ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --	)	
	)	
Parsons-UXB Joint Venture	)	ASBCA No. 56481
	)	
Under Contract No. N62742-95-D-1369	)	

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OPINION BY ADMINISTRATIVE JUDGE MELNICK

Appellant, Parsons-UXB Joint Venture, removed unexploded bombs from the Hawaiian island of Kaho'olawe under a contract with the United States Navy. After it settled a lengthy dispute with the State of Hawaii over payment of state excise taxes, it sought reimbursement from the Navy, along with associated expenses. The Navy refused to pay, leading to this appeal. We sustain the appeal in part.

FINDINGS OF FACT

I. Background

1. Kaho'olawe is a remote, uninhabited island 94 miles southeast of Oahu, and 6 miles southwest of Maui (R4, tab 1 at 14). It is one of Hawaii's historic lands that was conveyed to the United States by the Republic of Hawaii in 1898 (R4, tab 131 at 6046). Department of Defense Appropriations Act of 1994, Pub. L. No. 103-139, § 10001(a), 107 Stat. 1418, 1480 (1993). Kaho'olawe is included on the National Register of Historic Places, and has a long history of cultural significance to the people of Hawaii. *Id.* However, for 50 years the Navy used it as a weapons range (R4, tab 1 at 14). Accordingly, when Congress decided in 1993 to convey Kaho'olawe to the State, it recognized that it would be necessary to clear unexploded ordnance, and perform environmental restoration, before the island could be devoted to "appropriate cultural,

historical, archaeological and educational purposes." § 10001(a), 107 Stat. at 1480. To achieve those goals, Congress required the Navy to retain control over access to the island and authorized $400,000,000 for its cleanup. §§ 10001-03, 107 Stat. at 1480-83. In 1994, the Navy and the State entered into a Memorandum of Understanding that included a cleanup plan for the island (R4, tab 131).

II. The Parsons-UXB Joint Venture

2. On 21 March 1997, Parsons Infrastructure and Technology Group, Inc. (Parsons) executed an agreement with UXB International, Inc. (UXB) to establish the Parsons-UXB Joint Venture (JV) (R4, tab 135). The companies created the JV to respond to the Navy's request for contract proposals to clear Kaho'olawe of unexploded ordnance and to perform environmental restoration (*id.* at 6086).

3. Under the agreement, the JV partners acknowledged that they would be jointly and severally liable to the government for actions within the scope of any contract between it and the JV, and to other parties with whom the JV contracted (R4, tab 135 at 6088). Each partner provided 50 percent of the working capital and possessed a 50 percent interest in the assets, obligations, liabilities, equity, profits or losses of the JV (*id.* at 6089-90). The agreement designated a president, who was from Parsons, to conduct the JV's affairs and to act as chairman of a president's board (*id.* at 6090-91). The board also consisted of the presidents of Parsons and UXB, and was vested with corporate oversight responsibilities. Its actions were binding and conclusive upon both partners. (*Id.* at 6091)

4. The JV agreement provided that the JV would be staffed with its partners' employees, and that the partners would contract with the JV to provide personnel and services (R4, tab 135 at 6092-93). The JV would pay amounts due to its partners "promptly upon their submission of invoices covering Joint Venture costs paid or incurred by them, and amounts due and owing under the contracts with the" JV. The JV would also pay all taxes imposed upon it by relevant governmental entities. (*Id.* at 6093) Finally, the JV agreement stated that it was governed by Hawaii state law (*id.* at 6095).

5. On 14 November 1997, the JV registered with the State of Hawaii as a domestic general partnership organized on 21 March 1997 (Bd. corr. order dtd. 2 February 2012).

III. The Contract

6. On 29 July 1997, the Navy awarded Contract No. N62742-95-D-1369 to the JV. It was a cost plus award fee, indefinite-delivery, indefinite-quantity contract for removal of unexploded ordnance and environmental restoration on Kaho'olawe (R4, tab 1). The contract's base year was from 29 July 1997 to 28 July 1998, and it provided

seven option years. At award, the total cost plus award fee was limited to $280,000,000. (*Id.* at 2-4)

