ARMED SERVICES BOARD OF CONTRACT APPEALS

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| Appeal of -- | ) | |
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| Thomas Associates, Inc. | ) | ASBCA No. 57126 |
| | ) | |
| Under Contract Nos. N61331-04-D-0007 | ) | |
| N00178-04-D-4142 | ) | |
| N61331-05-D-0019 | ) | |
| N61331-05-D-0025 | ) | |

APPEARANCE FOR THE APPELLANT: Mr. Michael L. Fretwell
Vice President, Finance & Administration

APPEARANCES FOR THE GOVERNMENT: E. Michael Chiaparas, Esq.
DCMA Chief Trial Attorney
Robert L. Duecaster, Esq.
Trial Attorney
Defense Contract Management Agency
Manassas, VA

OPINION BY ADMINISTRATIVE JUDGE JAMES

This dispute arises from the appeal by Thomas Associates, Inc. (TAI) from the final decision of the Defense Contract Management Agency (DCMA) administrative contracting officer (ACO) who determined that six indirect cost items submitted for TAI's fiscal year 2005 under the four captioned contracts were expressly unallowable and demanded payment of $73,552 in penalties and interest pursuant to FAR 42.709-1(a)(1). The Board has jurisdiction of this appeal under the Contract Disputes Act of 1978, 41 U.S.C. § 7105(e)(1)(A). The appeal was submitted on the record pursuant to Board Rule 11. The record consists of the government's Rule 4 file as supplemented on 5 April 2011, attachments to TAI's 17 June 2010 letter and the parties' initial and reply briefs. We decide entitlement only.

## FINDINGS OF FACT

1. TAI is a small business concern wholly owned by its president, Ms. Alexis Thomas, aka Alexis Thomas Dutcher (R4, tab 5 at 136,[1] tab 8 at 176, 274).

2. The Naval Surface Warfare Center (NSWC), Panama City, awarded the following engineering support services contracts to TAI (R4, tab 1 at 1, tab 3 at 53, tab 4 at 83):

| Contract No. | Award date |
|---|---|
| N61331-04-D-0007 (contract 7) | 29 January 2004 |
| N61331-05-D-0019 (contract 19) | 11 February 2005 |
| N61331-05-D-0025 (contract 25) | 3 May 2005 |

3. On 5 April 2004 NSWC Dahlgren awarded Contract No. N00178-04-D-4142 (contract 4142) to TAI. Contract 4142 was an indefinite quantity type contract providing for issuance of delivery orders (DO) on a cost plus fixed-fee (CPFF) or firm fixed-price basis and was administered by DCMA. (R4, tab 2 at 35, 42)

4. Contracts 7, 19 and 25 were SBA § 8(a) direct awards (SBA was the nominal "prime contractor" pursuant to DFARS 252.219-7009), were all of the indefinite quantity type providing for issuance of DOs on a CPFF basis and were all administered by DCMA (R4, tab 1 at 2, 15-17, tab 2 at 42, tab 3 at 55, 74-75, 78, tab 4 at 85, 103, 105-06, 108).

5. The Standard Form 26 Award/Contract of the four captioned contracts stated in block 15G, "TOTAL AMOUNT OF CONTRACT":

| | |
|---|---|
| Contract 7 | $ 2,999,981.10 EST |
| Contract 4142 | See Section B...$13,507,335,368 |
| Contract 19 | $ 2,999,984.12 EST |
| Contract 25 | $29,855,247.57 EST |

Contracts 7, 4142, 19 and 25 incorporated the FAR 52.216-7, ALLOWABLE COST AND PAYMENT (DEC 2002) clause, whose ¶ (a) required the government to pay costs "determined to be allowable...in accordance with [FAR] subpart 31.2 in effect on the date of this contract," and the FAR 52.242-3, PENALTIES FOR UNALLOWABLE COSTS (MAY 2001 (sic)) clause (although effective 11 May 2001, that clause was dated "MAR 2001") (R4, tab 1 at 1-3, 13-14, tab 2 at 4 of 135, 39-40, tab 3 at 53, 72-73, tab 4 at 83, 103-04).

[1] All Rule 4 file page citations are to Bates numbers, unless otherwise indicated.

6. On 19 May 2008 TAI submitted a "Certificate of Final Indirect Costs" required by FAR 52.242-4 to DCAA stating that its proposed costs incurred in calendar year 2005 did "not include any costs which are expressly unallowable" under applicable FAR cost principles (R4, tab 5 at 112, 140).

