ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeals of --	)	
	)	
Tecom, Inc.	)	ASBCA Nos. 53884, 54461
	)	
Under Contract No. DAKF48-96-C-0001	)	

APPEARANCES FOR THE APPELLANT: Theodore M. Bailey, Esq.
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Acting Chief Trial Attorney
MAJ Jennifer S. Zucker, JA
CPT Sean M. Connolly, JA
Trial Attorneys

OPINION BY ADMINISTRATIVE JUDGE VAN BROEKHOVEN
ON CROSS-MOTIONS FOR PARTIAL SUMMARY JUDGMENT

Appellant appealed the contracting officer's failure to issue a final decision on its claim for costs incurred by appellant in its defense in a lawsuit related to allegations of sexual harassment, which costs had been disallowed by the government. ASBCA No. 53884. The costs at issue included the attorneys' fees and expenses incurred by appellant in the defense of that lawsuit, and the payments made by appellant under a settlement agreement that resolved the lawsuit.

According to appellant's complaint, these costs are allowable costs under Federal Acquisition Regulation (FAR) Part 31. In its answer to appellant's complaint, the government asserted that all of the costs associated with appellant's defense and settlement of the former employee's lawsuit are unallowable as either direct or indirect charges, and that the settlement cost is not allowable under any circumstances. The government asserted an affirmative defense, that included *inter alia*, an assertion that, costs, including the cost of settlement and legal fees incurred in defending the former employee's lawsuit, are unallowable, unless appellant proves that the claim of reprisal for sexual harassment, if litigated, had "very little likelihood of success on the merits," relying on *Boeing North American, Inc. v. Roche*, 298 F.3d 1274, 1289 (Fed. Cir. 2002) (sometimes referred to herein simply as the *Boeing* decision or the *Boeing* standard), and further, that the actual cost of settlement is never allowable as it is "similar or related" to

a penalty for wrongdoing and is completely out of the scope of the contract (FAR 31.204 (c)).

Appellant filed a motion for partial summary judgment in the appeal docketed as ASBCA No. 53884, seeking relief in the nature of declaratory judgment, asserting that appellant is entitled to judgment as a matter of law on the government's affirmative defense claim. Appellant also relies on the *Boeing* decision, arguing that a cost is allocable to a given contract or other cost center if there is a logical connection, or nexus, between the incurrence of the cost and the performance of the contract, or operation of the cost center.

The government filed its opposition to appellant's motion and a cross-motion for partial summary judgment, also based in part on its interpretation of *Boeing*, arguing that *Boeing* disposed of the benefit test for allocability and that the test for allowability involved an inquiry as to whether appellant was likely to prevail on the merits in the civil suit that was subject to the settlement. In response, appellant argues that the *Boeing* requirement for a showing of likely success only applies where the lawsuit involved some form of fraud or false claim on the government by the contractor seeking to recover the costs.

As we detail below, appellant also filed a direct appeal in the U.S. Court of Federal Claims from a contracting officer's decision demanding repayment of $96,163.16 in legal fees which, according to appellant, the government believed had been paid as reimbursement of General and Administrative (G&A) expenses. The Court of Federal Claims transferred that appeal to the Board for consolidation with ASBCA No. 53884, since both actions relate to the same contract, same facts, same costs, and same dispute, and that appeal was docketed as ASBCA No. 54461. Inasmuch as the proposed findings of fact and arguments by the parties in ASBCA No. 53884 apply to ASBCA No. 54461, we address the consolidated appeals in this opinion and decision.

STATEMENT OF FACTS FOR THE PURPOSE OF THE MOTIONS

The parties have generally agreed to statements of uncontroverted material facts, except with respect to appellant's paragraph 18, which according to the government, mischaracterizes the report issued by the Defense Contract Audit Agency (DCAA). Moreover, the government proposes additional proposed statements of fact which because of their nature do not appear to be controverted by appellant. We, therefore, set forth those uncontroverted material facts proposed by appellant, subject to minor editorial modifications, the proposed additions submitted by the government similarly subject to minor editorial modifications, additions from the complaint and answer and from the record to which there can be no dispute required for clarity, and relevant provisions from the FAR and Cost Accounting Standards (CAS).

1. Appellant, Tecom, Inc., was awarded the subject contract for the military housing maintenance at Fort Hood, Texas on 13 December 1995. The contract was a negotiated cost reimbursement contract, in the estimated amount of $8,253,719.07, for labor, management, supervision, supplies, materials, and tools supporting family housing maintenance and repair activities, and occupant self-help. The contract incorporated by reference the clauses prescribed by the FAR Part 52 in effect at the time of the contract award. (R4, tab 1)[1] These included FAR 52.216-7 ALLOWABLE COST AND PAYMENT (JUL 1991), FAR 52.222-26 EQUAL OPPORTUNITY (APR 1984), 3 FAR 52.230-3 DISCLOSURE AND CONSISTENCY OF COST ACCOUNTING PRACTICES (NOV 1993), and FAR 52.230-5 ADMINISTRATION OF COST ACCOUNTING STANDARDS (FEB 1995). The ALLOWABLE COST AND PAYMENT clause provided, in pertinent part:

> (a) *Invoicing.* The Government shall make payments to the Contractor when requested as work progresses, . . .The Contractor may submit to an authorized representative of the Contracting Officer, in such form and reasonable detail as the representative may require, an invoice or voucher supported by a statement of the claimed allowable cost for performing the contract.
>
> (b) *Reimbursing costs.* (1) For the purpose of reimbursing allowable costs (except as provided in subparagraph (2) below, with respect to pension, deferred profit sharing, and employee stock ownership plan contributions), the term "costs" includes only –
>
> (i) Those recorded costs that, at the time of the request for reimbursement, the Contractor has paid by cash, check, or other form of actual payment for items or services purchased directly for the contract;
>
> (ii) When the Contractor is not delinquent in paying costs of contract performance in the ordinary course of business, costs incurred, but not necessarily paid, for –
>
> . . . .

[1] Federal Acquisition Regulation as of 1 January 1995 and updated as of 1 January 1996 with incorporated amendments contained in Federal Acquisition Circulars through FAC 90-36.

> (D) Other direct in-house costs; and
>
> (E) Properly allocable and allowable indirect costs, as shown in the records maintained by the Contractor for purposes of obtaining reimbursement under Government contracts; . . . .

The EQUAL OPPORTUNITY clause provided, in part:

> (b) During performing [sic] this contract, the Contractor agrees as follows:
>
> (1) The Contractor shall not discriminate against any employee or applicant for employment because of race, color, religion, sex, or national origin.
>
> (2) The Contractor shall take affirmative action to ensure that applicants are employed, and that employees are treated during employment, without regard to their race, color, religion, sex, or national origin. This shall include, but not be limited to, (i) employment, (ii) upgrading, (iii) demotion, (iv) transfer, (v) recruitment or recruitment advertising, (vi) layoff or termination, (vii) rates of pay or other forms of compensation, and (viii) selection for training, including apprenticeship.

2. During performance of the contract, a former employee of Tecom who had worked on the contract sued Tecom under various theories relating to sexual harassment pursuant to Title VII of the Civil Rights Act of 1964, as a result of her employment on the subject contract. This lawsuit was ultimately settled on 19 March 1999. (R4, tab 3(a)) The record does not contain any evidence that indicates the lawsuit or any of the events giving rise to the lawsuit were linked in any way to any allegations of submission of false claims, misrepresentation or fraud against the government (app. mot. for summary judgment, ¶ 20; gov't opp'n to app. mot. for summary judgment and cross-motion ¶ II.1).

