶ 175). However, the Navy

withdrew this argument in its post-hearing response brief, referring to the statement in its initial brief as erroneous (gov't reply. br. at 29 n.4). Accordingly, as there is no dispute, we hold that KBR has established entitlement to the claimed hours.

E. BMS-CAT, Subcontract S0015

129. On 19 October 2004, KBR issued a request for proposals for infrastructure dry-out stabilization work at Naval Air Station Pensacola, Florida (supp. R4, tab 1200).

130. In the cover letter to the request for proposals, KBR stated that all offerors were required to submit a time-and-material price "with All Inclusive Fixed Unit Labor Rates (to Include Labor, Overhead, Profit, Consumable Material, Transportation, Per Diem, Lodging, Meals and Miscellaneous)" (supp. R4, tab 1200 at 56714).

131. Offerors were notified that, if they discovered any ambiguity in the request for proposals, they were required to discuss that issue with KBR immediately (supp. R4, tab 1200 at 56717; tr. 1/34).

132. With regard to pricing of labor rates, the request for proposals stated that "[a]ll burdens and benefits, supervision, tools, equipment, other overhead costs and profit shall be accounted for within the combined hourly rates provided" (supp. R4, tab 1200, 56720).

133. BMS-CAT submitted its proposal on 21 October 2004 (supp. R4, tab 1201).

134. BMS-CAT proposed a labor rate of $39.86 per hour (supp. R4, tab 1201 at 56705).

135. Next to the line for "Equipment & Material Markup Rate" in the "unit" column appears the term "10% + 10%" (supp. R4, tab 1201 at 56705).

136. KBR received five proposals in addition to the proposal from BMS-CAT. KBR determined that BMS-CAT offered the best value based on technical ability, available labor and equipment, past performance, and price. (App. R4, tab 609 at 5746; tr. 6/202-03)

137. Prior to award of the subcontract, KBR and BMS-CAT agreed to permit markup of labor costs in the proposed subcontract (tr. 6/205-06).

138. On 26 October 2004, KBR awarded a time-and-materials subcontract for stabilization and dry-out of Corry Station and Saufley Field at Naval Air Station Pensacola, Florida, to BMS-CAT (supp. R4, tab 1206).

139. The subcontract, as awarded, states in paragraph 3.4:

> *The following prices are subject to a 10% markup for overhead and a 10% markup for profit.* Labor rates shall be based on

> staffing the work 10 productive work hours per day, six days per week. At the subcontractors' option work can be expanded to 12 productive work hours per day, seven days a week at the same hourly rate but [must] be coordinated and approved prior to working the longer hours. Rates shall be weighted to include any overtime and are for personnel actually performing the work. *All burdens and benefits, supervision, tools, equipment, other overhead costs and profit shall be accounted for within the combined hourly rate provided.*

(Supp. R4, tab 1206 at 56561) (Emphasis added) Below the language quoted above is a rate table for equipment and labor, including a rate for personnel listed at $39.86 per man hour (*id.*).

140. Even with the markups included in BMS-CAT's adjusted labor rate of $48.23 per hour ($39.86 + 21%) their rate was lower than all but one of the other responsive offerors (app. supp. R4, tab 609). While one of the other offerors, submitted a slightly lower labor rate—$48.00 per hour—the difference was not enough to offset its higher equipment prices and lower technical ratings (*id.* at 5749, 5757, 5759, 5779; tr. 6/207). Another offeror also proposed a lower rate, but its proposal was not submitted in the required format, was ambiguous, and was nonresponsive (app. supp. R4, tab 609 at 5750, 5756, 5761, 5764).

141. BMS-CAT received $644,373 from a 21% markup on $3,068,443 of labor charges under the subcontract with KBR (R4, tab 325 at 1243; supp. R4, tab 1229, Questioned Cost; tr. 1/66-67).

142. In its 10 July 2009 audit report, DCAA questioned $644,373 of markup on labor costs under KBR's subcontract with BMS-CAT (supp. R4, tab 2903 at 19249).

143. DCAA issued a supplemental audit report on 19 August 2010 in which DCAA again questioned $644,373 for the markup on labor under the subcontract (R4, tab 325 at 1243).

144. On 27 February 2012 the contracting officer issued her final decision disallowing costs that were paid to BMS-CAT for the 21% markup on its labor and finding that the markup created a prohibited cost plus percentage of cost contract (R4, tab 149 at 663).

DECISION

Separate from the BMS-CAT subcontract HUR004 pertaining to Hurricane Katrina relief efforts discussed above, the contracting officer's final decision also questioned costs on subcontract S0015, pertaining to Hurricane Ivan relief efforts in Florida. Here, the contracting officer's final decision disallowed $644,373 in markup on labor costs (finding 144). Because the terms of this subcontract differ from those of master agreement HUR004, we must separately determine whether the subcontract provides for a markup on

labor. As with master agreement HUR004, the KBR request for proposals specified that offerors should submit fully burdened rates (findings 130, 132). In addition, BMS-CAT's pricing sheet did not indicate that there would be a markup on labor, but included a markup on equipment and materials (findings 134-35).

However, KBR presented the unrefuted testimony of Mr. Hayward that KBR and BMS-CAT agreed, before award of the subcontract, that markups for overhead and profit would apply to labor as well as to material and equipment (finding 137). Thus, the pricing provision of the subcontract provides that "[t]he following prices are subject to a 10% markup for overhead and a 10% markup for profit.... All burdens and benefits, supervision, tools, equipment, other overhead costs and profit shall be accounted for within the combined hourly rate provided." Below the quoted language is a table with prices for equipment and labor, including personnel priced at $39.86 per man hour. (Finding 139) As noted above in the discussion of the master agreement HUR004, unless specifically incorporated, the terms of the request for proposals do not control the language of the subcontract.

The Navy argues that the sentence providing that all "burdens and benefits" shall be accounted for in the hourly rates controls the interpretation of the paragraph and, that the subcontract should be interpreted in accordance with the request for proposals that clearly required BMS-CAT to propose a fully-burdened labor rate (gov't br. at 53). KBR argues the opposite, that the first sentence, providing that "the following prices are subject to a 10% markup for overhead and a 10% markup for profit" controls the interpretation of the subcontract, and that the last sentence should be read to provide that no markups, other than the 10% overhead and 10% profit, are permitted (app. br. at 48).

Contract interpretation is a matter of law. *See, e.g., ThinkQ, Inc.* ASBCA No. 57732, 13 BCA ¶ 35,221 at 172,825. One canon of contract interpretation is that the contract should be read as a whole, harmonizing and giving meaning to all provisions. *Id.* (citing *NVT Technologies, Inc. v. United States*, 370 F.3d 1153, 1159 (Fed. Cir. 2004)). Here, the Navy's proffered interpretation of paragraph 3.4 of the subcontract renders the first sentence of the paragraph internally contradictory and superfluous. Conversely, the interpretation proffered by KBR, while certainly not a model of the draftsman's art, would allow the clauses to be read together and provides meaning to each part of the paragraph. Moreover, to the extent the clause was still ambiguous, we note that the unrebutted testimony of Mr. Hayward, that the parties agreed to provide a markup on labor (finding 137), supports KBR's interpretation of the contract provision. Mr. Hayward's testimony was based on his first-hand knowledge of the negotiations between KBR and BMS-CAT. In addition, the testimony explains the evolution of the subcontract language from the terms initially contained in the request for proposals (*compare* findings ¶¶ 130, 132, 135 *with* 139), and BMS-CAT's purported failure to seek clarification regarding ambiguity in the proposal (finding 131).

The Navy additionally argues that the markup on labor creates an impermissible cost-plus-percentage-of-cost contract. Although the contractual provisions of this subcontract differ from the master agreement discussed above, in both cases the dispute

involves KBR's payment of a 21% markup on direct labor in a time and materials subcontract. For the reasons discussed in section A above, we continue to hold that the markup on this subcontract would not be an illegal cost-plus-percentage-of-cost contract.

Once again, to the extent that the Navy is challenging the price reasonableness of BMS-CAT's billings, we find that the prices were reasonable. KBR received six offers in response to its request for proposals (finding 136). Even with the addition of the 21% markup on labor, its prices were lower than all but one other responsive offeror, and KBR presented testimony that that offeror's slightly lower price did not offset its higher equipment rental rates and lower technical ratings (finding 140). Accordingly, we hold that KBR has established entitlement to the disallowed markup on labor costs for the S0015 subcontract.