7. TAI's job cost accounting system included two intermediate indirect cost pools, "fringe costs" and "facility costs," whose costs were reallocated to three indirect cost pools, "overhead," "G&A" and "subcontract handling" (R4, tab 5 at 136, 117, 120).

8. The Defense Procurement Improvement Act of 1985, Pub. L. No. 99-145, § 901 *et seq.*, codified as amended at 10 U.S.C. § 2324, prescribes a penalty in the amount of the disallowed cost plus interest on any amount paid, when a contractor submits "expressly unallowable" costs in a proposal for settlement of indirect costs (10 U.S.C. § 2324(b)(1); FAR 42.709-1(a)(1)). DCAA calls this a "level 1" penalty (R4, tab 5 at 120, 127, 131, 134).

9. DCAA Report No. 6431-2005P10100024, dated 20 April 2009, disallowed eight items of TAI's proposed indirect costs for its fiscal year ending 31 December 2005. DCAA recommended level 1 penalties for the following six disallowed cost items: under the "Fringe Expense Rate" intermediate pool, (a)[2] the $2,400 premium on a $1,000,000 life insurance policy for TAI's president, Alexis Thomas Dutcher (R4, tab 5 at 116-17), (b) $6,080 for employee morale (R4, tab 5 at 117-18) and (c) $23,506 for an automobile given to TAI employee Paul J. Cahill (R4, tab 5 at 118); under the "Facilities Expense Rate" intermediate pool, (d) $44,959 for TAI's corporate office building rented from "a related party" (R4, tab 5 at 120) and (f) $776 in title taxes on a boat TAI purchased for personal use (R4, tab 5 at 121-22); and under the "Overhead Expense Rate" pool, (h) $3,866 for a "business meeting" (R4, tab 5 at 124-25). DCAA recommended assessing $61,378 in level 1 penalties on the allocable portions of the costs described in the foregoing six cost items (R4, tab 5 at 116, 119, 124, 127, 131, 134). The other two cost items DCAA disallowed, but for which it did not recommend level 1 penalties, were (e) $8,180 for a Jaguar automobile used by TAI's president, and (g) $5,431 for depreciation, insurance and taxes on a Panama City townhouse that TAI purchased, but was idle (R4, tab 5 at 121-22, 124-25).

10. DCMA ACO Roslyn Woods' 21 April 2009 letter to TAI stated her intent to assess a $61,378 penalty pursuant to FAR 42.709-1(a)(1) and asked TAI to state whether it agreed or disagreed (R4, tab 6 at 146-47).

11. TAI's 11 May 2009 letter to DCMA stated that TAI requested a waiver of the ACO's proposed level 1 penalties because the DCAA auditor had a differing

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[2] Item numbering follows respondent's proposed finding of fact ¶ 4a-h (gov't br. at 2-3).

interpretation of FAR Part 31 requirements, TAI did not flagrantly or maliciously disregard those regulations, and although TAI "did not concur with DCAA's findings, to avoid prolonged and potentially excessive legal costs, TAI agreed to concur with their position" (R4, tab 7).

12. DCMA's ACO David Mason decided that TAI did not meet any of the three waiver requirements enumerated in FAR 42.709-5, the imposition of level 1 penalties was appropriate and the reasons advanced in TAI's 11 May 2009 letter to waive such penalties were not appropriate (R4, tab 10).

13. ACO Mason accepted DCAA's computation of the $61,378 level 1 penalty. His 2 February 2010 final decision to TAI determined that the six items of fiscal year 2005 indirect costs as to which DCAA recommended level 1 penalties were "expressly unallowable" under FAR 42.709-1(a)(1) and demanded that TAI pay to the government $73,552 ($61,378 penalties + $12,174 interest). The ACO also concurred with DCAA's position on the other two items, the Jaguar automobile and the Panama City townhouse, as to which DCAA did not recommend penalties. (R4, tab 9) On 19 February 2010 TAI timely appealed from such decision, which appeal was docketed as ASBCA No. 57126.

14. TAI "concurs with the ACO's determination that...costs associated with employee morale [finding 9(b)], business meetings [finding 9(h)], related party rent [finding 9(d)]...are expressly unallowable, and has agreed to remit costs associated with those items to the Government," although it does not agree a penalty should be imposed (app. br. at 2). TAI's brief offers no evidence or argument about the $776 in title taxes for the boat TAI purchased "for personal use" (finding 9(f)). We find that the costs for that item are expressly unallowable.