3. In the course of defending and settling that lawsuit, appellant incurred legal fees and settlement cost (R4, tab 3).

4. Appellant's legal fees totaled $96,163.16 (R4, tab 3(a), 3(c)).

5. The settlement expense was $50,000.00 (R4, tab 3(a)). No part of the settlement amount included back pay (R4, tab 3(d), ¶ 5), and there was no admission of wrongdoing on the part of appellant (R4, tab 3(d)). The settlement agreement further included a confidentiality provision under which the former employee and her attorneys agreed to keep the existence, amount, and terms of the agreement confidential (R4, tab 3(d), ¶ 9). Although the existence, allegations, and proceedings of the lawsuit were a matter of public record, the settlement agreement provided that the former employee was not, subject to certain exceptions, to disclose the proceedings and disposition of the lawsuit. In the event that the employee violated any of the confidentiality and non-disclosure restrictions, the former employee could be liable to appellant in the amount of $7,500.00, as liquidated damages, as well as forfeit of all monies due under the agreement (R4, tab 3(d), ¶¶10, 12).[2]

6. By letter dated 2 September 1999, appellant submitted its invoice and request for reimbursement in the total amount of $146,163.16, the amount it claimed for legal expenses and settlement costs relating to the layoff of the former employee, which had been alleged to be in retaliation against the employee for filing a sexual harassment charge (R4, tab 3). Appellant asserted in this letter that the accusation was false, but that it would have cost approximately twice the amount of the invoice to try the case. As a result, appellant asserted that it made a prudent business decision to settle the case without any admission of guilt.

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[2] The government filed a motion to compel appellant to waive the confidentiality and breach provisions of the settlement agreement. The basis for the government's motion was that the Court in *Boeing North American, Inc. v. Roche*, 298 F.3d 1274, *supra*, established new and important legal standards for allocability and allowability of costs under government cost-reimbursement contracts, and that under the principles of this decision, the allegations of sexual harassment must be considered. In order to do so, the government argued, that appellant must waive the confidentiality and breach clauses of the settlement agreement. The Board denied the government's motion on the basis that the U.S. District Court for the Western District of Texas approved the settlement agreement and issued the protective order in *Curlee v. Tecom, Inc., et al.*, Civil Action No. A-98-286-SS, that the government was not a party to that lawsuit, and had not intervened therein seeking modification of the settlement agreement and protective order. We held that the jurisdiction to modify or lift the protective order was retained by the U.S. District Court for the Western District of Texas, and that we had no jurisdiction to require the release of any employee information covered thereunder when that Court retained jurisdiction to modify or lift the restriction of the confidentiality agreement.

7. On 11 February 2000, the contracting officer responded to appellant's request for reimbursement, stating:

> Reference TECOM letter dated September 2, 1999, requesting reimbursement for legal fees and settlement cost as a result of a sexual harassment lawsuit instituted by Ms. Lisa Linderman Curlee, former employee of your firm.
>
> A cost is allocable only if there is some benefit to the Government for incurring the cost. TECOM must show a benefit to the Government work from an expenditure of a cost that it claims is "necessary to the overall operations of TECOM's business."
>
> Request you submit evidence that the defense and settlement of this suit benefits the Government within 30 days from the date of this letter.

Statement of Uncontroverted Material Facts, ¶ 7 (letter not included in R4, file although listed in the R4 Index).

8. Counsel for appellant responded by letter dated 13 March 2000 with an analysis of the relevant FAR provisions and case law which appellant believed demonstrated that there was no requirement to demonstrate a direct benefit to the government of the particular costs claimed (R4, tab 5(a)). Counsel for appellant supplemented that letter with further analysis on 4 April 2000 (R4, tab 5(b)).

9. On 9 June 2000, the DCAA issued audit report number 3511-2000K17900005, which reviewed appellant's claim (R4, tab 6). The audit report contained three disclaimers. First, the audit report noted that DCAA had requested, but not received, a legal opinion from Army counsel regarding the applicability of *Caldera v. Northrop Worldwide Aircraft Services, Inc.*, 192 F.3d 962 (Fed. Cir. 1999), to appellant's claim. Second, the audit report stated that the claimed costs were in "potential noncompliance" with CAS 401 and CAS 402 because the auditor was concerned that appellant's claim might be seeking as direct costs amounts which had already been allocated to an indirect pool. Third, the audit report stated that it had requested from appellant, but not received, an explanation of the direct benefit received by the government for these costs.

10. By letter dated 16 June 2000, the contracting officer wrote directly to appellant in response to counsel for appellant's 4 April 2000 letter, stating:

> Reference letter received from Mr. Theodore Bailey, P.C. dated April 4, 2000, requesting information on case(s) supporting the Government's request for TECOM to show "some benefit to the Government for incurring the cost of subject claim."
>
> It is a requirement of the Government that TECOM show some benefit to the Government for incurring legal fees and settlement cost as a result of a sexual harassment lawsuit arising out of performance of the contract.
>
> The Louis Caldera V. [sic] Northrop Worldwide Aircraft Services, Inc., No. 98-1500 (Fed. Cir. Sep. 10, 1999) case supports the Government's request.
>
> Request you submit evidence that the defense and settlement costs of this suit benefits the Government within 30 calendar days from the date of this letter. At that time, the Government will determine if the legal costs are allocable to the cost reimbursement contract.

(R4, tab 7)

11. Appellant responded by letter dated 18 July 2000, reiterating appellant's position that there was no legal requirement that appellant demonstrate a direct benefit to the government before the costs in question could be considered allocable (R4, tab 8(a)). Without waiving that objection, appellant offered the following explanation of the benefit to the government flowing from the costs in question:

> The immediate benefit to the Government is that these costs were incurred as part of TECOM's effort to perform its contract duties in an efficient, orderly, proper, and effective manner. The more general benefit to the Government is to have TECOM a reasonable, efficient, strong competitor, so as to help the Government achieve the lowest possible price and best services possible for its money. Settling the case also benefits the Government by eliminating disruption of the contract, due to employees [sic] involvement giving testimony during the trial.

> Providing a defense to a management employee being alleged to have committed sexual harassment and settling when appropriate, based on the facts and litigative costs to be incurred, benefits the Government in that it helps to provide: (1) orderly administration of the contract; (2) support of contract managers who are charged with contract management, which improves their morale; (3) discourages frivolous or groundless claims to improve the overall morale of all employees; (4) payment when appropriate of legitimate portions of claims, so as to improve the morale of all employees; and (5) eliminates a larger fee from being bid because it would include a factor for this legitimate cost of business. Thus, incurrence of these costs was to the ultimate benefit of the Government.

(R4, tab 8(a))

12. On 24 October 2000, counsel for appellant wrote the contracting officer inquiring about the status of the issue of reimbursement of these costs (R4, tab 10). The contracting officer responded to appellant's 24 October 2000 letter on 8 November 2000 (R4, tab 11). According to the contracting officer, the DCAA report "revealed that the legal and settlement costs that TECOM proposed as a direct charge to the [contract], were accumulated and charged to the General and Administrative expense pool and allocated to all contracts." *Id.* Moreover, the contracting officer stated that appellant had "historically classified and allocated all similar costs as G&A expense," and that "[m]oving these costs from its G&A expense pool and reallocating the costs as direct to the contract would cause TECOM to be in noncompliance with CAS 401." *Id.* Accordingly, it was the contracting officer's position that, in light of appellant's accounting practices, "charging this as a direct expense is really a mute [sic] issue at this time." *Id.* Therefore, in light of the DCAA report, the contracting officer did not believe that there was any further basis for discussion. The letter did not mention any concerns about direct benefit to the government.