7. The contract incorporated FAR 52.216-7, ALLOWABLE COST AND PAYMENT (AUG 1996) clause (R4, tab 1 at 127). That clause required the Navy to pay the contractor's allowable costs as work progressed, and as governed by the terms of FAR Subpart 31.2. The contract also required that "[a]ll invoiced costs...be substantiated by evidence of actual payment prior to billing" (*id.* at 96). Additionally, the contract incorporated FAR 52.232-20, LIMITATION OF COST (APR 1984) (LOC) clause, and FAR 52.232-22, LIMITATION OF FUNDS (APR 1984) (LOF) clause (*id.* at 129). The LOF clause states the following in pertinent part:

> (a) The parties estimate that performance of this contract will not cost the Government more than (1) the estimated cost specified in the Schedule or, (2) if this is a cost-sharing contract, the Government's share of the estimated cost specified in the Schedule. The Contractor agrees to use its best efforts to perform the work specified in the Schedule and all obligations under this contract within the estimated cost....
>
> (b) The Schedule specifies the amount presently available for payment by the Government and allotted to this contract, the items covered, the Government's share of the cost if this is a cost-sharing contract, and the period of performance it is estimated the allotted amount will cover. The parties contemplate that the Government will allot additional funds incrementally to the contract up to the full estimated cost to the Government specified in the Schedule, exclusive of any fee. The Contractor agrees to perform, or have performed, work on the contract up to the point at which the total amount paid and payable by the Government under the contract approximates but does not exceed the total amount actually allotted by the Government to the contract.
>
> (c) The Contractor shall notify the Contracting Officer in writing whenever it has reason to believe that the costs it expects to incur under this contract in the next 60 days, when added to all costs previously incurred, will exceed 75 percent of (1) the total amount so far allotted to the contract by the Government or, (2) if this is a cost-sharing contract, the amount then allotted to the contract by the Government plus the Contractor's corresponding share. The notice shall state

the estimated amount of additional funds required to continue performance for the period specified in the Schedule.

(d) Sixty days before the end of the period specified in the Schedule, the Contractor shall notify the Contracting Officer in writing of the estimated amount of additional funds, if any, required to continue timely performance under the contract or for any further period specified in the Schedule or otherwise agreed upon, and when the funds will be required.

(e) If, after notification, additional funds are not allotted by the end of the period specified in the Schedule or another agreed-upon date, upon the Contractor's written request the Contracting Officer will terminate this contract on that date in accordance with the provisions of the Termination clause of this contract. If the Contractor estimates that the funds available will allow it to continue to discharge its obligations beyond that date, it may specify a later date in its request, and the Contracting Officer may terminate this contract on that later date.

(f) Except as required by other provisions of this contract, specifically citing and stated to be an exception to this clause—

> (1) The Government is not obligated to reimburse the Contractor for costs incurred in excess of the total amount allotted by the Government to this contract; and
>
> (2) The Contractor is not obligated to continue performance under this contract (including actions under the Termination clause of this contract) or otherwise incur costs in excess of (i) the amount then allotted to the contract by the Government...until the Contracting Officer notifies the Contractor in writing that the amount allotted by the Government has been increased and specifies an increased amount, which shall then constitute the total amount allotted by the Government to this contract.
>
> ....

> (h) No notice, communication, or representation in any form other than that specified in paragraph (f)(2) above, or from any person other than the Contracting Officer, shall affect the amount allotted by the Government to this contract. In the absence of the specified notice, the Government is not obligated to reimburse the Contractor for any costs in excess of the total amount allotted by the Government to this contract, whether incurred during the course of the contract or as a result of termination.

8. The Navy ordered work under the contract through written task orders, and the contract applied the requirements of the LOC and LOF clauses to each individual task order. The LOC clause applied if a task order was fully funded when issued; the LOF clause applied if a task order was incrementally funded. "Task Order" was substituted for "Schedule" wherever it appeared in the two clauses. (R4, tab 1 at 88, 91) The JV began performing contract administrative work in the fall of 1997, and began field work in early 1998 (tr. 1/104-05). The Navy issued 67 task orders between 13 August 1997 and 3 August 2004 (R4, tabs 61-130).