F. Rene Cross Construction Co., Subcontract S0001

145. The Army Corps of Engineers retained Rene Cross Construction Co. (Rene Cross) to repair levee breaches immediately following Hurricane Katrina. Although the record does not appear to be complete with regard to the contract between the Corps and Rene Cross, KBR asserts that performance began around September 2005 (compl. ¶ 159).

146. The Navy subsequently issued a task order to KBR for unwatering operations in the New Orleans area. KBR asserts that they were directed to assume the Corps' contracts already in place, including the contract with Rene Cross. (Compl. ¶ 160) Accordingly, KBR awarded subcontract S0001 to Rene Cross for construction of a temporary dike and repair of two levees in Plaquemines Parish, Louisiana (compl. ¶ 158).

147. DCAA questioned, and the contracting officer's final decision ultimately disallowed, Rene Cross' 20% markup, in the amount of $576,276, on the costs of its subcontractor, Luhr Brothers (R4, tab 149 at 664-65). The contracting officer disputed KBR's assertion that it was required to adopt the working relationships already established and that Rene Cross' supervision and coordination was required to allow Luhr Brothers to correctly place the stone for the levee repairs (*id.*).

DECISION

In its pre-hearing brief, the Navy conceded that Rene Cross' markup costs were allowable (gov't pre-hearing br. at 5), and no evidence was presented regarding the claim at the hearing. Thus, based on the Navy's concession, the Board finds entitlement in favor of KBR with regard to this portion of the claim.

G. Freedom Support Services, Inc., Master Agreement

148. KBR issued a request for proposals for dry out stabilization work and disaster recovery efforts at Navy and Marine Corps facilities in Florida. The request for proposals

stated that "labor hours worked and invoiced will also be verified through submission of certified payrolls." (Supp. R4, tab 1900 at 26803)

149. KBR awarded Master Agreement HUR018 to Freedom Support Services, Inc. (FSS) on 18 September 2005 (supp. R4, tab 1903).

150. FSS was the lowest bidder (R4, tab 149 at 661; tr. 3/169-70).

151. On 20 September 2005, KBR issued Work Release 01 under Master Agreement HUR018 to FSS for $500,000 to repair housing located at Sand Hill and Navy Construction Battalion Center Gulfport, MS (supp. R4, tab 1912).

152. FSS submitted its Invoice No. 1 to KBR on 24 October 2005, for work performed 18 September 2005 through 14 October 2005, but the invoice did not include any payroll records (supp. R4, tab 1916 at 38490-92, tab 1919; app. supp. R4, tabs 327-29, 331-32).

153. FSS submitted just one invoice before KBR stopped using FSS on the project and directed the work to LJC (tr. 6/226).

154. On 12 December 2005, FSS submitted adjustments to the original invoice but with uncertified payroll information that does not show the hours each employee worked each day (supp. R4, tab 1919).

155. KBR paid FSS 75% of the invoiced amount but retained 25% of the invoiced amount because FSS failed to submit legible invoices with certified payrolls (supp. R4, tab 1916 at 38488).

156. On 2 February 2006, KBR sent a letter to FSS refusing to process the invoice in full until it received supporting documentation, including summary sheets, backup receipts, and certified payrolls (supp. R4, tab 1939).

157. KBR sent another letter to FSS on 14 March 2007 indicating that its payment of $196,683 would be considered final if it didn't receive any additional documentation (supp. R4, tab 1943).

158. DCAA questioned the $196,683 paid to FSS due to the lack of certified payrolls (supp. R4, tabs 325, 1283-84, 2903, 19291-92). The audit finding was solely due to the lack of certified payrolls and was not based on any finding questioning FSS' performance of the work (tr. 3/172-73, 5/139).

159. In a final decision, the contracting officer agreed with DCAA and questioned $196,683 for the lack of supporting payroll information (R4, tabs 149, 670).

DECISION

The Navy argues that the contract unambiguously required KBR to provide certified payrolls to establish compliance with the Davis-Bacon Act and that it is undisputed that FSS did not provide certified payrolls. Thus, the Navy argues, it was unreasonable for KBR to pay FSS without receipt of the certified payrolls, and it further asserts that it is unaware of any provision permitting it to waive the requirement for certified payrolls. (Gov't reply br. at 29)

KBR asserts that it was unreasonable for the Navy to disallow the FSS invoice amount in its entirety, especially because KBR had already reduced the invoiced amount by 25%. KBR further argues that the contracting officer and DCAA auditor both testified that the disallowance was for a lack of documentation and that there were no findings that FSS had not actually performed the work. (App. br. at 67-68)

It is undisputed that KBR breached the terms of the CONCAP III contract by failing to obtain certified payroll information from FSS, but the appropriate remedy is less clear. In *Acme Missiles & Construction Corp.*, ASBCA No. 11786, 69-2 BCA ¶ 8057, a contractor failed to provide the required payroll information. The agency withheld a portion of the invoiced amount and the contractor appealed that action. The Board held that that the "Government may retain the amount of money previously withheld provided the amount was reasonable in relation to [the] work or service not performed.... [T]he Government may retain only a reasonable amount for each incomplete item." *Id.* at 37,446. Moreover, the FAR provides at 31.201-2(d) that the "contracting officer may disallow all *or part* of a claimed cost that is inadequately supported." FAR 31.201-2(d) (emphasis added).

In this appeal the record evidence demonstrates that FSS submitted payroll information, but that the payroll information was not provided in the correct format (finding 154). We note that FSS performed on the subcontract entirely during the period when the Davis-Bacon Act was suspended (finding 19). The Davis-Bacon Act was retroactively reinstated on the contract, but only after FSS' performance (*id.*). Additionally, KBR worked with FSS in an attempt to obtain corrected payroll information (findings 152, 155-57). Moreover, FSS provided payroll information, in an incorrect format, which distinguishes the facts here from the situation in *Fireman's Fund Indemnity Co. v. United States*, 93 Ct. Cl. 138, 144 (1941), where there was "no evidence to show what amount was paid the workmen."

The DCAA audit and the final decision denied payment based solely upon the failure to provide the certified payroll information, and the disallowance was not based on any finding that the payroll information provided, although not in the correct format, was inaccurate (finding 158). Under these circumstances, we hold that the Navy improperly denied any payment of the invoice; however, there is a quantum issue to determine the appropriate amount of withholding. Here the contracting officer denied 100% of the amount invoiced, which already reflected a 25% discount from FSS' invoice. Pursuant to the

Board's holding in *Acme*, the withholding must be a "reasonable" amount. The reasonable amount is a quantum issue to be remanded to the parties.

Separately, the Navy argues that, even if the payment is not disallowed due to FSS' failure to certify its payroll information, the Board should deny recovery because FSS' prices were not reasonable pursuant to FAR 31.201-3. We note that the FSS was the low bidder on the contract, and then was paid only 75% of its bid amount (findings 150, 155). Thus, we hold that FSS' prices under the subcontract were reasonable.

H. Kustom Industrial Fabricators, Inc., Master Agreement

160. KBR issued a request for proposals on 3 October 2005 for work to repair shingle roof damage and gutters, and to remove and replace roofs at the Navy Construction Battalion Center Gulfport (supp. R4, tab 2201).

161. Kustom Industrial Fabricators, Inc. (Kustom) of Akron, Ohio, replied to the request for proposals on 5 October 2005. Kustom bid $10,000, plus an additional $1,000 per person for mobilization and demobilization. (Supp. R4, tab 2202 at 62618, tabs 2203, 2235; tr. 4/37-39). Kustom also initially proposed an hourly rate for roofers of $72 per hour (supp. R4, tab 2202 at 62618).

162. On 7 October 2005, KBR re-solicited proposals from potential roofing contractors based on a "Fair Market Per Square Foot" rate that it had calculated based on market research and the assistance of a third-party consultant (app. supp. R4, tab 710 at 6967; tr. 4/36-37).

163. On 16 October 2005, KBR awarded Master Agreement HUR025 to Kustom (supp. R4, tab 2210).

164. On 20 October 2005, KBR sent an email to Kustom stating "should your requirements for Mob/Demob are [sic] by the person to eliminate confusion, then please feel free to make that amendment and adjust accordingly" (app. supp. R4, tab 710 at 6970).