13. In its letter of 22 March 2001, appellant's counsel responded to the contracting officer's letter and pointed out that the $50,000.00 settlement was not charged to G&A, contrary to the erroneous statement to that effect in the DCAA Report (R4, tab 12). Counsel further stated that:

> This letter is in response to your November 8, 2000 letter. The settlement amount of $50,000 was not charged to G&A. Instead, it was put in a "prepay" account until

> approved by Fort Hood to bill on the contract. As a cost reimbursement contract, Tecom needed Government approval in order to bill this amount. This amount has always been treated as a cost of this contract. The legal costs were treated differently, but are not a part of the $50,000. Therefore, the $50,000 is not a part of any G&A pool or forward pricing rates. To the extent the audit report states that it is, it is incorrect. Thus, there is no change in Tecom's accounting practices or its disclosure statement. Based on the above, the Government should approve the $50,000 for payment under the contract so that we can settle the claim.

Id. Appellant has continued to allege, in its correspondence with the contracting officer, and both in its pleadings and in its motion for partial summary judgment that the $50,000.00 settlement paid to the former employee ($49,000.00 direct payment to the former employee/plaintiff in the lawsuit related to the alleged sexual harassment, and $1,000 for costs incurred in selection of the jury) was charged as a direct cost to the contract in a "pre-paid" account (R4, tabs 12, 17; compl. ¶ 7; app. mot. for partial summary judgment ¶ 18). The government did not deny this assertion; rather, it stated in its answer that this addressed a matter or information peculiarly within appellant's purview, to which the government could not form a responsive pleading (answer ¶ 7). In its response to appellant's motion, the government conceded that the settlement costs were not included in G&A (gov't opp'n to app. mot. and cross mot. for partial summary judgment ¶ II.1).

14. By letter dated 22 June 2001, appellant converted the request for payment to a claim and requested a contracting officer's final decision (R4, tab 16). Appellant filed its notice of appeal on 30 July 2002 from a contracting officer's failure to issue a final decision. Appellant alleged that the government had not paid the $50,000.00 settlement costs, and had not reimbursed appellant any of the legal fees alleged to have totaled $96,163.16 as reimbursement for G&A expenses.

15. The relevant Cost Accounting Standards (CAS) at issue in these appeals, current as of the date of contract award were: CAS 402-30 Definitions, which defined terms, such as "allocate," cost objective, direct cost, final cost objective, indirect cost, and indirect cost pool; CAS 401-40 Fundamental requirement, which required consistency in estimating, accumulating, and reporting costs, and the appellant's disclosed accounting practices; CAS 402-20 Purpose; and CAS 402-40 Fundamental requirement. CAS 402-20 Purpose provided that:

> The purpose of this standard is to require that each type of cost is allocated only once and on only one basis to any contract or other cost objective. The criteria for determining the allocation of costs to a product, contract, or other cost objective should be the same for all similar objectives. Adherence to these cost accounting concepts is necessary to guard against the overcharging of some cost objectives and to prevent double counting. Double counting occurs most commonly when cost items are allocated directly to a cost objective without eliminating like cost items from indirect cost pools which are allocated to that cost objective.

CAS 402-40 Fundamental requirement provided:

> All costs incurred for the same purpose, in like circumstances, are either direct costs only or indirect cost only with respect to final cost objectives. No final cost objective shall have allocated to it as an indirect cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included as a direct cost of that or any other final cost objective. Further, no final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included in any indirect pool to be allocated to that or any other final cost objective.

16. The relevant cost principles in issue here include FAR 31.201-2, FAR 31.203, and FAR 31.205-47. FAR 31.201-2 provided in pertinent part:

> (a) The factors to be considered in determining whether a cost is allowable include the following:
>
> (1) Reasonableness.
>
> (2) Allocability.
>
> (3) Standards promulgated by the CAS Board, if applicable; otherwise, generally accepted accounting principles and practices appropriate to the particular circumstances.
>
> (4) Terms of the contract.

(5) Any limitations set forth in this subpart.

FAR 31.201-4, Determining allocability, provided that:

> A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it –
>
> (a) Is incurred specifically for the contract;
>
> (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
>
> (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

FAR 31.205-15, Fines, penalties, and mischarging costs, provided in pertinent part that:

> (a) Costs of fines and penalties resulting from violations of, or failure of the contractor to comply with, Federal, State, local, or foreign laws and regulations, are unallowable except when incurred as a result of compliance with specific terms, and conditions of the contract or written instructions from the contracting officer.

FAR 31.205-33, Professional and consultant service cost, defined professional and consultant services as those services rendered by members of a particular profession or persons who possess special skills, but are not officers or employees of the contractor. Examples included legal services acquired to enhance the legal position of the contractor, and included various forms of representation. The cost principle provided in pertinent part:

> (b) Costs of professional and consultant services are allowable subject to this paragraph and subparagraphs (c) through (f) of this subsection when reasonable in relation to the services rendered and when not contingent upon recovery

> of the costs from the Government (but see 31.205-30 [patent costs] and 31.205-47).

FAR 31.205-47, Costs related to legal and other proceedings, provided in pertinent part, as follows:

> (a) *Definitions.* "Conviction," as used in this subsection, is defined in 9.403. ["'Conviction' means a judgment or conviction of a criminal offense by any court of competent jurisdiction, whether entered upon a verdict or a plea, and includes a conviction entered upon a plea of nolo contendere." FAR 9.403]
>
> *Costs* include, but are not limited to, administrative and clerical expenses; the costs of legal services, whether performed by in-house or private counsel; . . . and any similar costs incurred before, during, and after commencement of a judicial or administrative proceeding which bears a direct relationship to the proceedings.
>
> "Fraud," as used in this subsection, means (1) acts of fraud or corruption or attempts to defraud the Government or to corrupt its agents; (2) acts which constitute a cause for debarment or suspension under 9.406-2(a) and 9.407-2(a) and (3) acts which violate the False Claims Act . . . or the Anti-Kickback Act, ...
>
> "Penalty," does not include restitution, reimbursement, or compensatory damages.
>
> "Proceeding," includes an investigation.
>
> (b) Costs incurred in connection with any proceeding brought by a Federal, State, local or foreign government for violation of, or a failure to comply with, law or regulation by the contractor (including its agents or employees) are unallowable if the result is –
>
> (1) In a criminal proceeding, a conviction;

(2) In a civil or administrative proceeding, either a finding of contractor liability where the proceeding involves an allegation of fraud or similar misconduct or imposition of a monetary penalty where the proceeding does not involve an allegation of fraud or similar misconduct.

(3) A final decision by an appropriate official of an executive agency to:

(i) Debar or suspend the contractor;

(ii) Rescind or void a contract; or

(iii) Terminate a contract for default by reason of a violation or failure to comply with a law or regulation;

(4) Disposition of the matter by consent or compromise if the proceeding could have led to any of the outcomes listed in subparagraphs (b)(1) through (3) of this subsection

. . . .

(f) Costs not covered elsewhere in this subsection are unallowable if incurred in connection with –

(1) Defense against Federal Government claims or appeals or the prosecution of claims or appeals against the Federal Government (see 33.201).

(2) Organization, reorganization, (including mergers and acquisitions) or resisting mergers or acquisitions (see also 31.205-27).