15. The record contains additional facts regarding the disputed costs in findings 9(a) and 9(c).

(a) Life Insurance. On 15 February 2002 IDS Life Insurance Co. issued a $1,000,000 insurance policy on the life of Alexis Thomas Dutcher, with a $2,400 annual premium paid by TAI (R4, tab 8 at 176-77). TAI did not treat the cost of the insurance as compensation to Ms. Thomas. Ms. Thomas' 2005 payroll information did not identify the $2,400 life insurance premium as additional compensation, nor was that figure identified among her "Gross1" compensation. (TAI ltr., attach. E)

(c) Jeep Vehicle Transfer. On 25 March 2005 TAI sent Virginia Certificate of Title No. 81295934 to a 2004 Jeep vehicle that TAI assigned to its employee Paul Cahill for a "sale price" of $26,361.00. TAI's forwarding letter to Mr. Cahill stated: "This amount will be considered as a fringe benefit in your 2005 compensation and is subject to Social Security and Medicare income tax withholding." (R4, tab 8 at 174-75) TAI

claimed a $23,505.01 fringe benefit to Mr. Cahill for the 2004 Jeep in its indirect costs proposed for 2005 (R4, tab 8 at 172). Mr. Cahill's 2005 gross income included $23,505.01, which we find tracks to the 2004 Jeep vehicle (TAI ltr., attach. C).

16. We find that the record contains no evidence that TAI withdrew its final indirect cost rate proposal before DCAA's April 2009 audit and submitted a revised proposal to DCAA, or that it demonstrated to the satisfaction of ACO Mason that it had established an internal control and review system to preclude the inclusion of unallowable costs in its indirect cost rate proposals and its inclusion of unallowable costs in the 2005 proposal was due to unintentional error notwithstanding the exercise of due care.

17. The FAR Part 31 cost principles pertinent to the disputed costs and in effect on the dates of contracts 7, 4142, 19 and 25 (*viz.*, 29 January 2004, 5 April 2004, 11 February 2005 and 3 May 2005 (findings 2-3)), are as follows:

> 31.205-6 Compensation for personal services.
>
> ....
>
> (m) *Fringe benefits.* (1) Fringe benefits are allowances and services provided by the contractor to its employees as compensation in addition to regular wages and salaries. Fringe benefits include, but are not limited to, the cost of vacations, sick leave, holidays, military leave, employee insurance, and supplemental unemployment benefit plans. Except as provided otherwise in Subpart 31.2, the costs of fringe benefits are allowable to the extent that they are reasonable and are required by law, employer-employee agreement, or an established policy of the contractor.
>
> ....
>
> 31.205-8 Contributions or donations.
>
> Contributions or donations, including cash, property and services, regardless of recipient, are unallowable, except as provided in 31.205-1(e)(3).
>
> ....

31.205-19 Insurance and indemnification.

....

(e) Self-insurance and purchased insurance costs are subject to the cost limitations in the following paragraphs:

....

(2) Costs of insurance maintained by the contractor in connection with the general conduct of its business are allowable subject to the following limitations:

....

(v) Costs of insurance on the lives of officers, partners, proprietors, or employees are allowable only to the extent that the insurance represents additional compensation (see 31.205-6).

## DECISION

This appeal presents two issues: (1) Was either of the disputed cost items (relating to life insurance and the 2004 Jeep) "expressly unallowable?" (2) Was respondent required to waive level 1 penalties for any expressly unallowable costs in dispute?[3]

### I.

FAR 31.001 defines an "Expressly unallowable cost" as a "particular item or type of cost which, under the express provisions of an applicable law, regulation, or contract, is specifically named and stated to be unallowable." We address and decide the disputed cost items in turn.

With respect to the $2,400 insurance premium for 2005 on the life of Alexis Thomas, TAI's president (finding 1), FAR 31.205-19(e)(2)(v) provides that the costs of insurance on the lives of officers "are allowable only to the extent that the insurance represents additional compensation (see 31.205-6)" (finding 17). TAI did not treat the cost of the insurance as compensation to Ms. Thomas. Ms. Thomas' 2005 payroll information did not identify the $2,400 life insurance premium among her 2005

[3] We do not address the items pertaining to the Jaguar automobile and the Panama City townhouse since no penalty was assessed as to them (finding 13).

compensation. (Finding 15(a)) Therefore, we hold that the disputed premium is expressly unallowable.