165. On or about 20 October 2005, Kustom submitted a permanent roofing pricing clarification that proposed prices in line with KBR's identified market rates, but revising its mobilization rate to $45,000 and de-mobilization rate to $45,000 (supp. R4, tab 2801 at 70442-45). Kustom also proposed an hourly rate for roofers of $75.00 per hour (*id.*).

166. On or about 25 October 2005, KBR issued a Procurement Summary regarding the competition for permanent roofing work in Gulfport, Mississippi. In the summary, KBR explained that, based on the bids it received for the roofing work, it decided to only pay accepted "fair market" rates for the work. The prices for mobilization and demobilization were not identified. The summary stated that "[a]ll subcontractors solicited will be paid at the same scale as listed in the table above with the exception of mobilization and demobilization

rates. Each subcontractor that requires these fees will be paid a one-time fee." KBR received several bids in excess of expected pricing from roofing contractors, so KBR asked the contractors to rebid. These bids were also high so a consultant came up with the "market rates" for the roofing work. (Supp. R4, tab 2209; tr. 4/36-37)

167. Kustom submitted three invoices to KBR (supp. R4, tab 2271 at 32147-48). On 24 March 2006, Kustom submitted an invoice for mobilization costs of $45,000. Kustom submitted another invoice for demobilization costs of $45,000 on 20 April 2006. (supp. R4, tab 2235 at 27740, tab 2236 at 27742). On 19 May 2006, Kustom submitted an invoice for labor, materials, and equipment, in the amount of $332,970.11 (supp. R4, tab 2238 at 28390). Kustom billed its labor exclusively at a flat rate of $85 per hour (*id.* at 28389). KBR approved $263,037.62 of the invoiced amount (*id.*).

168. Kustom's 19 May 2006 invoice indicates only 11 employees were mobilized (supp. R4, tab 2238 at 28389-90, 8400-14).

169. DCAA questioned $69,000 of costs paid to Kustom under Master Agreement HUR025 Work Release 03 related to Task Order 17 in its 10 July 2009 audit report. The questioned costs were due to mobilization and demobilization fees in excess of the amounts originally bid. Based on Kustom's original bid of $10,000 plus $1,000 for every employee, KBR would have only paid Kustom $21,000 in mobilization and demobilization costs so DCAA questioned the difference between these amounts. (Supp. R4, tab 2903 at 19294-95; tr. 4/35-37)

170. DCAA continued to question $69,000 in its supplemental audit report, issued 19 August 2010 for the same reasons (R4, tab 325 at 1286-87). The audit report noted that the award to Kustom was based on adequate competition (*id.* at 1286).

171. The contracting officer agreed with DCAA and in the final decision disapproved of $69,000 of the costs paid to Kustom for demobilization and mobilization rates in excess of the amounts it originally bid (R4, tab 149 at 671-72).

DECISION

The Navy challenges KBR's invoiced amount asserting that the mobilization and demobilization costs were not reasonable, relying upon the FAR's cost reasonableness requirement FAR 31.201-2 (gov't br. at 72-73). In response, KBR asserts that the costs were reasonable because of the lower negotiated per square foot rates, the fact that KBR asked the contractors to quote a lump-sum mobilization and demobilization cost rather than allowing a per worker charge. KBR notes that the DCAA audit found that there was adequate proposal review. Moreover, KBR expected that there would be a larger number of workers mobilized, such that the fee would be small based on the total billing. (App. br. at 68-71)

Despite KBR's reliance on the negotiation of "fair market" rates to justify the mobilization and demobilization charges, KBR actually negotiated a substantial price increase for Kustom. While KBR cites the negotiated reduction in the "market rate" per square foot roofing costs, the record demonstrates that Kustom billed exclusively at an hourly rate of $85 per hour, and did not bill any labor at the negotiated per square foot rates. (Finding 167) Kustom initially proposed an hourly rate of $72 per hour (findings 161, 165). KBR argues that there is "nothing to prevent the subcontractor from proposing lower prices for some items and higher prices [for] others," and that KBR made its award based on the total proposed pricing, not just the pricing for one element (app. br. at 71; *see also* findings 162, 166). However, here, Kustom increased its mobilization and demobilization charge by $69,000 (more than a 300% increase) and also increased its hourly labor rate by $13 per hour (findings 161, 165, 167-68).

The DCAA audit report found the award to be based upon adequate competition (finding 170). As the $85 per hour labor rate for roofers was not challenged in the contracting officer's final decision, we do not disturb it (finding 171). However, we note the fact that the hourly rate *increased* as evidence against the reasonableness of the dramatic increase in the mobilization and demobilization rates. Obviously, a contractor may elect to accept a lower hourly rate in exchange for a higher fixed payment. Had Kustom *reduced* the hourly rate and charged a higher fixed fee, as KBR asserts happened, KBR's reasonableness argument would be more credible.

Here, Kustom increased both its hourly rate *and* the mobilization and demobilization rates. Accordingly, we hold that the charges were unreasonable.

I. Bear Industries, Inc., Purchase Order PA-0002

172. The U.S. Army Corps of Engineers initially retained Bear Industries, Inc. (Bear) by leasing property owned by Bear and filling the wetlands on their property to create a building site (tr. 6/211).

173. On 8 September 2005 the Navy issued Task Order 19 requiring KBR to work with the Corps to construct a mortuary facility for victims of Hurricane Katrina. The facility, known as the Victim's Identification Center was to be constructed on land owned by Bear Industries in Carville, Louisiana. (R4, tab 104)

174. Section 8.1.8 of KBR's subcontract with Bear provided that:

> In the event Subcontractor contends that...(ii) there is a change in conditions...for which Subcontractor is entitled to an adjustment compensation...and such action is not incorporated in a written Change Order, Subcontractor must submit a claim in the manner and within the time prescribed under the disputes procedure provided in 8.2 below, failing which Subcontractor's

claim for an adjustment in compensation or in the time of performance shall be waived.

Section 8.2 provides that the subcontractor must present its claim for adjustment to the KBR project manager "in writing in accordance with 8.3 below within ten (10) days after Subcontractor obtains knowledge of the facts giving rise to the claim. Subcontractor shall continue to prosecute the Sublet Work pending determination of the claim." (App. supp. R4, tab 65 at 610)

175. On 8 September 2005, the Navy also issued a notice to proceed with site preparation work, because the site for the mortuary was not graded properly to serve as a base for the facility (R4, tab 104).

176. On 9 September 2005, Bear agreed to furnish 24,000 tons ASTM 610 limestone at a rate of $20.50 per ton for the mortuary facility (supp. R4, tab 1140).

177. On 10 October 2005, Bear agreed to provide 50,000 tons of bearlite at $14.50 per ton, 24,000 tons of ASTM 610 limestone at $20.50 per ton, and 24,000 tons of material to compact the limestone at $12.50 per ton (supp. R4, tab 1107).

178. Bear submitted an invoice to KBR on 28 September 2005 billing 21,060.83 tons of ASTM 610 limestone at $20.50 per ton (supp. R4, tab 1136 at 65903).

179. On 22 October 2005, Bear informed KBR that the cost of freight and the cost of fuel had increased and requested that the additional costs be allowed (supp. R4, tab 1143; app. supp. R4, tab 72 at 649-50).

180. Bear submitted an invoice on 22 October 2005 that removed the 9,603.65 tons of limestone already laid and invoiced at $20.50 and re-invoiced the same 9,603.65 tons of materials at $23.16 per ton. Bear also invoiced an additional 22,326.59 tons of limestone at $24.20 per ton. (Supp. R4, tab 1138 at 65983)

181. In the request for adjustment, Bear cites to an invoice from its supplier dated 19 September 2005, applying a fuel surcharge, with a resulting increase of $2.66 per ton of limestone (supp. R4, tab 1143). The Bear invoice notes that material and freight both increased, in addition to the application of a fuel surcharge (*id.*).

182. Bear invoiced KBR for $2.66 per ton more than the quoted price for 9,604 tons of limestone already placed, and 2,939 tons of the initial quoted 24,000 at $3.70 per ton more than the quote (tr. 1/74-75; supp. R4, tab 2903 at 19297).

183. DCAA questioned $36,421 representing the difference between the adjusted rates used in the billings and the fixed unit rates in the original purchase order award (supp. R4, tab 2903 at 19295-96; R4, tab 325 at 1287-88).

184. The contracting officer disapproved $36,421 of costs paid to Bear under the theory that the cost for the original quantity should not have been changed because it was based on a fixed rate which was agreed to by KBR and Bear at time of award and Bear didn't notify KBR of the increase rate until after the limestone had been purchased and laid (R4, tab 149 at 672-73).