(3) Defense of antitrust suits.

(4) Defense of suits brought by employees or ex-employees of the contractor under section 2 of the Major Fraud Act of 1988 where the contractor was found liable or settled.

> (5) Costs of legal, accounting, and consultant services and directly associated costs incurred in connection with the defense or prosecution of lawsuits or appeals between contractors arising from either (1) an agreement or contract concerning a teaming arrangement, a joint venture, or similar arrangement of shared interest; or (2) dual sourcing, coproduction, or similar programs, are unallowable, except when (i) incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer, or (ii) when agreed to in writing by the contracting officer.

17. Although FAR 31.205 contained 52 subsections, each covering in detail the allowability and limitations regarding selected costs, FAR 31.204 set forth the application of the principles and procedures. Specifically, it provided that "[c]osts shall be allowed to the extent that they are reasonable, allocable, and determined to be allowable under 31.201, 31.202, 31.203, and 31.205." Moreover, as FAR 31.204 makes clear, "[s]ection 31.205 does not cover every element of cost," nor does it imply that the failure to include any item of cost is either allowable or unallowable. Thus, FAR 31.204(c) provided that: "The determination of allowability shall be based on the principles and standards in this subpart and the treatment of similar or related selected items."

18. On 4 September 2002 (misdated 2001), the contracting officer issued a final decision demanding repayment of the $96,153.16 in legal fees that appellant allegedly had charged to G&A (supp. R4, tab 19). Appellant timely appealed the contracting officer's final decision to the United States Court of Federal Claims. According to the complaint filed in the Court of Federal Claims action, the contracting officer had failed to issue a final decision with respect to appellant's claim for reimbursement, and the basis for the contracting officer's demand for payment in this final decision of 4 September 2002 was the same as the contracting officer's position in denying appellant's claim. That appeal, *TECOM, Inc. v. United States*, No. 03-1671 C, was subsequently transferred to the Board for consolidation with ASBCA No. 53884, and docketed as ASBCA No. 54461.

DECISION

In its motion for partial summary judgment, appellant seeks a decision holding that *Boeing North American, Inc. v. Roche*, 298 F.3d 1274, *supra*, is inapplicable to the disputed costs in question, and holding that, as a matter of law, the government's affirmative defense based on *Boeing* is not available to the government as a bar against appellant's recovery of the settlement cost and legal fees. The government, in opposition

to appellant's motion, argues that appellant's motion should be denied because it is based on a faulty premise that the *Boeing* decision is limited to allegations of fraud against the government and does not apply to the facts in this case. The government further asserts that it is entitled to partial summary judgment in its favor because the only reasonable interpretation of *Boeing* in the context of a settled private lawsuit is that for costs to be allowable, appellant is required to show that the plaintiff in a Title VII lawsuit had "very little likelihood of success on the merits." The government further alleges that it is entitled to partial summary judgment with respect to the settlement amount of $50,000.00, which according to the government is unallowable because it is "related" to penalties made unallowable under FAR 31.205-15.

As argued by appellant, the standards for granting summary judgment are clear; there is no genuine issue of material fact and the movant is entitled to judgment as a matter of law. *Mingus Constructors, Inc. v. United States*, 812 F.2d 1387, 1390 (Fed. Cir. 1987). Moreover, a material fact is one which may make a difference in the outcome of the case. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). As movant, appellant must show that there is an absence of a genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 325 (1986). Appellant argued that there are no genuine issues as to any material facts, and that the government's affirmative defense is entirely a question of law; *i.e.*, whether the costs in question are subject to the Court's decision in *Boeing North American, Inc. v. Roche*, 298 F.3d 1274, *supra*. Appellant, thus argued that the *Boeing* decision does not apply to this appeal, and that the effect of the government's affirmative test would be to require the parties to litigate before the Board the employment suit that was settled.

The government does not dispute the standards for granting summary judgment, nor does the government dispute the factual basis for the dispute. Rather, the government's entire argument in its opposition to appellant's motion and its cross-motion for partial summary judgment is based on its interpretation and application of the Court's decision in *Boeing North American, Inc. v. Roche*, 298 F.3d 1274, *supra*. According to the government:

> The Army does not look forward to litigating the underlying strength or weakness of settled lawsuits as required by the Federal Circuit in [the] *Boeing* decision. Delving into fraud, sexual harassment, and other non-contract matters will be distasteful but necessary. The much-criticized "benefit" standard in *Northrop* [*Caldera v. Northrop Worldwide Aircraft Services, Inc.*, 192 F.3d 962, 972 (Fed. Cir. 1999)] presented a far more manageable burden for both parties than the new "little likelihood of success" standard. However, the auditors and private bar derided the CAFC's

> *Northrop* decision and now we have *Boeing.* The old adage is once again proven – "be careful what you ask for."

(Gov't opp'n to mot. and cross-mot. for partial summary judgment at 13)

Appellant argues that the condition under which settlement expenses and attorneys' fees are allowable and allocable expenses under cost contracts depends primarily upon the object of the representation for which the fees were incurred. According to appellant, in the instant case, the settlement expenses at issue were incurred in connection with legal proceedings which in today's business and litigation climate are a fact of business life. "The costs of defending and settling such cases are costs that are routinely incurred by prudent businessmen and represent a cost of doing business, both in the commercial sector and on public contracts." (App. mot. for partial summary judgment at 9-10) Appellant argues that Title VII lawsuits are a fact of life for employers in the private sector. It is "simply another cost of doing business." *Id.* at 10. Moreover, appellant argues that the Court of Appeals for the Federal Circuit resolved the issue of allocability in *Boeing North American, Inc. v. Roche*, 298 F.3d 1274, *supra,* and that allowability of the costs is at issue in this appeal. In this regard, appellant argues that the costs in issue here do not fall within the category of costs that are unallowable under FAR 31.205-47(b) through (f), and thus should be allowable in the instant case.

The government, on the other hand, argues that the Court in its *Boeing* decision held that costs incurred in an unsuccessful defense of a private suit charging contractor wrongdoing are not allowable since such costs are "similar" to disallowed costs in FAR 31.205-47. The government argues that since the *Boeing* Court was unable to determine if such costs were "similar" because the case against Boeing North American, Inc. had settled, it applied a standard in which an inquiry was necessary to determine whether the plaintiff in the civil suit was likely to prevail. (Gov't opp'n to mot. for partial summary judgment and cross-mot. at 8, 10) The government contends that the holding in *Boeing* was not based on any fraudulent conduct, but was based on a breach of fiduciary duty, and as such was "related" under FAR 31.204 and FAR 31.205-47 to proceedings brought by a third party under the False Claims Act in which the United States did not intervene. The Court then applied the same standard, the "very little likelihood" of success, for allowability in FAR 31.205-47(c)(2) (2000). What the government ignores in this argument is, as the Court pointed out, that FAR 31.205-47(c)(2) (2000) did not exist at the time the legal costs in question were incurred, but was designed "*to clarify* the proper interpretation of cost principle FAR § 31.205-47 as it relates to *qui tam* suits [brought under the False Claims Act] not joined in by the Government." *Boeing North American, Inc. v. Roche*, 298 F.3d at 1288, n.17.