With respect to the costs of TAI's transfer of the 2004 Jeep to Mr. Cahill in March 2005, TAI's forwarding letter to Mr. Cahill stated: "This amount will be considered as a fringe benefit in your 2005 compensation and is subject to Social Security and Medicare income tax withholding." TAI claimed a $23,505.01 fringe benefit to Mr. Cahill for the 2004 Jeep in its proposed 2005 indirect costs. Mr. Cahill's 2005 gross income included $23,505.01, which correlates to the 2004 Jeep vehicle. (Finding 15(c)). The transfer of the Jeep vehicle was not a gift or donation to Mr. Cahill under FAR 31.205-8 as alleged by the government (resp. br. at 5). In view of TAI's treatment of this cost as a fringe benefit, we hold that the Jeep transfer costs were not "expressly unallowable" costs under FAR 31.001.

II.

We turn to whether the CO was required to waive the level 1 penalty on the disputed cost items. Since we have held that the Jeep transfer cost was not "expressly unallowable," we need not reach waiver of penalty as to it.

10 U.S.C. § 2324(c) states that the FAR shall provide that the 10 U.S.C. § 2324(b) penalty "shall...be waived" in three instances: when (1) the contractor withdraws its proposal for settlement of indirect costs before an audit of such costs is initiated and submits a revised proposal, or (2) the amount of the unallowable costs "is insignificant" or (3) the contractor demonstrates to the CO's satisfaction that it has established policies and training and an internal control and review system to assure that unallowable costs are precluded from being included in such proposals and the penalized costs "were inadvertently included into the proposal."

In implementation of 10 U.S.C.§ 2324(c), the FAR provides:

> 42.709-5 Waiver of the penalty.
>
> The cognizant contracting officer shall waive the penalties at 42.709-1(a) when—
>
> (a) The contractor withdraws the proposal before the Government formally initiates an audit of the proposal and the contractor submits a revised proposal (an audit will be deemed to be formally initiated when the Government provides the contractor with written notice, or holds an

entrance conference, indicating that audit work on a specific final indirect cost proposal has begun);

(b) The amount of the unallowable costs under the proposal which are subject to the penalty is $10,000 or less (*i.e.*, if the amount of expressly or previously determined unallowable costs which would be allocated to the contracts specified in 42.709(b) is $10,000 or less); or

(c) The contractor demonstrates, to the cognizant contracting officer's satisfaction, that—

(1) It has established policies and personnel training and an internal audit control and review system that provide assurance that unallowable costs subject to penalties are precluded from being included in the contractor's final indirect cost rate proposals (*e.g.*, the types of controls required for satisfactory participation in the Department of Defense sponsored self-governance programs, specific accounting controls over indirect costs, compliance tests which demonstrate that the controls are effective, and Government audits which have not disclosed recurring instances of expressly unallowable costs); and

(2) The unallowable costs subject to the penalty were inadvertently incorporated into the proposal; *i.e.*, their inclusion resulted from an unintentional error, notwithstanding the exercise of due care.

Accordingly, based on FAR 42.709-5(b), we hold that the CO was required to waive the penalty for the allocated portions of the $2,400 life insurance premium, $6,080 for employee morale, $776 for boat title taxes and $3,866 for a business meeting (findings 9(a), (b), (f), (h)). *See Fiber Materials, Inc.*, ASBCA No. 53616, 07-1 BCA ¶ 33,563 at 166,259-60 (CO was required to waive each penalty for "expressly unallowable" individual cost items that was less than $10,000).

The record contains no evidence that TAI withdrew its final indirect cost rate proposal before DCAA's April 2009 audit and submitted a revised proposal to DCAA, or that it demonstrated to the satisfaction of ACO Mason that it had established an internal control and review system to preclude the inclusion of unallowable costs in its indirect cost rate proposals and its inclusion of unallowable costs in the 2005 proposal was due to

unintentional error notwithstanding the exercise of due care (finding 16). Therefore, pursuant to FAR 42.709-5(a), (c), the CO was not required to waive the penalty on the $44,959 for related party office rent (findings 9(d), 12).

## CONCLUSION

We sustain the appeal with respect to whether the $23,505.01 fringe benefit to Mr. Cahill for the 2004 Jeep was "expressly unallowable" (*see* I above) and the waiver of the statutory penalty on the $2,400 life insurance premium, $6,080 employee morale cost, $776 for boat title taxes and $3,866 for a business meeting (*see* II above). We deny the appeal with respect to the penalty and interest related to the $44,959 related party office rent.

Dated: 17 May 2011

DAVID W. JAMES, JR.
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 No. 57126, Appeal of Thomas Associates, Inc., rendered in conformance with the Board's Charter.

Dated:

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