ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --	)	
	)	
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.
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OPINION BY ADMINISTRATIVE JUDGE JAMES ON RESPONDENT'S MOTION FOR RECONSIDERATION

On 16 June 2011 the government timely moved for reconsideration of our 17 May 2011 decision, *Thomas Associates, Inc.*, ASBCA No. 57126, 11-1 BCA ¶ 34,764, and requested the Chairman to refer the motion to the senior deciding group. On 24 June 2011 the Board ordered appellant to respond to the motion by 25 July 2011. Appellant advised the Board that it did not intend to reply on 29 July 2011. We assume familiarity with the findings and holdings in our May 2011 decision. The Chairman has considered and denied movant's request to refer this motion to the senior deciding group.

Movant asserts that the Board erred as a matter of law in holding that the CO was required to waive the FAR 42.709-1(a)(1) penalties for individual costs of $2,400 for life insurance, $6,080 for employee morale, $776 for boat title taxes and $3,866 for a business meeting, since such waiver is required only when the aggregate of unallowable costs is less than the $10,000 threshold for mandatory waiver prescribed by FAR 42.709-5(b) (gov't mot. at 1). Movant did not address this point in its Rule 11 filings. It argues for the first time in its motion that "amount" in the FAR 42.709-5(b) phrase "amount of the unallowable costs" can only mean the aggregate amount of unallowable costs (*id.* at 2-3); FAR/DFARS Case No. 94-751 records submitted with respondent's motion (ex. G-2)

establish that "the amount referenced [in FAR 42.709-5(b)] is the total of all costs, not each...cost analyzed separately" (gov't mot. at 3-4); and our interpretation can encourage deceptive accounting practices and produce illogical results (*id.* at 4-5), and is not supported by *Fiber Materials, Inc.*, ASBCA No. 53616, 07-1 BCA ¶ 33,563 (*id.* at 5). Since appellant did not object to the FAR/DFARS case file (ex. G-2) submitted on reconsideration by the government, it has been admitted into the record. We proceed to consider this additional evidence in deciding the pending motion.

In analyzing the clarification cited by movant in FAR/DFARS Case No. 94-751 with respect to waiving the penalty on unallowable costs in 10 U.S.C. § 2324(a)-(c), it is useful first to review the statutory and regulatory history of the pertinent provisions.

On 23 October 1992 Public Law No. 102-484, the National Defense Authorization Act for Fiscal Year 1993, § 818(a), amended 10 U.S.C. § 2324 to provide in pertinent part:

> (a) The Secretary of Defense shall require that a covered contract provide that if the contractor submits to the Department of Defense a proposal for settlement of indirect costs incurred by the contractor for any period after such costs have been accrued and if that proposal includes the submission of a cost which is unallowable because the cost violates a cost principle in the [FAR] or the [DFARS], the cost shall be disallowed.
>
> (b)(1) If the Secretary determines that a cost submitted by a contractor in its proposal for settlement is expressly unallowable under a cost principle referred to in subsection (a) that defines the allowability of specific selected costs, the Secretary shall assess a penalty against the contractor in an amount equal to—
>
> (A) the amount of the disallowed cost allocated to covered contracts for which a proposal for settlement of indirect costs has been submitted; plus
>
> (B) interest (to be computed based on regulations issued by the Secretary) to compensate the United States for the use of any funds which a contractor has been paid in excess of the amount to which the contractor was entitled.
>
> (2) If the Secretary determines that a proposal for settlement of indirect costs submitted by a contractor includes

> a cost determined to be unallowable in the case of such contractor before the submission of such proposal, the Secretary shall assess a penalty against the contractor in an amount equal to two times the amount of the disallowed cost allocated to covered contracts for which a proposal for settlement of indirect costs has been submitted.
>
> (c) The Secretary shall prescribe regulations providing for a penalty under subsection (b) to be waived in the case of a contractor's proposal for settlement of indirect costs when—
>
> ....
>
> (2) the amount of the unallowable costs subject to the penalty is insignificant; or....

Defense Acquisition Circular No. 91-5, issued 13 May 1993, implemented Pub. L. No. 102-484, § 818(a), adding DFARS 231.7002-5 – Waiver of the Penalty, which provided:

> Pursuant to 10 U.S.C. 2324(c), the cognizant ACO shall waive the penalties at 231.7002-1(a) when—
>
> ....
>
> (b) The amount of the unallowable costs under the proposal which are subject to the penalty is $10,000 or less....

The Federal Acquisition Streamlining Act of 1994, Pub. L. No. 103-355, §§ 2101, 2151, amended 10 U.S.C. § 2324 and 41 U.S.C. § 256, to extend to all executive agencies the penalties on unallowable indirect costs in 10 U.S.C. § 2324 previously applicable only to Defense agencies. The FAR Council oversaw implementation of the Act (ex. G-2 at 3) and established FAR/DFARS Case No. 94-751 to draft the regulations with respect to such penalties in 10 U.S.C. § 2324 (ex. G-2 at 15, 67).

With respect to waiver of penalties, as stated above, DFARS 231.7002-5(b) provided: "The amount of the unallowable costs under the proposal which are subject to the penalty is $10,000 or less." The Case No. 94-751 drafting team proposed to add to that DFARS provision the parenthetical phrase: "(i.e., if the amount of expressly or previously determined unallowable costs allocable to the contracts specified in 42.709(b) is $10,000 or less)," and published such provision as proposed FAR 42.709-5(b) in the

Federal Register for public comment. 59 F.R. 65460-61 (Dec. 19, 1994). The Case No. 94-751 drafting team had stated on 17 November 1994: "The...Team deliberately included the parenthetical explanation in 42.709-5(b) to clarify that the wavier [sic] criterion refers to the amount of unallowable cost allocated to covered contracts and not to the gross amount of unallowable costs claimed as part of an overhead pool" (ex. G-2 at 49, 54-55, emphasis in original).

