ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --	)	
	)	
Inframat Corporation	)	ASBCA No. 57741
	)	
Under Contract Nos. F29601-02-C-0031	)	
FA9300-04-C-0033	)	

APPEARANCE FOR THE APPELLANT: Mr. Nicholas Vlahos
General Manager/Controller

APPEARANCES FOR THE GOVERNMENT: E. Michael Chiaparas, Esq.
DCMA Chief Trial Attorney
Stephen R. Dooley, Esq.
Senior Trial Attorney
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Trial Attorney
Defense Contract Management Agency
Boston, MA

OPINION BY ADMINISTRATIVE JUDGE JAMES ON THE GOVERNMENT'S MOTION TO DISMISS FOR FAILURE TO STATE A CLAIM UPON WHICH RELIEF MAY BE GRANTED, OR IN THE ALTERNATIVE, MOTION FOR SUMMARY JUDGMENT

Inframat Corporation (Inframat) timely appeals from the administrative contracting officer's (ACO) decision which denied its request to waive penalties under the FAR 52.243-3, PENALTIES FOR UNALLOWABLE COSTS (MAR 2001) clause on various expressly unallowable costs in its final indirect cost proposal for 2004. The decision demanded payment of $29,016.00 in penalties and simple interest thereon. Inframat does not dispute the unallowability of the underlying indirect costs; it disputes the assessment of penalties and interest thereon.

On 28 November 2011 the government moved to dismiss the appeal for failure to state a claim upon which relief may be granted, or alternatively, for summary judgment. Movant asserts that the facts presented by the appellant demonstrate that the ACO appropriately refused to waive penalties and interest under FAR 42.709-5, Waiver of the penalty. Appellant opposed the motion on 12 April 2012, but did not submit a brief. Since the motion presents matters outside the pleadings, we treat the government's motion as one for summary judgment. FED. R. CIV. P. 12(b).

STATEMENT OF FACTS (SOF) FOR PURPOSES OF THE MOTION

1. The U.S. Air Force awarded Inframat two contracts affected by the ACO's demand for payment of penalties and interest. Contract No. F29601-02-C-0031 was awarded on 4 February 2002 (R4, tab 1 at 1). Contract No. FA9300-04-C-0033 was awarded on 8 June 2004 (R4, tab 2 at 1). Each contract was for technical supplies and services and was administered by Defense Contract Management Agency (DCMA), Hartford (R4, tab 1 at 1-3, tab 2 at 1-5).

2. Each contract incorporated by reference the FAR 52.242-3, PENALTIES FOR UNALLOWABLE COSTS (MAR 2001) clause, which provides in pertinent part:

> (b) Contractors which include unallowable indirect costs in a proposal [for a final indirect cost rate or final statement of costs incurred and estimated to be incurred under the Incentive Price Revision clause (if applicable)] may be subject to penalties. The penalties are prescribed in 10 U.S.C. 2324 or 41 U.S.C. 256, as applicable, which is implemented in Section 42.709 of the [FAR].
>
> (c) The Contractor shall not include in any proposal any cost that is unallowable, as defined in Subpart 2.1 of the FAR, or an executive agency supplement to the FAR.
>
> (d) If the [CO] determines that a cost submitted by the Contractor in its proposal is expressly unallowable under a cost principle in the FAR, or an executive agency supplement to the FAR, that defines the allowability of specific selected costs, the Contractor shall be assessed a penalty equal to —
>
> (1) The amount of the disallowed cost allocated to this contract; plus
>
> (2) Simple interest, to be computed —
>
> (i) On the amount the Contractor was paid (whether as a progress or billing payment) in excess of the amount to which the Contractor was entitled; and
>
> (ii) Using the applicable rate effective for each six-month interval prescribed by the Secretary of the Treasury pursuant to Pub. L. 92-41 (85 Stat. 97).

(e) If the [CO] determines that a cost submitted by the Contractor in its proposal includes a cost previously determined to be unallowable for that Contractor, then the Contractor will be assessed a penalty in an amount equal to two times the amount of the disallowed cost allocated to this contract.

(f) Determinations under paragraphs (d) and (e) of this clause are final decisions within the meaning of the Contract Disputes Act of 1978 (41 U.S.C. 601, et seq.).

(g) Pursuant to the criteria in FAR 42.709-5, the [CO] may waive the penalties in paragraph (d) or (e) of this clause.

(R4, tab 1 at 17, tab 2 at 19) The contracts miscite this clause as dated May 2001.