DECISION

The Navy contends that Bear is not entitled to an adjustment for the limestone that had already been placed at the time of the adjustment, but did not challenge the adjustment for the limestone placed after the date of the adjustment (gov't br. at 74).

KBR contends that Bear was entitled to an adjustment pursuant to the terms of the subcontract. Specifically, section 8.1.8 of the agreement provides that:

> In the event Subcontractor contends that...(ii) there is a change in conditions...for which Subcontractor is entitled to an adjustment compensation...and such action is not incorporated in a written Change Order, Subcontractor must submit a claim in the manner and within the time period prescribed under the disputes procedure provided in 8.2 below, failing which Subcontractor's claim for an adjustment in compensation or in the time of performance shall be waived.

(App. br. at 74) Section 8.2 provides that the subcontractor must present its claim for adjustment to the KBR project manager "in writing in accordance with 8.3 below within ten (10) days after Subcontractor obtains knowledge of the facts giving rise to the claim" (finding 174). It is not clear from the record when Bear first became "aware" of its increased costs; however, Bear's written request for an adjustment was provided to KBR on 22 October 2005 (finding 179). In the request for adjustment, Bear cites to an invoice from its supplier dated 19 September 2005, applying a fuel surcharge, with a resulting increase of $2.66 per ton of limestone (finding 181). While KBR describes this as an increase due to fuel prices, the Bear invoice notes that material and freight both increased, in addition to the application of a fuel surcharge (*id.*) These deliveries of limestone were billed at $23.16 per ton, rather than the $24.20 per ton for the later deliveries (finding 180).

Regardless of the apportionment of the extra costs, it is clear that Bear was entitled to an adjustment under the terms of the subcontract – a point that DCAA and the Navy do not dispute with regard to the limestone provided after the date of the request for adjustment (finding 184). The subcontract permitted the supplier to request an adjustment after performance, although it appears that KBR did not enforce the time limit. Regardless, KBR reasonably granted the adjustment as permitted by the terms of the subcontract. Moreover, the recognition by DCAA and the Navy that the adjustment due to increased transportation costs for the majority of the limestone purchased under the subcontract was justified would be

inconsistent in these circumstances with a finding that the price was not reasonable. Thus, we find entitlement in favor of KBR with regard to the Bear subcontract.

J. Commercial Marketing International, Inc., Subcontract SA-00033

185. On 4 September 2005, Carol Lloyd of NAVFAC issued Technical Direction 002 under Task Order 16 to KBR. Technical Direction 002 instructed KBR to "provide all labor, materials and equipment necessary to: ... 3) Provide 2500 Man Tent Camp with including but not limited to; galley, port-a-lets, shower facilities." (Supp. R4, tab 1451)

186. NAVFAC promptly changed Technical Direction 002 stating: "Change 2500 man tent camp to 2000 man tent camp.... Also, to include galley, temporary toilet facilities, and necessary utilities to be used by approximately 5500 military and civilian forces" thus reflecting an expected total of 7,500 personnel. (Supp. R4, tab 1451)

187. On 7 September 2005, KBR issued a request for proposals to Commercial Marketing International, Inc. (CMARK) for "all food, material, equipment and labor to operate the dining facilities with the capability of feeding up to 7,500 people/day in accordance with Attachment 'A.'" Attachment "A" requested a pricing breakout including "Food & Materials" with a quantity of 2,500 units per day. In addition, the statement of work requested a "Lump sum weekly amount for all specified services to serve 2500 meals per day" with a "Unit price amount for each meal served above the first 2500." (Supp. R4, tab 1400 at 40012-13, 40016-17)

188. In response to the request for proposals, on 7 September 2005, CMARK submitted a proposal with a lump sum weekly price of $546,875 for the first 2,500 meals and $12.80 per person per meal for meals in excess of 2,500 meals per day (app. supp. R4, tab 160 at 1991).

189. CMARK also requested clarification about KBR's request for proposals stating "we still have a discrepancy on how many individual people are going to be at the camp. By the title of the solicitation and the statement of work, it leads us to believe that we need capacity for 7500 bodies to be each fed 3 times a day. Your attachment A says you would like pricing for 2500 bodies or 7500 total meals per day." (App. supp. R4, tab 160 at 1989)

190. The same day, KBR clarified its requirements and CMARK confirmed the pricing of its initial proposal (app. supp. R4, tab 160 at 1989).

191. CMARK's initial proposal included all tents, utilities, and food service, with mobilization time of 48 hours for "cooking and serving" and mobilization time of 7 days for "tent setup" (app. supp. R4, tab 160 at 1991).

192. On 9 September 2005, KBR reduced the scope of the request for proposals by removing the requirement for CMARK to provide and construct its own tents and provide the utilities for the dining facilities (supp. R4, tab 1457).

193. Based on the reduced scope, CMARK submitted a second version of its proposal (revision 2) with a lump sum weekly price of $428,750 for the first 2,500 meals served plus $12.80 per person per meal for each meal served over 2,500 meals per day. This proposal eliminated "fixed costs" for the buildings and utilities. (Supp. R4, tab 1457; tr. 2/31-35)

194. In revision 2, CMARK explained that:

> This proposal as requested is to create the capacity to provide 22,500 meals per day (7500 people) while pricing it as a minimum of 2500 meals a day (833 people). This is a large spread of min to max so the number for the minimum is large. However, [KBR has] capacity built in to expand with no hesitation to what is believed to be the level of occupancy of the camp.

(Supp. R4, tab 1457 at 40067)

195. On 9 September 2005, KBR again revised the scope of work. Mr. Hayward informed CMARK that KBR required "a lump sum weekly price for serving THREE meals to 2500 people daily" (supp. R4, tab 1454).

196. Hayward explained that he made the decision to have a daily minimum meal requirement of 7,500 because to serve a camp of 7,500 personnel in a two-hour period the infrastructure required had to accommodate 2,500 people to be seated and fed in forty minutes. It was Hayward's judgment to establish a "fixed price...that captures all the fixed costs legitimately within that fixed rate." (Tr. 6/159-61)

197. Mr. Hayward testified that he had experience with dining facilities in other contingency environments and that the dining facilities in Iraq and Afghanistan were very different from the facility at issue here because the facilities in Iraq and Afghanistan were constructed to be used for a period of years, with more elaborate facilities, that were planned and constructed over a much longer period of time (tr. 6/22, 155).

198. CMARK submitted revision 3 of its proposal on 9 September 2005. The proposal was based on a minimum daily meal service of 7,500 meals with a lump sum weekly price of $874,125 for a minimum of 7,500 meals, without potable water, and $929,250 with potable water, and a unit price of $12.80 per person per meal over 7,500 meals per day, without potable water, and $13.85 with potable water (supp. R4, tab 1454).

199. After receiving CMARK's revision 3 proposal, Hayward instructed CMARK to "proceed with mobilizing assets to New Orleans while [KBR's] Procurement folks work on getting the subcontract issued" (supp. R4, tab 1455 at 40149).

200. After instructing CMARK to mobilize assets, Hayward requested that KBR's procurement personnel issue a subcontract to CMARK with a not to exceed amount of $9,142,500. Hayward stated that the "price is fair and reasonable. We have a pricing structure that will ensure that we only pay for actual meals served only." (Supp. R4, tab 1454)

201. The Navy's contract specialist, Ms. McMahon testified that, given the technical directive to prepare for 7,500 people, "[t]he fact that KBR decided to limit that to 2,500 when we looked at it at that time, we thought there was a prudent, reasonable approach to handling the influx of people that would be coming in and structuring the contract" (tr. 5/5-6), and the Navy's chief of the contracting office for the Naval Facilities Command, Mid-Atlantic, Ms. Kahler also testified that KBR's choice of a minimum 2,500 head-count per meal was a valid assumption (tr. 5/78). Moreover, Ms. Kahler testified that "KBR could have easily written a subcontract that said 7,500 per meal and, you know, that would have been a valid basis based on our direction. So in this case KBR did, you know, say it's reasonable that maybe 7,500 aren't going to come per meal." (Tr. 5/75)

202. On or about 9 September 2005, the KBR Procurement Review Board began reviewing the potential CMARK subcontract (supp. R4, tabs 1409, 1411, 1417).