There is no apparent dispute between the parties regarding the existence of a lawsuit related to alleged sexual harassment filed against appellant by a former employee,

the terms of the settlement and confidentiality agreement, the incurrence of attorneys' fees, the allocation of the settlement cost in the total amount of $50,000.00 paid to the former employee as a direct charge to the contract, and the allocation of the legal fees in defending that cost to the G&A pool. The record contains an itemization of the legal fees, including the description of the services performed, the attorney performing those services, the hours or portions thereof allocated to each of the identified services, and the amounts attributed to each of the identified services, the hourly rates charged for the services, the expenses charged to appellant, and the payment of fees and reimbursement of expenses by appellant (R4, tab 3(c)). We make no judgment concerning the reasonableness of the legal fees and expenses.

The only issues before us relate to the applicability of the *Boeing* decision to these facts, and the standards set forth in that decision. The issues, therefore, are: does *Boeing* require appellant to prove in this appeal that the former employee had "very little likelihood of success on the merits" in her sexual harassment lawsuit against appellant, as argued by the government, or is this *Boeing* standard of "very little likelihood of success on the merits" limited solely to costs of legal defense and settlement of lawsuits involving directly, or indirectly allegations of fraud or false claims against the United States by the contractor, as contended by appellant (*see* 298 F.3d at 1289); and is the settlement expense similar to, or related to fines and penalties as defined and made unallowable in FAR 31.205-15(a). Both parties present their arguments in the context of the relevant FAR language and of the historical case law preceding the *Boeing* decision.

In light of the government's argument that the *Boeing* decision changed the standard set forth in *Caldera v. Northrop Worldwide Aircraft Services, Inc.*, 192 F.3d 962, *supra*, as well as the import of the *Boeing* decision, we address the *Northrop* decision. Moreover, in order to understand *Northrop,* which found its genesis in a series of cases before this Board, we also review the *Northrop* decisions of this Board.

Northrop was awarded a cost-plus-award-fee contract to provide maintenance, transportation, supply, and logistical support services at Fort Sill, Oklahoma. Former employees filed a civil suit against Northrop in an Oklahoma state court claiming wrongful termination, alleging that they were discharged for refusing to follow Northrop direction and participate in fraud against the Army in connection with the contract. One of these employees had filed a complaint with the Army Criminal Investigation Division (CID) alleging that Northrop might be committing fraud in its inspections. The CID completed its investigation and determined that there was insufficient evidence to prosecute Northrop for the alleged offenses. Following a trial and jury verdict in favor of the plaintiffs in that case, the verdict was upheld on appeal. Prior to the Oklahoma jury verdict, the contracting officer granted Northrop's request for reimbursement of its legal fees incurred in defending the lawsuit. Northrop subsequently submitted a claim for

further reimbursement of its legal fees, which was denied by the contracting officer. The contracting officer also demanded and received a refund on the fees previously paid.

On appeal to this Board, the government argued that the legal fees were not allocable to the contract because the lawsuit "did not involve the Government as a party, did not benefit the contract work, and did not result in any benefit or thing of value to the Government." *Northrop Worldwide Aircraft Services, Inc.*, ASBCA Nos. 45216, 45877, 95-1 BCA ¶ 27503 at 137,057. We held that it was not necessary that the costs incurred be specifically related to the government contract, but that they may be allocable to the contract if they were necessary to the overall operation of Northrop's business, and if they were the types of costs which would be incurred by a reasonably prudent person in the conduct of competitive business. Thus, we said that the more appropriate issue before the Board was whether the costs "were necessary to the overall operation of the business," *i.e.* were allocable under FAR 31.201-4, and whether they were of the type that would be incurred by a prudent person in the conduct of competitive business. Without deciding that issue, the Board proceeded to address the allowability of the legal costs incurred in the defense of the wrongful termination lawsuit. Our denial of the cross-motions for summary judgment was based on our conclusion that a hearing was necessary to determine the allowability of the legal costs based on the reasonableness of incurring fees to defend the litigation in the Oklahoma state court considering such matters as the justification for the parties' positions advanced in that lawsuit, the evidence proffered or introduced in support thereof, and the advisability of alternative methods of resolution. *Id.* at 137,059.

Northrop filed a second motion for summary judgment presenting alleged undisputed facts obtained through discovery. *Northrop Worldwide Aircraft Services, Inc.*, ASBCA Nos. 45216, 45877, 96-2 BCA ¶ 28,574. The Board noted, in a footnote, that the government had raised, in its opposition to the motion, the issue of whether the legal costs were allocable to the contract under FAR 31.201-4. Although the Board stated in this footnote that the criterion for allocation is extremely broad and does not require a finding of a connection between the cost incurred and a government contract, it said that the government's position that the costs were not allocable would be considered together with the government's opposition to their allowability. Without specifically addressing the question of whether or not the legal costs were allocable to the contract, the Board stated that the issue was whether Northrop's legal costs were, by their nature, allowable costs, which involved the consideration of the reasonableness of the costs under a cost-plus-fixed-fee contract. The Board, denying the motion, held that there was a genuine issue of material fact as to whether appellant took the actions of a prudent business person that precluded summary judgment for Northrop. The government also raised for the first time an affirmative defense that the Limitation of Cost clause was a bar to liability for legal fees on a fiscal year basis to the contract in question. Since the Board

was denying the motion for summary judgment, it stated that the government could amend its answer to include the Limitation of Cost defense.

Following a hearing on the merits, the Board sustained the appeals, holding Northrop's actions in incurring costs to defend the litigation were reasonable and that the costs were reasonable and, therefore, allowable. *Northrop Worldwide Aircraft Services, Inc.*, ASBCA Nos. 45216, 45877, 98-1 BCA ¶ 29,654. First, we held that the outcome of the litigation in the Oklahoma state court was not determinative of the question of the reasonableness of costs under FAR 31.201-2, which depended more on the circumstances at the time the costs were incurred. Second, we held that Northrop had the burden of proof, unaided by a presumption of reasonableness, to establish that its legal costs were reasonable. Third, we rejected the government's conclusion that there existed overwhelming evidence that Northrop engaged in fraudulent conduct. In this regard, although there was an investigation by the CID, the government took no action, criminal or civil, against Northrop following the final receipt of the CID report. We held that the jury verdict does not determine the disposition of these appeals. Moreover, although the government presented as proof of fraud, the jury verdict, and the underlying evidence, which we found disputed, we were not persuaded that the alleged offenses alleged to be fraudulent occurred, that they constituted illegal conduct, or that Northrop had engaged in any deliberate improper action which could constitute fraud. We made no holding as to whether the legal costs were allocable to the contract, although by implication, based on FAR 31.201-2, such costs would not have been allowable, as we held, unless they were also allocable.

The Court in *Caldera v. Northrop Worldwide Aircraft Services, Inc.*, 192 F.3d 962, *supra*, reversed the Board holding that the Board had failed to grant preclusive effect to the Oklahoma state court proceedings and because the government did not benefit from Northrop's defense of the Oklahoma lawsuit. The government had conceded that the Board had not addressed the issue of collateral estoppel. The Court held that the Oklahoma state court proceedings had preclusive effect on the Board, following the Oklahoma law of collateral estoppel which required that "(1) the issue sought to be precluded is the same as that involved in the prior action; (2) the issue was actually litigated; (3) the determination of the issue was necessary to the final judgment; and (4) the party against whom estoppel is invoked was adequately represented in the prior action." *Id.*, 192 F.3d at 971.

On appeal from the Board's decision, the government renewed its "benefits" argument as requiring something of value to flow to the government.

> The Army argues that the Board did not properly interpret FAR 31.201-4, the regulation governing allocable costs for the contract at issue. The Army contends that the

> standard for allocability is benefit to the government. The Army also argues that in this case, there was no benefit to the government for reimbursing a contractor for defending a lawsuit wherein the contractor was found to have wrongfully terminated employees who refused to commit fraud against the government; the government could not tell if it would be benefited until the close of the Oklahoma litigation.