3. On 31 August 2006 Inframat submitted a certified final incurred cost rate proposal for fiscal year 2004[1] for government audit. Among its overhead and general and administrative costs, the Defense Contract Audit Agency (DCAA) questioned pensions, legal fees, interest, convention/seminar, travel, consultant, audit, entertainment and advertising costs and expenses as expressly unallowable. (R4, tab 3 at 1, 17 of 26)

4. DCAA's 21 November 2007 Audit Report No. 02901-2004I10100011 on Inframat's "Calendar Year 2004 Final Incurred Cost" questioned its failure to exclude the foregoing expressly unallowable costs (SOF ¶ 3) and recommended that Inframat be assessed a total of $21,238 in FAR 42.709-3 level one penalties (R4, tab 3 at cover page, 1, 16-17).

5. The 7 February 2011 letter of ACO Michael Galvagni to Inframat enclosed a copy of the audit report and informed the contractor that he had determined that its final indirect cost rate proposal for FY 2004 included the foregoing expressly unallowable costs, and, therefore, he intended to impose penalties on such costs pursuant to FAR 42.709-3. The ACO requested Inframat to respond in writing within 30 days with justification for any disagreement with his position on unallowable costs and penalties. (R4, tab 4)

6. Inframat's 17 February 2011 letter responding to the ACO stated:

We feel a waiver is justified pursuant to FAR 42.709-5 regarding the proposed penalties outlined in your February 7, 2011 letter. We have taken multiple steps to

[1] Inframat's fiscal year was the calendar year (R4, tab 3 at 1, 18).

remedy the situation for future incurred cost submissions. Below are the steps and background information the company has taken in order to correct the situation.

During 2003 the company was using an accounting software package called DELTEK after a recommendation from DCMA. After the Deltek system was installed the company failed to make yearly maintenance payments and thus, support for the system broke down. The accounting staff was unable to use certain modules of the accounting system. The certified public accountants who reviewed their financial statements typically only used the general ledger that the controller provided them. The general ledger did not match the balance sheet and income statements. The bookkeeper was unable to make timely entries into the system because the software would close each period after each month. This compounded the problem as entries were not being made and amounts that were paid were left on the accounts payable ledgers. The Deltek system crashed during 2004. The company was able to recapture some of the lost information but [not] to recreate other information that was missing. Starting in 2006 we switched to Quickbooks accounting software to fix the problems.... The new accounting system worked better at being able to separate...allowable and unallowable costs by using the class tracking system.

The 2004 incurred cost submissions were submitted by the former controller, Hank Taylor. He was inexperienced in the submissions required. Mr. Taylor also felt that he could submit everything and just be told by DCAA what was not acceptable, which demonstrates his lack of understanding of the FAR. During 2008 the company attained the services of a qualified controller, Nicholas Vlahos (the entire accounting staff has been replaced). Mr. Vlahos has extensive experience in all matters of accounting and specifically was a former auditor of the company. Mr. Vlahos also has experience in FAR and the procedures for submitting information for the indirect cost rates required for doing business with the Federal Government. Additionally Mr. Vlahos has begun training to get his Masters Certificate in Government Contracting from ESI International in conjunction with George Washington University.

> The Company has since submitted incurred cost rates which excluded the items mentioned in your letter.... Attached is the overhead & general and administrative pages from our 2006 ICE submission that shows we removed questionable items for future submissions.

(R4, tab 5)

7. In his 17 May 2011 final decision ACO Galvagni reiterated that many of the costs submitted by Inframat in fiscal year 2004 for payment were expressly unallowable under FAR 31.205; noted that Inframat did not dispute this fact, but instead requested a waiver in accordance with FAR 42.709-5(c); and stated that Inframat had not satisfied the waiver requirements set forth in FAR 42.709-5(c). The ACO stated that FAR 42.709-5(c) requires a showing that the contractor exercised due care, but "by placing such an inexperienced employee in such [a] key role, [Inframat] has not shown such due care." The ACO's decision demanded payment of $29,016.00, including $21,238.00 for the penalty and $7,778.00 for interest through 17 May 2011. (R4, tabs 6, 7)

8. By letter postmarked 15 August 2011, Inframat appealed within 90 days after receiving the final decision pursuant to 41 U.S.C. § 7104(a).