203. On 9 September 2005, KBR issued a Notice to Proceed to CMARK pursuant to the revised proposal from the same day. KBR stated that the "subcontract for this effort is forthcoming pending resolution of terms, conditions, pricing, and payment." (Supp. R4, tab 1412)

204. On 9 September 2005, KBR recommended soliciting CMARK as a sole source supplier. The Sole Source justification notes that "competition was not sought due to the critical and compelling need to immediately setup a [dining facility] in New Orleans" and CMARK was providing the "same service in Gulfport...the decision was made to continue with CMARK." (Supp. R4, tab 1411)

205. CMARK started serving meals prepared by a caterer at dinner on 13 September 2005. At the first meal, 345 people were served. (Supp. R4, tabs 1465, 1466) Prior to this time, most of the workers at Joint Reserve Base New Orleans were eating Meals Ready-to-Eat (MREs) (tr. 8/15).

206. Mr. Hayward testified that even in the first days of the contract, some of the food, such as salads, were prepared on site, even though the hot entrees were catered (tr. 6/177).

207. On 16 September 2005, KBR's senior subcontract administrator, Dolores Bewley, requested that CMARK submit its proposal for the New Orleans dining facility with a price breakdown for "food, equipment, labor, overhead and profit" (app. supp. R4, tab 171).

208. On 16 September 2005, CMARK submitted proposal revision 4 with a lump sum weekly price of $874,125 for a minimum of 7,500 meals, without potable water, and $12.80

per person per meal over 7,500 meals per day. The price breakdown per person per day included: food and materials for $25.36; equipment and supplies for $12.14; labor for $4.96; overhead and profit for $7.49; totaling $49.95 per person per day. (App. supp. R4, tab 171)

209. On 21 September 2005, CMARK submitted proposal revision 5. The proposal presented six different pricing scenarios based on headcounts from 2,500 to 7,500. The Labor/Workforce rates in the revision 5 proposals increased as the headcounts rose. The rates for Kitchen and Food Storage Equipment ($1,073,656), and the "Variable Prices" for consumables ($2.49/meal) and food ($6.38/meal) did not change as headcounts increased. (Supp. R4, tab 1461)

210. Mr. Hayward emailed Lauri Paggi, the NAVFAC administrative contracting officer, on 21 September 2005 informing her that CMARK had not reached attendance of 2,500 per meal in the galley yet, but it expected to soon. Mr. Hayward explained that "[t]here is a minimum infrastructure required for just having the capability in place to serve 7500 meals at each meal that is not dependent upon the actual quantity of meals served" and "the pricing structure remains reasonable for this start up period." (Supp. R4, tab 1460) Mr. Hayward additionally provided testimony that he did not believe the 2,500 number was too high based on the direction he had received from the Navy and the information that he had (tr. 6/185).

211. The record does not contain a response to Mr. Hayward's email; however, two of the email's recipients testified that, while they did not recall responding to the email, in the normal course of dealing they would have responded to such a question, and if they had not responded, they would have expected a follow-up email from Mr. Hayward (tr. 8/63-64, 125).

212. CMARK submitted its last proposal, revision 5.1 on 22 September 2005. Revision 5.1 adjusted "the equipment amount to bring the overall total for the 2,500 head count to $46.96 per day ($3,521,972 monthly divided by 225,000 meals times 3 meals per day)." The apparent difference between revision 5 and revision 5.1 was a slight reduction in the Kitchen and Food Storage Costs (down from $1,073,656 to $990,806). (Supp. R4, tab 1462)

213. CMARK did not serve meals on 23 September 2005 or 24 September 2005 as the tent camp was evacuated due to Hurricane Rita. CMARK resumed meal service at dinner 25 September 2005. (Supp. R4, tab 1466 at 39982)

214. KBR signed the Price Reasonableness Determination Form on 24 September 2005. The memo noted that "CMARK's pricing is deemed fair and reasonable based on their recent award (See Subcontract SC-00031) of a dining facility in Gulfport, Mississippi.... Furthermore, CMARK's unit price at $46.96/day is in alignment with the current GSA per diem rate of $47 for New Orleans." (App. supp. R4, tab 176 at 2062-63)

215. The Award Documentation Summary for the subcontract was signed by Betty Hayes and Sharon Steele on 7 October 2005. Under the Price Analysis,

"Comparison with Similar Item" is checked. Other categories (e.g., competition, market price, KBR estimate, cost analysis) are not. (Supp. R4, tab 1409)

216. In a KBR Negotiation Memorandum, dated 7 October 2005, Ms. Bewley summarized the events relating to the CMARK procurement and CMARK's revisions 4, 5, and 5.1, as follows:

> The original proposed price was not broken out and appeared to be very high. The Subcontractor was then asked to breakout the cost. After receipt of their breakout (see proposals), the prices appeared to be high, particularly the food cost and the equipment per person. CMARK was then provided a spreadsheet that requested their fixed cost and variable cost, such as food and consumables. The prices that were provided averaged out to the original $49.95 per person per day. CMARK was then asked why the equipment cost was so high, at which CMARK could not provide an acceptable answer. At that time, CMARK was asked to go back and reduce their costs. It was also pointed out that KBR would not pay higher than the current per diem rate for Fiscal Year 2005 in that area, which was $47.00. CMARK claimed to be feeding the personnel items such as steak and eggs and other high cost food items. Again, CMARK was advised that KBR would not pay higher than the going per diem rate in the area. We also stated that we wanted to see a cost scale that decreased as the numbers in the camp increased.

(Supp. R4, tab 1463)

217. The Negotiation Memorandum concludes that CMARK's "price is found to be fair and reasonable to both KBR" and the Navy (supp. R4, tab 1463).

218. KBR's Procurement Review Board Pre-Award Approval Form was signed on 10 October 2005 (supp. R4, tab 1417).

219. On 11 October 2005, 32 days after the effective date of the contract, 9 September 2005, CMARK and KBR executed a 90-day contract to establish a dining facility for a 7,500 man camp in New Orleans, Louisiana with a not to exceed amount of $8,927,500. The subcontract pricing provided for a minimum of 2,500 people based on $46.96 per day, with bands for each additional 1,000 persons per day. (Supp. R4, tab 1507 at 10220-23)

220. The CMARK subcontract contained KBR's Subcontract General Conditions, which included terms reserving the right to modify, descope, or terminate any subcontract (supp. R4, tab 1507 at 10232-33 (Section 7, Suspension and Termination)).

221. KBR's Subcontract General Conditions included a provision "to suspend all or any portion of the Sublet Work." Upon any such suspension, CMARK was obligated to obtain terms favorable to KBR and, thereafter, to minimize the costs associated with the suspension. CMARK was entitled to costs associated with any such suspension. (Supp. R4, tab 1507 at 10232 (Section 7.1, Suspension))

222. Similarly, the CMARK subcontract contained a Termination for Convenience clause stating that KBR had the right to "terminate for convenience the Sublet Work in whole or, from time to time, in part, at any time by written notice to Subcontractor. Such notice shall specify the extent to which the performance of work is terminated and the effective date of such termination." CMARK was entitled to amounts due that had not been previously paid, but was not entitled to lost profits or other avoidable costs. (Supp. R4, tab 1507 at 10232 (Section 7.3.1, Termination for Convenience))

223. KBR's Subcontract General Conditions included a Changes clause reserving the right for KBR "to make changes to the Sublet Work or the manner of its performance" and establishing terms for pricing any such change in the scope of work (supp. R4, tab 1507 at 10233 (Section 8, Changes, Disputes, Notices)).

224. The CMARK subcontract prohibited CMARK from making any change without a written change order (supp. R4, tab 1507 at 10233 (Section 8.1.1)).

225. The CMARK subcontract also prohibited CMARK from subcontracting any portion of the contract, without KBR's prior written consent (supp. R4, tab 1507 at 10234 (Section 9.3)).

226. On 17 October 2005, six days after the contract was signed, KBR issued CMARK a Stop Work Order effective after dinner that night (supp. R4, tab 1418). The Navy had earlier informed KBR that KBR would no longer be performing the galley contract (tr. 6/190).

227. CMARK's meal count never reached 2,500 for any 1 meal at the dining facility (supp. R4, tab 1466 at 39982); however by technical direction 8, CMARK was also required to provide 150 meals 3 times per day to the Naval Support Activity East New Orleans and an additional 150 meals 3 times per day to the Naval Support Activity West New Orleans (supp. R4, tab 1459). The 300 meals 3 times per day delivered to other naval facilities are not included in the meal count for Joint Reserve Base New Orleans, and there is no information in the record regarding the number of meals actually served (rather than delivered) to the other naval facilities.