Id., 192 F.3d at 967. The Army argued that the cost was allocable only if there was some benefit to the government for incurring the cost. Thus, the issue before the Court was whether the Northrop legal costs were allocable to the cost reimbursement contract and, therefore allowable costs. In this regard, the Court held:

> It is established that the contractor must show a benefit to government work from an expenditure of a cost that it claims is "necessary to the overall operation of the [contractor's] business." . . . The Board erred in failing to make a determination of whether or not NWASI's [Northrop's] defense of the Oklahoma lawsuit benefited the government. We can discern no benefit to the government in a contractor's defense of a wrongful termination lawsuit in which the contractor is found to have retaliated against the employees for the employees' refusal to defraud the government.

Id., 192 F.3d at 972. Because the Board failed to grant preclusive effect to the Oklahoma state court proceedings, and because the government did not benefit from Northrop's defense in the Oklahoma lawsuit, the Court reversed the Board's decision, which had reversed the contracting officer's final decision denying Northrop's claim for reimbursement of legal costs.

As we understand *Northrop*, the Court's decision denying reimbursement of the legal costs was based both on the allocability principle of FAR 31.201-4, and implicitly, the allowability cost principle that rendered unallowable legal costs incurred in legal proceedings in which there is a finding of contractor liability involving fraud or similar misconduct. Moreover, since allocability of costs is one factor to be considered together with reasonableness of the costs, standards promulgated by the CAS Board if applicable, terms of the contract, and limitations set forth in FAR subpart 31.2, FAR 31.201-2 merely codifies the general principle that a cost is not allowable if that cost cannot be allocated to a government contract. Therefore, the "benefit to government work" test expressed in *Northrop* addresses the accounting principle stated in FAR 31.201-4 that "[a] cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship," and is allocable to a

government contract if it is, *inter alia*, "necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown."

We note that the Army argued in *Northrop*, that the costs were not allocable under FAR 31.201-4 because they did not benefit the government, an argument which it essentially makes in this appeal, although couched in terms of allowability rather than allocability, which according to the government was changed to the new "little likelihood of success" standard set forth in *Boeing North American, Inc. v. Roche*, 298 F.3d 1274, *supra*.

In *Boeing North American, Inc.*, ASBCA No. 49994, 00-2 BCA ¶ 30,970,[3] the government had disallowed legal costs incurred to litigate and settle a shareholders' derivative suit against the directors of the predecessor corporation, Rockwell International Corporation, which had been awarded the cost-reimbursement contract at issue in that appeal. (*Citron v. Beall*, No. C728809 (Cal. Super. Ct., filed June 26 1989)("*Citron*")) The shareholders alleged that the directors had failed to institute and enforce adequate internal controls, and fostered a "corporate climate" that encouraged employee misconduct under federal contracts and resulted in criminal and civil penalties and fines. The gravamen of the shareholder's complaint was that the defendant directors "knowingly, recklessly, or culpably breached their fiduciary duties to the corporation by . . . failing to establish internal controls sufficient to insure that the corporation's business was carried on in a lawful manner. . . ." *Boeing North American, Inc. v. Roche*, 298 F.3d at 1277. The shareholders further alleged, *inter alia*, that Rockwell had perpetrated frauds and false claims in connection with certain government contracts, that it had been subject to continuing legal expenses and possible debarment from government contracting, that it conspired and engaged in a continuing course of conduct which was designed to insulate the directors and officers from liability, that the directors caused Rockwell to vigorously defend various government prosecutions alleging violations in performing federal contracts, and that the directors discouraged Rockwell employees from reporting fraudulent and criminal activities of the company.

Moreover, on appeal, the parties agreed that that there were five instances of underlying misconduct alleged in the "*Citron*" suit. (*Id.).* First, the government had brought a civil suit under the False Claims Act, 31 U.S.C. § 3730, alleging that Rockwell fraudulently mischarged the government for work performed on the Space Shuttle contract under which Rockwell entered into a consent decree to settle the suit. Secondly, the government brought criminal charges against Rockwell for making false statements under 18 U.S.C. § 1001 in connection with work performed under another contract. Rockwell pled guilty and paid a $5.5 million fine. Third, the government alleged that

[3] *See also Boeing North American, Inc. v. Roche*, 298 F.3d 1274, *supra*, for additional description of the facts involved in the Rockwell proceedings.

Rockwell had engaged in defective pricing related to a 1982-83 Global Positioning System subcontract. A grand jury indicted Rockwell and two Rockwell employees, charging them with fraud, mail fraud, and willfully making false statements. Fourth, a civil *qui tam* lawsuit was filed against Rockwell on behalf of the government under the False Claims Act, charging that Rockwell had permitted employees to use government assets for personal gain in 1984. Fifth, the Department of Justice investigated Rockwell for alleged illegal hazardous waste dumping and other environmental law violations. Rockwell pled guilty to four felony violations of the Resource Conservation and Recovery Act, one felony and five misdemeanor violations of the Clean Water Act, and agreed to pay a criminal fine of $18.5 million.

All parties subsequently agreed to settle the lawsuit. Rockwell included $4,576,000.00 in its corporate overhead for fiscal years 1989, 1990, and 1991. Rockwell allocated 33.2 percent of these costs to its various cost-type and flexibly priced contracts with the government and the remainder 66.8 percent to its commercial and fixed-price contracts. Although government auditors did not point to any failure regarding these litigation costs to conform to the Rockwell's CAS disclosure statements, the contracting officer disallowed this charge. Rockwell then filed a claim for the portion of these expenses related to the contract at issue in that appeal. The contracting officer denied the claim because the costs were unreasonable under FAR 31.201-3, they were costs, prescribed in FAR 31.204(c) as "similar or related" to costs that were unallowable under FAR 31.205-15 (fines, penalties, and mischarging costs), and FAR 31.205-47 (costs related to legal and other proceedings). The contracting officer asserted that but for the admitted and proven misconduct, civil fraud, and other contractor wrong doings, that lawsuit would not have been filed.

We decided the appeal on the basis of allocability, and therefore, did not address the issues of allowability, including reasonableness of the costs, limitations contained in FAR subpart 31.2, and terms of the contract. Accordingly, we denied the appeal, holding that:

> The rationale of *Northrup* [sic] [the no discernable benefit to the government test] can properly extend to the facts in this appeal so as to bar the allocability of the disputed costs under FAR 31.201-4(c). We can discern no benefit to the Government in a contractor's defense of a third party lawsuit in which the contractor's prior violations of federal laws and regulations were an integral element of the third party allegations. We hold that appellant has not met the burden of proving the allocability of the disputed costs.

Boeing North American, Inc., supra, 00-2 BCA at 152,848.

Boeing North American, Inc. appealed to the Federal Circuit. *Boeing North American, Inc. v. Roche*, 298 F.3d 1274, *supra.* First, the Court held that questions of cost allowability concern whether a particularly cost can be recovered from the government in whole or in part. Whereas, cost allocability is determined under CAS, allowability is governed by the FAR Part 31 cost principles. Thus,

> Although a cost may be allocable to a contract, the cost is not necessarily allowable. We have agreed with the general proposition that "costs may be assignable and allocable under CAS, but not allowable under [FAR]." *United States v. Boeing Co.*, 802 F.2d 1390, 1394 (Fed. Cir. 1986) [footnote omitted]. And the FAR makes clear that "[w]hile the total cost of a contract includes all cost properly allocable to the contract, the allowable costs to the Government are limited to those allocable costs which are allowable pursuant to [FAR] part 31 and applicable agency supplements."