GSA commented in February 1995 that the term "unallowable costs" in proposed FAR 42.709-5(b) was not clear as to "whether the $10,000 applies to each individual cost element in the contractor's indirect cost proposal which is unallowable, the sum of all unallowable cost elements in the proposal or the unallowable costs that were allocated to the Government's covered contracts" (ex. G-2 at 134-35). The Case No. 94-751 drafting team stated on 24 March 1995 (ex. G-2 at 96, 99, 103):

> GSA suggests that...42.709-5(b)...is not clear that the amount referenced is the total of all such costs, not each classification of cost analyzed separately. We note that the waiver threshold refers to the portion of the total penalizable costs (included in a settlement proposal) which are allocated to covered contracts using the contractor's established allocation practice. We have proposed revised language for 42.709-5(b) in TAB A to clarify this fact.
>
> [TAB A included]:
>
> (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 ~~allocable~~ [which would be allocated] to the contracts specified in 42.709(b) is $10,000 or less)....

On 16 August 1995 Federal Acquisition Circular No. 90-31, *inter alia*, issued final FAR 42.709, which provided in pertinent part (60 Fed. Reg. 42657-59; ex. G-2 at 84-86):

> **42.709 Scope.**
>
> (a) This section implements 10 U.S.C. 2324(a) through (d) and 41 U.S.C. 256(a) through (d)....

42.709-1 General.

(a) The following penalties apply to contracts covered by this section:

(1) If the indirect cost is expressly unallowable under a cost principle in the FAR...that defines the allowability of specific selected costs, the penalty is equal to—

(i) The amount of the disallowed costs allocated to contracts that are subject to this section for which an indirect cost proposal has been submitted; plus

(ii) Interest....

(2) If the indirect cost was determined to be unallowable for that contractor before proposal submission, the penalty is two times the amount in paragraph (a)(1)(i) of this section.

....

42.709-3 Assessing the penalty.

Unless a waiver is granted pursuant to 42.709-5, the cognizant [CO] shall—

(a) Assess the penalty in 42.709-1(a)(1), when the submitted cost is expressly unallowable under a cost principle in the FAR...that defines the allowability of specific selected costs;....

....

42.709-5 Waiver of the penalty.

The cognizant [CO] shall waive the penalties at 42.709-1(a) when—

....

(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 of less); or....

With immaterial, minor wording changes, the above-quoted 10 U.S.C. § 2324 and FAR 42.709 provisions were in effect in 2004-2005 when the Thomas Associates contracts were awarded.

In summary, (1) each statutory and regulatory penalty applies to an expressly or previously determined unallowable cost and (2) the statutory and regulatory penalty-waiving provisions apply to the amount "of the unallowable costs" in a contractor's indirect cost proposal. Thus, FAR 42.709-1(a) refers to an "indirect cost" in the singular and 42.709-5(b) refers to "the unallowable costs" in the plural.

To the extent that there is uncertainty about the meaning or intent of a FAR provision, it is appropriate to examine the contemporaneous explanatory statements of the drafters of the regulation retained in the official records. *See Kearfott Guidance & Navigation Corp. v. Rumsfeld*, 320 F.3d 1369, 1373-74 (Fed. Cir. 2003) (citing memoranda from the DAR Council case file). Here, GSA posed the question before us. Although the Case No. 94-751 drafting team's 24 March 1995 clarification of FAR 42.907-5(b) might have been more explicit, we are satisfied that it evinced the intent that the FAR 42.709-5(b) $10,000 waiver threshold referred to the portion of the total penalizable costs (included in a settlement proposal) allocated to covered contracts as opposed to individual cost elements.

In *Fiber Materials*, the allowability of, and penalty for, each cost category were tried and decided individually. The parties did not raise, and the Board did not address, the issue of aggregation of expressly unallowable costs for purposes of penalty waiver. The government did not submit the FAR/DFARS Case No. 94-751 materials it has now submitted in this appeal. The Board determined that, as allocable to the subject contracts, each of the patent amortization and cabin costs that the government claimed were expressly unallowable and subject to penalties was under $10,000, and the contracting officer was required to waive each such penalty. However, the aggregate, allocable, expressly unallowable costs in the contractor's 1995 and 1996 indirect cost proposals also were less than $10,000 (findings 61, 65, 07-1 BCA ¶ 33,563 at 166,242-43). Thus, *Fiber Materials* is consistent with FAR 42.709-5(b) as we have interpreted it above. The facts are different in this appeal, where the total of the allocable, expressly unallowable costs exceeds $10,000.

CONCLUSION

The government's motion for reconsideration is granted. We delete the paragraph in our 17 May 2011 opinion starting "Accordingly," following the quotation of FAR 42.709-5 Waiver of the Penalty (*see* 11-1 BCA ¶ 34,764 at 171,098-99). The final paragraph of our opinion (*id.* at 171,099) is modified to state as follows:

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). We deny the appeal with respect to the penalty and interest related to the $2,400 life insurance premium, $6,080 employee morale cost, $776 for boat title taxes, $3,866 for a business meeting, and the $44,959 related party office rent (*see* II above).

Dated: 18 October 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