228. CMARK prepared varying amounts of food at the dining facility and many of the hot lunch and dinner entrees were catered from Alec Naman (supp. R4, tab 1446).

229. CMARK used refrigerated storage trailers, generators, serving equipment, washing and cleaning equipment, dining room furnishings and certain food preparation equipment during the contract period (tr. 6/176-78).

230. On 2 November 2005, KBR performed an internal review of the meal counts. Mr. Hayward acknowledged that meal counts averaged 3,672 per day or "just over half [the amount KBR] projected" (supp. R4, tab 1466 at 39980), and that paying the "entire daily amount" is likely to result in "problems with auditors." He also believed that CMARK saved money on labor because of the low meal counts (*id.*).

231. Alec Naman, the caterer, invoiced CMARK approximately $50,000-$56,000 per day for 2,500 meals (3 times a day) or approximately $20-22 per person per day. Naman Catering sent these invoices throughout October. (Supp. R4, tabs 1443-50)

232. On 7 November 2005, Ms. Bewley informed Mr. Hayward that KBR would pay the fixed costs, but that the variable costs were subject to change based on the information CMARK would provide on the meals (supp. R4, tab 1470).

233. Mr. Hayward recommended paying the daily "fixed" costs, and only the variable costs for meals actually served. He noted his opinion that CMARK experienced costs savings because it did not serve hot lunches and saved on labor costs because of catering, in addition to reduced labor costs from the Hurricane Rita evacuation. (Supp. R4, tab 1474)

234. On 16 November 2005, Ms. Bewley recommended the following proposal to CMARK: paying half of CMARK's equipment costs, all of its labor costs, and all of its invoiced meals (supp. R4, tab 1481).

235. CMARK submitted revised invoices on 18 November 2005, but did not make any adjustment for equipment costs or variable costs (supp. R4, tab 1482).

236. KBR informed CMARK of its proposal to only pay half of CMARK's equipment costs on 22 November 2005. Ms. Bewley stated that the "equipment was not fully utilized due to [CMARK] catering the majority of the meals." (Supp. R4, tab 1483)

237. In a KBR internal email dated 28 November 2005, Ms. Bewley stated that KBR's main issue was with CMARK's equipment costs as CMARK purchased the majority of the food from a caterer. She also stated that "it was KBR's original position to pay for only the actual number of meals as served, which differed drastically from the minimum number of meals as invoiced by CMARK." Ms. Bewley indicated that CMARK did not present a proposal to KBR regarding the cost dispute. (Supp. R4, tab 1486 at 40119)

238. Mr. Hayward replied that "[t]he client won't have a problem with [KBR's] proposal of paying half the equipment." He also stated that there was a changed condition

justifying the price reduction and paying the full amount may result in "potential determination of some unallowable costs." (Supp. R4, tab 1486 at 40117-18)

239. Ms. Hayes emailed CMARK on 14 December 2005 requesting information about CMARK's employees, as well as its catering invoices. She "[needed] this information to support [her] position to the government when audited next month." (Supp. R4, tab 1487)

240. CMARK responded on 14 December 2005 and said it "paid the caterer a total of $1,793,353.21 during the time we were under the KBR contract at the New Orleans camp." CMARK's direct labor cost was $593,412 (not including on site management and home office administration). (Supp. R4, tab 1493)

241. Mr. Hayward testified that he attempted to negotiate a lower price for the Navy on the CMARK subcontract, but found that CMARK incurred labor expenses not only to serve the meals, as alleged by DCAA, but also for preparing food on site, heating any catered food, and performing clean-up (tr. 6/177-78). Moreover, Mr. Hayward testified that, to the extent there were any labor savings due to the lower headcount, these costs were offset by labor costs for transporting the catered food from more than one and one-half hours away, delivering food three times per day to the Naval Support Activity, in two different locations, and extending the galley's hours of operation from two hours per meal service to two and a half hours per meal service. (Tr. 6/175-76, 186, 191, 195; supp. R4, tab 1459; app. supp. R4, tab 640 at 6280)

242. KBR presented undisputed testimony that CMARK prepared sufficient food to serve 2,500 people for each meal (tr. 2/67), with the excess food donated to local churches and charities (tr. 6/187).

243. CMARK eventually sued KBR seeking $2,500,000.00. The litigation between CMARK and KBR was settled with KBR making payment of $301,750.00. (App. supp. R4, tab 222) KBR did not pass this cost on to the Navy (tr. 6/196-97).

244. On 2 September 2005, the General Services Administration (GSA) issued guidance allowing an increase in the per diem rates of up to 300% of the applicable per diem rate (Fed. Travel Reg., GSA Bulletin, FTR 05-06), and this increase was in effect throughout CMARK's performance period (tr. 7/134).

245. As part of the normal annual update to per diem travel rates, the meals and incidentals per diem rate for New Orleans was increased from $47 per day to $59 per day (tr. 7/133).

246. In May 2007, DCAA issued its audit report with regard to the CMARK subcontract. In the "Results of Audit" section, DCAA concluded that KBR had failed to meet its responsibilities under the prime contract by issuing a subcontract with a minimum of 2,500 meals, 3 times per day, that was not set by technical direction from the Navy, and

by failing to have the dining facility tents ready in time and thus requiring CMARK to cater meals. (Supp. R4, tab 2902 at 18130)

247. DCAA concluded that the CMARK subcontract was not properly awarded because it was not the product of a competitive process. DCAA concluded that, as a sole source contract, KBR was required to provide cost or pricing data, but this information was never provided to DCAA. DCAA further found that there was no indication that any price analysis had been done despite the fact that the Negotiation Memorandum and the Pricing Memorandum indicated the pricing analysis was based on CMARK's contract with KBR in El Centro and Gulfport, as well as the GSA per diem rate. DCAA never received any analysis comparing CMARK's rate to the prevailing per diem rate, or any information at all about KBR's other subcontracts with CMARK at El Centro and Gulfport. (Tr. 2/69-71)

248. DCAA determined the questioned costs based on the three categories of costs identified in the CMARK invoices. For variable food and consumable costs, DCAA found the average amount of meals served by taking the highest attendance of a meal each day. The average amount served was 1,527. DCAA questioned 39% of the labor costs ((2,500-1,527)/2,500 = 39%) based on the average number of people served per day, assuming that the labor required would decrease based on the number of patrons. For equipment costs, DCAA used a 50% reduction as that was KBR's position in negotiations with CMARK.[8] (Tr. 2/71-78)

249. DCAA issued Audit Report No. 3321-2007K17900006 on 17 May 2007 regarding the CMARK subcontract. DCAA questioned $1,508,990 of the costs billed. (Supp. R4, tab 2902)

250. Consistent with the DCAA audit report, the contracting officer's final decision, issued on 27 February 2012, also disapproved $1,508,990 of the costs paid to CMARK for the dining facility (R4, tab 149 at 676).

251. On or about 23 May 2008, the Department of Defense, Office of the Inspector General concluded that KBR charged the Navy for more than 110,000 meals that were not served, the "meals and services" provided "should have cost $1.7 million," and "NAVFAC should, at a minimum, recover fair costs and fees associated with equipment totaling $1,368,077" (supp. R4, tab 2901 at 11495-97).