Id., 298 F.3d at 1280.

Secondly, the Court held that it was bound by its decision in *Northrop*, and reaffirmed that decision stating that a contractor's "legal costs are unallowable when incurred in the unsuccessful defense of a lawsuit that involved a judicial determination that the contractor sought to induce its employees to commit fraud against the government by the contractor." *Boeing North American, Inc. v. Roche*, 298 F.3d at 1281. As we noted above, the government, citing FAR 31.201-4, argued in *Caldera v. Northrop Worldwide Aircraft Services, Inc.*, 192 F.3d 962, 967, *supra*, that where the costs arise from wrongful conduct involving fraud upon the government, there is no reasonable benefit to the government and the costs are *not allocable* to the contract. Therefore, although the reasonable benefit language in *Northrop* was derived from FAR 31.201-4, which addresses allocability, which under FAR 31.201-2 is one of the elements in determining whether a cost is allowable, the deciding issue in *Northrop* was the allowability issue arising from the Oklahoma litigation and the Board's error in not considering the preclusive effect of that litigation. Except as it may be related to allowability under FAR 31.201-2, there was no discussion in *Northrop* concerning allocability, particularly as an accounting concept under CAS. Moreover, as stated in *Boeing North American*, the allocability issue was not contested in *Northrop*. Therefore, "[u]nder our established precedent we are not bound by *Northrop* on the issue of allocability under CAS standards since the CAS issue was neither argued nor discussed in our opinion." *Boeing North American, Inc. v. Roche*, 298 F.3d at 1282.

> Even where costs are unallowable, CAS Part 405 prescribes standards governing the identification and accounting treatment of such unallowable costs. The CAS Part 405 standards are "predicated on the proposition that costs incurred in carrying on the activities of an enterprise – regardless of the allowability of such costs under Government contracts – are allocable to the cost objectives with which they are identified on the basis of their beneficial or causal relationships." . . . .
>
> We have specifically held that, if there is any conflict between the CAS and the FAR as to an issue of allocability, the CAS governs. *United States v. Boeing Co.*, 802 F.2d 1390, 1395 (Fed. Cir. 1986); *Rice*, 13 F.3d at 1565, n. 2 [*Rice v. Martin Marrietta Corp*., 13 F.3d 1563 (Fed. Cir. 1993)]. Here the CAS clearly renders Rockwell's legal defense costs allocable as part of G&A expenses.

Id., 298 F.3d at 1283.

The Court in *Boeing* placed the "benefit to the government" test squarely under the FAR (and previously ASPR) criterion for allocating indirect costs, as discussed in *Lockheed Aircraft Corp. v. United States*, 179 Ct. Cl. 545, 375 F.2d 786, 796-97 (1967). Therefore, in addressing the "nexus" accounting requirement regarding the allocation of the cost in question and a government contract, the Court said:

> Thus, we agree with Boeing that allocability is an accounting concept and that CAS does not require that a cost directly benefit the government's interests for the cost to be allocable. The word, "benefit" is used in the allocability provisions to describe the nexus required for accounting purposes between the cost and the contract to which it is allocated. The requirement of a "benefit" to a government contract is not designed to permit contracting officers, the Board, or this court to embark on an amorphous inquiry into whether a particular cost sufficiently "benefits" the government so that the cost should be recoverable from the government. The question whether a cost should be recoverable as a matter of policy is to be undertaken by applying the specific allowability regulations, which embody the government's view, as a matter of "policy," as to whether

> the contractor may permissibly charge particular costs to the government (if they are otherwise allocable).

Id., 298 F.3d at 1284. Accordingly, the Court held that the "benefit"/"nexus" requirement in FAR 31.201-4 and CAS was inapplicable to its decision in *Boeing* because allocability was not an issue in *Boeing*. The government had conceded as much in its brief (*see, id*., n.10). The question in *Boeing* was whether the legal expenses were allowable and should be recoverable, a question of policy to be undertaken by applying the specific allowability regulations, specifically FAR 31.205-47.

Although the Court had not previously interpreted FAR 31.204(c) quoted above, its interpretation of that section formed the basis for its "likelihood of success" test, stating:

> The principle announced in FAR § 31.204(c) supports the allowability holding of *Northrop.* As discussed above, in *Northrop* we addressed the question whether legal defense costs (in an action charging that the contractor wrongfully terminated several employees because the employees refused to participate in fraud against the United States) were allowable costs. Despite the existence of detailed regulations providing that professional service costs were allowable and that certain categories of legal expenses were not allowable, the regulations did not explicitly govern the allowability of the costs in the *Northrop* situation. The FAR, however, dealt with closely comparable categories of selected costs. Statutes and the FAR regulations broadly disallowed legal defense costs in suits brought by the federal and state governments "involving an allegation of fraud or similar misconduct" by the contractor. *See* FAR §§ 31.205-47(b)(2) and (b)(4) [footnote omitted]. The regulations also disallowed costs of unsuccessfully defending suits brought under certain federal anti-fraud laws by a private party. . . .
>
> Properly understood, *Northrop* and FAR § 31.205-47 taken together establish a simple principle – that the costs of unsuccessfully defending a private suit charging contractor wrongdoing are not allowable if the "similar" costs would be disallowed under the regulations. The present case is, however, distinguishable from the situation involved in *Northrop*. Here the costs of defending the *Citron* lawsuit would not be, as in *Northrop*, "similar" to disallowed costs.

> The regulations disallowing particular items of cost do not address costs similar to the costs of defending a contractor's directors from charges that they tolerated inadequate controls concerning possible fraud or similar misconduct. However, we must also consider whether those costs are "related" to a category of disallowed costs, that is, costs of defending against government charges of wrongdoing.

Boeing North American, Inc. v. Roche, 298 F.3d at 1286.

If, according to the Court in *Boeing*, *Northrop* addressed the "similar" cost concept embodied in FAR 31.205-47, the Court in *Boeing*, recognizing the distinction between the situations in *Northrop* and *Boeing*, construed the "related" test of FAR 31.204(c), and we believe, by implication, the "related" costs concept embodied in FAR 31.205-47. As the Court pointed out in *Boeing*, "[i]n order for a cost to be "related," there must be a more direct relationship to the disallowed cost." *Id.*, 298 F.3d at 1287. Moreover, the Court recognized that the costs of defending corporate directors in frivolous lawsuits are essential to any business operation. The same would apply to the defense of the corporation or company from such lawsuits. Thus, in order for costs to be "related," there must be a more direct relationship to the unallowable costs identified in FAR 31.205-47 than merely the fact that they would not have been incurred but for the sexual harassment lawsuit filed by appellant's former employee. We see nothing in the language of FAR 31.205-47 that renders legal costs in such proceedings unallowable if there were no charges of criminal conduct, fraud, or similar misconduct, or violations of the Major Fraud Act of 1988. Further, the *Boeing* Court held that the required direct relationship "would exist here if there were a judicial determination that the Rockwell directors had failed to maintain adequate controls to prevent the occurrence of the wrongdoing [fostering a corporate climate that encouraged employee misconduct, fraud, and false claims] against the government," *id*., 298 F.3d at 1287.