9. Inframat's complaint repeated the accounting system failures and subsequent corrective actions described in its 17 February 2011 letter and alleged:

> We are concerned that the contracting officer may not have adequately reviewed or considered significant information provided to him regarding the situation, and we believe that a wavier [sic] is justified pursuant to FAR 42.709-5.... Since the time period that the violation occurred, the Company has reconstituted itself, and all of the administrative personnel in place when the violations occurred have been replaced. Further, the company has taken multiple steps to implement internal controls to prevent the situation for future incurred cost submissions. While penalties such as the one imposed may act as incentives for "bad" companies to take appropriate action to correct their behavior, in this situation, as corrective action had already taken place well before Mr. Galvagni's decision, we question the need for the Government to implement a significant (for us) financial penalty.

(Compl. at 1-3)

POSITIONS OF THE PARTIES

The government moves to dismiss the appeal for failure to state a claim upon which relief may be granted, or in the alternative, for summary judgment, on the ground that:

> The numerous factual allegations made by Inframat regarding the lack of training and oversight of its accounting staff and the lack of a system of internal control or review to prevent inclusion of unallowable costs in its 2004 proposal make clear that Inframat cannot prevail in this appeal. Inframat's own version of events is flatly inconsistent with a finding that it exercised due care in preparing its 2004 proposal, which is a prerequisite to its obtaining a waiver under FAR 42.709-5(c).

(Gov't mot. at 1) Inframat requests that "the Board review the decision by the contracting officer to impose a penalty when substantial steps [have been] taken to address the concerns of the contracting officer" (app. opp'n). Inframat avers that the ACO's assessment of penalties against Inframat was inappropriate because such penalties only should motivate "bad" contractors not to propose expressly unallowable costs.

DECISION

Summary judgment is appropriate when there are no genuine issues of material fact and the movant is entitled to judgment as a matter of law. FED. R. CIV. P. 56(a); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247 (1986). As to whether any genuine issue of material fact exists, the government alleges that none exists, and Inframat points to no evidence to the contrary. As to whether the movant is entitled to judgment as a matter of law, the sole issue is whether Inframat was entitled a waiver of the penalties the ACO assessed for including expressly unallowable costs in its 2004 final indirect cost rate proposal.

Title 10 U.S.C. § 2324 provides in pertinent part:

> **(c) Waiver of penalty**.—The Federal Acquisition Regulation shall provide for a penalty under subsection (b) to be waived in the case of a contractor's proposal for settlement of indirect costs when—

(1) the contractor withdraws the proposal before the formal initiation of an audit of the proposal by the Federal Government and resubmits a revised proposal;

(2) the amount of unallowable costs subject to the penalty is insignificant; or

(3) the contractor demonstrates, to the contracting officer's satisfaction, that—

(A) it has established appropriate policies and personnel training and an internal control and review system that provide assurances that unallowable costs subject to penalties are precluded from being included in the contractor's proposal for settlement of indirect costs; and

(B) the unallowable costs subject to the penalty were inadvertently incorporated into the proposal.

Title 10 U.S.C. § 2324(c) was implemented by FAR 42.709-5, which 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 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.

The issue before us is whether Inframat met the requirements for waiver in FAR 42.709-5(c)(1) and (2). Drawing all reasonable inferences in favor of Inframat, as the non-movant, subsequent to submission of its certified final incurred cost rate proposal for 2004, it established policies, controls and procedures to provide assurance of excluding unallowable costs in its final indirect cost rate proposals on government contracts as required by FAR 42.709-5(c)(1) (SOF ¶¶ 6, 9).

Inframat failed to raise a genuine issue of material fact, however, that it met the requirements of FAR 42.709-5(c)(2). On 31 August 2006 it submitted its 2004 final incurred indirect cost rate proposal (SOF ¶ 3). Prior thereto, it failed to exercise due care because its system support broke down for failure to make yearly maintenance payments, its Deltek system crashed, it lost cost information, its bookkeeper could not make timely cost entries, and its inexperienced controller included expressly unallowable costs in its 2004 final indirect cost rate proposal on the misunderstanding that DCAA later would tell him what costs were not acceptable (SOF ¶ 6). Therefore, ACO Galvagni properly determined that Inframat failed to exercise due care in preparing its 2004 indirect cost rate proposal and properly denied its request to waive the penalties.

CONCLUSION

We hold that the government is entitled to judgment as a matter of law in this appeal. We grant the government's motion for summary judgment and deny the appeal.

Dated: 3 August 2012

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. 57741, Appeal of Inframat Corporation, rendered in conformance with the Board's Charter.

Dated:

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