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[8] The DCAA audit report uses this pricing breakout to calculate the allowable cost for the contract, which is then subtracted from the net invoiced amount to calculate the total questioned cost. Apparently because of mobilization costs and rejected and withheld invoice amounts, it is not possible to calculate the questioned amount by cost element. (Supp. R4, tab 2902 at 18132)

DECISION

The Navy challenges the reasonableness of the CMARK costs on a number of theories. First the Navy alleges that KBR unreasonably established a minimum headcount of 2,500 people per meal (7,500 meals per day) when CMARK had initially submitted a bid with a lower minimum headcount of 833 people per meal (2,500 meals per day). Next the Navy asserts that KBR failed to perform a proper price reasonableness analysis in comparing CMARK's bid to the New Orleans Federal travel per diem rate because the per diem rate includes related taxes, tips, and incidentals that would not apply to meals eaten in a dining facility, and because dining facility meals should be substantially less expensive than restaurant meals where the customer has more extensive choices. Moreover, the Navy asserts that CMARK catered the meals, rather than cooking at the dining facility so the equipment costs were unjustified. Finally, the Navy asserts that KBR failed to exercise proper management of the contract by issuing a sole source contract and failing to de-scope the contract. (Gov't br. at 59-67)

KBR contends that the award to CMARK was reasonable given the urgent nature of the request and the information provided by the Navy regarding expected headcounts. KBR argues that, at the time it retained CMARK, the Navy had provided an estimated headcount of 7,500 per meal (22,500 meals per day), so using a minimum headcount of 1/3 of the estimated number of troops was reasonable, and that CMARK's bid with a minimum headcount of 833 per meal was not considered because it did not conform with KBR's solicitation and occurred during the chaotic days immediately following Hurricane Katrina when the scope of the project was changing rapidly. KBR disputes the Navy's comparison of CMARK's rates to the per diem rates in effect for New Orleans because the Navy's analysis is based on normal market conditions and not disaster response conditions, and notes that travelers were authorized 300% of the normal per diem rates in the aftermath of Hurricane Katrina. Additionally, KBR disputes that there was any performance cost savings to CMARK in catering the meals rather than cooking on site because of the costs of transporting the meals to the site in the post-hurricane conditions and because CMARK prepared enough food to serve 2,500 meals for each meal period. Finally, KBR disputes that it failed to properly manage the subcontract because the Navy continued to believe that troop levels would increase. (App. br. at 29-45)

The Navy challenges KBR's billing on the basis of price reasonableness. Accordingly, KBR has the burden of establishing that its prices were reasonable. Based on the totality of the record, we hold that KBR has satisfied this burden. We note that "the standard for assessing reasonableness is flexible, allowing the [Board] to consider many fact-intensive and context-specific factors." *Kellogg, Brown & Root*, 728 F.3d at 1360. Here we are mindful of the urgent need for food service at Joint Reserve Base New Orleans and the conditions in immediate post-hurricane New Orleans. While certain of KBR's decisions may appear unreasonable in hindsight, in an *ex ante* analysis we find the actions to be reasonable.

KBR began negotiating the CMARK subcontract beginning on 4 September 2005, just six days after Hurricane Katrina made landfall (finding 185). The Navy issued a task order for KBR to build a 2,000 man tent camp at Joint Reserve Base New Orleans, the scope of which was rapidly increased to a 7,500 man tent camp with electrical supply, heating and cooling, and galley capable of feeding the entire population of the tent camp (findings 185-86). During this rapid escalation in scope, KBR issued a request for proposals to CMARK for "all food, material, equipment and labor to operate the dining facilities with the capability of feeding up to 7,500 people/day in accordance with Attachment 'A;'" however, attachment A requested pricing based on serving 2500 meals per day (finding 187). CMARK requested clarification regarding the headcount, but submitted a bid based on the lower estimate of 2,500 meals per day (833 people x 3 meals per day) (findings 188-89). Following some back-and-forth negotiations (findings 190-94), KBR clarified that it was requesting 2,500 meals per meal service, 3 times per day or 7,500 meals per day (finding 195). CMARK submitted a revised bid that was accepted and KBR issued a notice to proceed on 9 September 2005 (findings 198-99, 203).

In hindsight, KBR would have saved money by contracting with CMARK on the basis of a minimum 2,500 meals per day rather than the 7,500 meals per day contained in the subcontract (*compare* findings 193 and 198). However, *ex ante*, all KBR knew was that the Navy requested construction of a 7,500 man tent camp and that the scope of the tent camp had quickly escalated from a 2,000 man camp to a 7,500 man camp. We find that negotiating a contract with a minimum charge of one-third the estimated capacity of the camp was reasonable. *See Boeing Aerospace Operations, Inc.*, ASBCA Nos. 46274, 46275, 94-2 BCA ¶ 26,802 at 133,282 (reasonableness determined based on circumstances existing at the time costs were incurred).

Admittedly, KBR could have negotiated a lower minimum number of meals, that *ex post*, would have been more advantageous to the Navy. KBR explained that with a lower guaranteed number of meals, the price per meal or the fixed price would be too high relative to the number of meals and the project would be less cost effective (finding 196). Additionally Mr. Hayward explained that the 2,500 minimum per meal was a function of the Navy's requirement that the dining facility be able to serve 7,500 meals in a two-hour period. Mr. Hayward explained that allowing 40 minutes per meal, they would need tables and chairs for 2,500 people to accommodate 7,500 diners in a two-hour period. (*Id.*)

The Navy's contract specialist, Ms. McMahon testified that "[t]he fact that KBR decided to limit that to 2,500 when we looked at it at that time, we thought there was a prudent, reasonable approach to handling the influx of people that would be coming in and structuring the contract" and the Navy's chief of the contracting office for the Naval Facilities Command, Mid-Atlantic, Ms. Kahler also testified that KBR's choice of a minimum 2,500 head-count per meal was a valid assumption. Moreover, Ms. Kahler testified that "KBR could have easily written a subcontract that said 7,500 per meal and, you know, that would have been a valid basis based on our direction. So in this case KBR did, you know, say it's reasonable that maybe 7,500 aren't going to come per meal." (Finding 201)

The Navy attempts to undercut this testimony by its own witnesses, arguing that "[i]n contrast to the NAVFAC witnesses – who did not have experience setting up [dining facilities] and/or years of experience running [dining facilities] in Iraq and Afghanistan – KBR has substantial experience setting-up [dining facilities] and had adopted special procurement policies for [dining facility] services" (gov't reply br. at 19). We reject the Navy's suggestion that KBR should have known better than the Navy's own procurement employees what the expected number of meals would be at the dining facility. As Mr. Hayward explained, the dining facilities in Iraq and Afghanistan were very different from the facility at issue here because the facilities in Iraq and Afghanistan were constructed to be used for a period of years, with more elaborate facilities, and were planned and constructed over a much longer period of time. (Finding 197) Thus, we find that KBR acted reasonably in setting the minimum head-count per meal.

The Navy's challenge to the price reasonableness of the per-person per day meal cost of the CMARK subcontract fares no better. According to the Navy, KBR failed to perform a proper price evaluation for the sole-source award. The Navy asserts that the dining services were not a commercial item, so KBR was required pursuant to FAR 15.404 to obtain cost and pricing data. Additionally, the Navy asserts that KBR's comparison of the per person per day meal rate to the Federal travel per diem rate for New Orleans did not provide a proper comparison.

KBR asserts that its retention of CMARK was justified by the urgency of the Navy's request, and the fact that the food service was a commercial item such that cost and pricing data were not required. Moreover, KBR asserts that the Federal travel per diem of $47.00 per day for meals and incidentals was an appropriate comparison because the per diem did not imply workers could actually dine for $47 per person during the disaster recovery.

As an initial point, we agree with KBR that the food service at the dining facility meets the definition of a "commercial item" pursuant to FAR 2-101 ("[a]ny item, other than real property, that is of a type customarily used by the general public or by non-governmental entities for purposes other than governmental purposes"). The Navy asserts that the dining services were not commercial items because they were a "specialized service" without adequate "benchmarks to compare its costs to" (gov't br. ¶ 157). However, the Navy's argument appears to apply the definition of a "commercially available off-the-shelf" item – a commercial item sold in substantial quantities and offered to the Government without modification. FAR 2.101. Thus, as a commercial item, certified cost and pricing data were not required (FAR 15.403-1(b), (c)(3)(i)), and price analysis was appropriate for determining that the price was fair and reasonable. FAR 15.404-1(a)(2).

The FAR describes a number of techniques for evaluating price reasonableness, and provides that comparison of proposed prices received in response to the solicitation and comparison to historical prices paid are the preferred price techniques, but "if the contracting officer determines that information on competitive proposed prices or previous

contract prices is not available or is insufficient to determine that the price is fair and reasonable, the contracting officer may use any of the remaining techniques as appropriate to the circumstances applicable to the acquisition." FAR 15.404-1(b)(3).