However, the "*Citron*" lawsuit was settled without any judicial determination of wrongdoing on the part of Rockwell or its directors. In addition to retaining counsel to defend the corporation and separate counsel to represent the directors, Rockwell formed a special litigation committee to investigate the complaint and report on the "*Citron*" allegations. Rockwell submitted the report to the court and moved for summary judgment in the "*Citron*" lawsuit. The court denied the motion. Rockwell and the "*Citron*" plaintiffs subsequently settled the lawsuit, which settlement agreement, in part, stated that Rockwell defendants "vigorously den[ied] all liability with respect to any and all of the purported facts or claims alleged in the Complaint," and agreed to maintain an Audit Committee to review policies and procedures and training programs designed to effect compliance with the laws and regulations applicable to federal government contracts. *Id*., 298 F.3d at 1278. Rockwell also agreed to pay the plaintiffs' attorneys

fees up to $1.5 million. The state court dismissed the "*Citron*" lawsuit with prejudice based on the settlement agreement.

Since there was no judicial determination made, the Court in *Boeing* turned to the regulations for guidance with respect to the treatment of settlement agreements. FAR 31.205-47(b)(4) provided, as we noted above, that if the disposition of the matter is by consent or compromise and could have led to any of the outcomes (conviction, determination of contractor liability as a result of a finding of fraud or similar misconduct, monetary penalty, final decision to debar or suspend the contractor, etc.) listed in subparagraphs (b)(1) through (3), the defense cost should be disallowed unless the government specifically agrees that they should be allowable. *See* FAR 31.205-47(c). The Court held that in such cases, in order for such costs to be allowable, the contractor must show that the allegations in the action giving rise to the incurrence of legal costs had "very little likelihood of success on the merits." *Boeing North American, Inc. v. Roche*, 298 F.3d at 1289.

In the instant appeal, the parties in their cross-motions for summary judgment merely seek our determination as to whether the *Boeing* standard for allowability applies to the costs in question, and whether appellant must show that the former employee/plaintiff in the sexual harassment lawsuit against appellant had "very little likelihood of success on the merits" as asserted by the government. We hold that it does not. The litigation in question did not involve a criminal prosecution; did not require a finding, absent a settlement, of contractor liability based on fraud or similar misconduct or imposition of a monetary penalty where the proceeding did not involve an allegation of fraud or similar misconduct; or did not require a final decision by an appropriate official of an executive agency to disbar or suspend appellant, or to rescind or void the contract, or to terminate the contract for default by reason of the contractor's violation or failure to comply with a law or regulation. Accordingly, we hold that FAR 31.205-47 does not present an allowability bar to appellant's recovery of its legal costs, as part of its reimbursement of G&A, in defending the lawsuit filed by its former employee.

The government further asserts that "[a] payment in a settlement of a civil suit is a substitute for the fine or penalty that was at risk in the action filed by Ms. Curlee [appellant's former employee]." (Gov't opp'n to mot. for partial summary judgment and cross-mot. at 12) According to the government, while this payment is "likely" encompassed by the non-allowability argument concerning legal fees and court costs, it is also unallowable under FAR 31.205-15 as an unallowable fine, penalty, and mischarged cost. The government, therefore, argues that the settlement is "related' to the unallowable fines and penalties of FAR 31.205-15 because appellant "paid the court and settlement costs to Ms. Curlee to limit its risk for the alleged wrongdoing and such payment is undoubtedly 'related' to a penalty." *Id.* However, the government also argues that there is no "little likelihood of success" standard in FAR 31.205-15, and that

this standard should not apply to the settlement payment at issue here. Despite this rather circular argument, and the absence of the definition of how appellant's ostensible risk for alleged wrongdoing in this instance would be similar or related to a "pecuniary criminal punishment or civil penalty payable to the public treasury," or a "punishment imposed on a wrongdoer, usu. in the form of a imprisonment or fine" as distinguished from compensation for an injured party's loss (BLACK'S LAW DICTIONARY 664, 1168 (8th ed. 2004)), the government argues that its argument of the relatedness of the settlement cost to the penalty language of FAR 31.205-15(a) is reasonable because appellant paid the court and settlement costs to limit its risk for the alleged wrongdoing.

Although we interpret the FAR provision according to its plain language and consider the terms in accordance with their common meaning, as the Court of Appeals pointed out in *Ingalls Shipbuilding, Inc. v. Dalton*, 119 F.3d 972, 976 (Fed. Cir. 1997), neither FAR 31.205-15(a), nor any other provision of the FAR attributes a specific meaning to the words, "fines and penalties." Similarly, although the definitions of those words in BLACK'S LAW DICTIONARY may be suggestive of the scope of those words, they do not provide definitive definitions that would be dispositive of the government's argument. Therefore, the Court in *Ingalls* looked to the statute (Longshore and Harbor Workers Compensation Act, 33 U.S.C. §§ 901-915) that provided for compensation to certain classes of maritime employees for work-related injuries. Thus, consistent with the Supreme Court's decision in *Huntington v. Attrill*, 146 U.S. 65 (1892), in which the Supreme Court distinguished between penal provisions and non-penal provisions for the purposes of the Full Faith and Credit Clause of the U.S. Constitution, Art. IV, § 1, the Court in *Ingalls* held that the relevant statute there should not be considered to impose a penalty unless:

> (1) the costs imposed are unrelated to the amount of actual harm suffered and are related more to the penalized party's conduct, (2) the proceeds from the infractions are collected by the state, rather than paid to the individual harmed, and (3) the statute is meant to address a harm to the public, as opposed to remedying a harm to an individual.

Ingalls Shipbuilding, Inc. v. Dalton, 119 F.3d at 978.

Here, the government attempts to link its argument as to the relatedness of the settlement agreement and payment thereunder to FAR 31.205-15(a), the EQUAL OPPORTUNITY clause, and *inter alia*, Title VII of the Civil Rights Act (42 U.S.C. § 2000e-2) as covered by the claim for which appellant's former employee was compensated in accordance with the settlement agreement. As set forth in the settlement agreement, the action brought by appellant's former employee was for money damages asserted by her in the lawsuit, and the settlement agreement provided for direct payment

to her for the alleged harm to her, rather than to the state or government entity. The government has not asserted, nor does the record contain any evidence, (1) that the costs imposed under the settlement agreement were unrelated to the alleged harm done to the employee and were related to appellant's conduct, (2) that proceeds collected under the agreement were paid to the government or state rather than to the former employee, and (3) that the relevant provision of Title VII of the Civil Rights Act of 1964 was meant to address the harm to the public rather than to provide a remedy to the former employee for the alleged injury to the employee. Accordingly, we hold that compensation paid to the former employee under the settlement agreement was not in the nature of a fine or penalty, nor was it "related" to a fine or penalty as asserted here by the government.

Accordingly, we grant appellant's motion for partial summary judgment and deny the government's cross-motion, holding that, as a matter of law, the government's affirmative defense asserting the *Boeing* standard is not a bar to appellant's recovery of its settlement costs and legal fees and further, that the payment made pursuant to the settlement agreement to appellant's former employee was not a "fine" or "penalty" thereby rendering it unallowable. Therefore, we sustain the appeals to that extent and remand them to the contracting officer for determination of the reasonable amounts to be reimbursed appellant consistent with this decision and the ALLOWABLE COST AND PAYMENT clause.

Dated: 21 September 2007

ROLLIN A. VAN BROEKHOVEN
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

EUNICE W. THOMAS
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 Nos. 53884, 54461, Appeals of Tecom, Inc., rendered in conformance with the Board's Charter.

Dated:

CATHERINE A. STANTON
Recorder, Armed Services
Board of Contract Appeals