The Navy asserts that KBR's price comparison to the Federal travel per diem rate is inappropriate because the per diem rate includes incidentals and is not limited to just food, and because KBR was providing mess-hall food, rather than cooked-to-order restaurant meals. The Navy additionally disputes the use of the per diem rate because CMARK catered much of the food served in the dining facility. The Navy also asserts that the proper comparison would be to the proportional meal rate, without incidentals, of $26 per day or the government meal rate, which is the daily rate for meals in a government dining facility of $8.90 per day. (Gov't br. at 65)

The Navy's analysis completely ignores the market conditions in effect at the time of the contract. The market was a disaster relief situation, where essential public utilities were unavailable, road and bridges were impassible, and there were shortages of gasoline, and labor (*see, e.g.*, finding 66). Because time was of the essence, KBR reasonably entered into a sole-source contract with CMARK. KBR was tasked with preparing a 7,500 man tent camp with a dining facility just six days after Hurricane Katrina made landfall, and began serving meals in the facility just nine days after that. Prior to this time, the emergency workers were living on MREs. (Finding 205) There is no evidence that there were commercial dining options available to accommodate the projected number of rescue workers at the per diem rate.

The Navy relies upon Ms. Kahler's testimony that the comparison to the per diem rate was not an "apples to apples" comparison because eating at a government dining facility costs less than "going out to Chipotle" (gov't post-hearing br. at 65 (quoting tr. 5/93-94). However, Ms. Kahler's analysis ignores that the travel per diem was set *before* Hurricane Katrina to reflect dining costs under normal market conditions. After Hurricane Katrina, market conditions were drastically different.

The GSA issued guidance allowing an increase in the per diem rates by up to 300% and this increase was in effect throughout CMARK's performance period (finding 244). In addition, the meals and incidentals per diem was increased from $47 per day to $59 per day as part of the normal annual update to the travel rates (finding 245). Thus, it is clear that the $47 per day price comparison point did not reflect the price at which an emergency worker could expect to dine at area restaurants. Instead that price would be up to $141 per day through 30 September 2005 and $177 per day effective 1 October 2005.

Given the emergency conditions in effect in New Orleans in early September 2005, we find that KBR satisfied the FAR's price analysis requirements with regard to the daily rate (*see* findings 200, 202, 204, 207, 214-18). While the GSA per diem rate was not a perfect yardstick for evaluating the reasonableness of CMARK's proposed costs, it may have been the best available information given the disruptions to communications, labor, utilities, and

distribution networks (finding 66). The Navy has not proposed a better source of pricing data that would have been available to KBR at the time. We find that the proportional meals rate, with or without incidentals, and the government meals rate were not appropriate benchmarks. However, we note that a 300% adjustment to the proportional meals rate of $26 per day would be $78 per day – substantially higher than the $46.96 per day in the CMARK contract.

The Navy further asserts that KBR's subcontract with CMARK was unreasonable because CMARK catered most of the meals rather than preparing the meals in the dining facility. The Navy asserts that catering the meals resulted in excessive charges for equipment, labor savings with regard to food preparation, and due to the lower than expected headcount, savings in the food costs. KBR asserts that the Navy's task order did not require that the meals be prepared on site, and that much of the equipment was required for storing, heating and serving the food, that there were no labor cost savings or food cost savings because CMARK prepared enough food to serve 2,500 people for each meal. Additionally, KBR notes that CMARK incurred substantial costs in transporting the catered food from the remote preparation site, and also in delivering meals to other Navy locations.

As an initial point, we agree with KBR that the CONCAP III master contract simply provided that KBR might be tasked with providing a galley (finding 1) and Task Order 16, Technical Direction 002 simply provided that KBR should "[p]rovide 2500 Man Tent Camp with including but not limited to; galley, port-a-lets, shower facilities" (finding 185). The size of the tent camp was later modified, but there was no additional direction provided regarding the "galley" (*id*). Thus, CMARK's provision of catered meals did not violate the terms of the contract.

With regard to the Navy's assertion that KBR's equipment costs were unreasonable because CMARK provided catered food, we find that this allegation was not supported by hearing testimony. The witnesses with personal knowledge of activities at Joint Reserve Base New Orleans during the relevant period testified that CMARK prepared some of the food in the dining facility. Admittedly, KBR did not have the tents prepared at the start of the performance period, but hearing testimony demonstrated that CMARK used the refrigerated storage trailers, generators, serving equipment, washing and cleaning equipment, dining room furnishings and certain food preparation equipment during the contract period. (Finding 229) Mr. Hayward also testified that even in the first days of the contract, some of the food, such as salads, were prepared on site, even though the hot entrees were catered (findings 206, 228, 231).

The Navy was also unable to support its contention that CMARK enjoyed significant labor savings due to the reduced headcount. As KBR noted, DCAA's determination to question 39% of the labor costs assumes a linear relationship between the number of meals served and labor costs. KBR presented testimony from Mr. Hayward that KBR had attempted to negotiate a reduction in the contract costs on behalf of the Navy, but was unsuccessful (findings 230, 232-40). Mr. Hayward further demonstrated that CMARK incurred labor expenses not only to serve the meals, as alleged by DCAA, but also for preparing food on site, heating any catered food, and performing clean-up (finding 241).

Moreover, Mr. Hayward testified that, to the extent there were any labor savings due to the lower headcount, these costs were offset by labor costs for transporting the catered food from more than one and one-half hours away, delivering food three times per day to the Naval Support Activity, in two different locations, and extending the galley's hours of operation from two hours per meal service to two and a half hours per meal service (*id.*).

The Navy's assertion that CMARK incurred reduced costs for food and consumables due to the lower than expected headcount was also unsupported by the evidence. KBR presented undisputed testimony that CMARK prepared sufficient food to serve 2,500 people for each meal, with the excess food donated to local churches and charities (finding 242). Accordingly, we find that CMARK's prices were reasonable with regard to the Navy's allegations that CMARK incurred decreased costs due to the lower headcount.

The Navy's final challenge to the CMARK subcontract asserts that, even if CMARK's proposal was reasonable when the terms were set on or about 9 September 2005, it was unreasonable for KBR not to decrease the scope of the contract once it was obvious that the dining facility would not be serving 7,500 or even 2,500 people per day. KBR responds that it raised the issue with the Navy, but received indications that the headcount numbers were expected to increase.

The record reflects that Mr. Hayward sent an email on 21 September 2005 to the Navy, including Ms. Paggi and Ms. Brunner, noting that the galley headcounts were significantly below the requirement of 7,500 meals 3 times per day, and that the meal count had not reached the 2,500 meal minimum (finding 210). The email provided that KBR still expected to meet the 2,500 meal contract minimum, and expressed Mr. Hayward's opinion that "the pricing structure remains reasonable for this start up period," but requesting the Navy's concurrence (*id.*) Mr. Hayward additionally provided testimony that he did not believe the 2,500 number was too high based on the direction he had received from the Navy and the information that he had (*id.*). The record does not include a response from the Navy to Mr. Hayward's email; however, two of the email's recipients testified that, while they did not recall responding to the email, in the normal course of dealing they would have responded to such a question, and if they had not responded, they would have expected a follow-up email from Mr. Hayward (finding 211). KBR executed the final subcontract with CMARK on 11 October 2005, and six days later, on 17 October 2005, KBR issued a stop work order to CMARK at the Navy's request (findings 219, 226). Thus, despite the fact that KBR had a contractual right to de-scope CMARK's contract (findings 220-24), we find that KBR acted reasonably. KBR reasonably sought concurrence from the Navy regarding the continued reasonableness of the continuing use of the 2,500 headcount per meal minimum. In addition, the contract was of a short duration. Had performance continued for a longer period of time, KBR's actions might not have been considered reasonable.

The Navy was the party more knowledgeable about the expected headcount at the base and was also the party that provided the specification for the construction of a 7,500

man camp. Accordingly, we hold that CMARK's prices were reasonable and find entitlement in favor of KBR with regard to the CMARK subcontract.

CONCLUSION

For the foregoing reasons, the appeal is sustained in part and we return the appeal to the parties to negotiate quantum consistent with this decision.

Dated: 2 December 2016

DAVID D'ALESSANDRIS
Administrative Judge
Armed Services Board
of Contract Appeals

I concur

OWEN C. WILSON
Administrative Judge
Armed Services Board
of Contract Appeals

I concur

MARK N. STEMPLER
Administrative Judge
Acting Chairman
Armed Services Board
of Contract Appeals

I concur

RICHARD SHACKLEFORD
Administrative Judge
Vice Chairman
Armed Services Board
of Contract Appeals

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA No. 58081, Appeal of Kellogg Brown & Root Services, Inc., rendered in conformance with the Board's Charter.

Dated:

JEFFREY D. GARDIN
Recorder, Armed Services
Board of Contract Appeals