9. The contract required the JV to comply with a subcontracting plan. That plan initially identified the JV's partners to receive subcontracts, but the parties executed a bilateral modification in 2001 deleting the partners from the subcontractor list. (R4, tab 1 at 69, tab 28, tab 604 at 170538) Although the JV agreement also contemplated that the JV would execute contracts with its partners for the services of their employees, the partners concluded later that none were needed (tr. 2/135-38). Instead, each partner billed its expenses to the JV at cost, plus applicable indirect overhead rates, which then became the direct costs the JV billed to the Navy (app. 21 Sept. 2011 opp'n to gov't mot. to dismiss ex. D).

10. Beginning in 1998, and then annually while auditing the JV's incurred cost submissions, the Defense Contract Audit Agency (DCAA) assessed and accepted the JV's practice of billing for its partners' contract performance costs (App. 21 Sept. 2011 opp'n to gov't mot. to dismiss ex. D; R4, tabs 171, 172, 214, 278; app. supp. R4, tabs 349, 361, 451). The Navy consistently paid the JV for its partners' costs, which were approximately $70,000,000 for UXB alone. The JV then forwarded the payments to the partners. (App. supp. R4, tabs 387, 465; tr. 2/140-41, 4/34-35) There is no evidence that either DCAA or the Navy considered the existence of express subcontracts between the JV and its partners to be a condition for paying the JV's partner costs, or sought proof of such subcontracts. There is also no evidence the Navy required the JV to pay its partners' costs to them before the Navy paid JV invoices for those costs (tr. 6/129).

IV. Hawaii General Excise Tax

A. Initial Navy GET Positions and Establishment of JV Practices

11. Hawaii imposes a General Excise Tax (GET) on all gross revenues of business activities (R4, tab 291 at 7099). Because GET had been a major expense on numerous Navy contracts, the Navy wanted to minimize it as much as possible and establish a definitive method for computing it (R4, tabs 218-19; tr. 1/147). On 3 December 1996, prior to the award of the contract, the Navy wrote to the Hawaii Department of Taxation, informing it of the Navy's intention to award this cost reimbursement contract. The Navy expressed to Hawaii a belief that, for GET purposes, a "federal cost-plus contractor" could exclude from its revenues the reimbursements it received from the government for purchases of material, plant, and equipment from another Hawaii taxpayer. The Navy sought confirmation that the awardee of this contract would be able to rely upon that exclusion. (App. supp. R4, tab 308 at 21) Hawaii agreed, stating in its 14 January 1997 response that the costs of such purchases, "may be considered an exempt reimbursement by the federal cost-plus contractors or subcontractors from their gross contracting income as a result of the work performed for the federal government" (*id.* at 19-20).

12. On 24 September 1997, after the contract was awarded, the Navy addressed the GET material purchase exemption with Parsons' parent corporation. The Navy forwarded to Parsons' parent its prior correspondence with Hawaii about the matter, and also identified another potential exclusion from income arising from subcontractor payments. The Navy "request[ed] that [Parsons] research these two tax issues as it pertains to the subject contract to ensure...proper payment of Hawaii general excise tax." (App. supp. R4, tab 308 at 18)

13. Upon receipt of the Navy's request, the parent corporation's tax manager noted the JV had originally contemplated paying GET on all gross receipts. However, she agreed that exemptions were available related to its subcontracting. (App. supp. R4, tab 308 at 15-17) The JV transmitted those conclusions back to the Navy, which then requested that the JV define its policy on the treatment of GET (*id.* at 13).

14. By letter dated 26 February 1998, the JV informed the Navy that it would exclude its purchases of material, plant, and equipment from GET at its level. The JV's suppliers paid GET and so the JV would reimburse them. However, it would exclude the reimbursements of those costs that it received from the Navy from its own GET tax base so that it would not pay GET a second time, avoiding "layering." The JV would treat its subcontractor payments, including payments to its partners, the same way. The JV reimbursed its subcontractors for GET, but then excluded its own receipts reflecting those subcontractor payments from its GET tax base. The JV noted in this letter that the State would audit it in 1998, and expressly warned the Navy that "[s]hould the State take

exception and assess additional tax, interest, and penalties, then we will seek reimbursement for these under the applicable task order." The Navy did not object to either the methodology described or to the warning. (App. supp. R4, tab 495; supp. R4, tab 623 at 241570-80; tr. 1/147-52, 155)

15. The JV billed, and received reimbursement from the Navy for, $9,909,653 in GET through 31 December 2005 (app. supp. R4, tab 278 at 6914).

B. Hawaii's 1998 Audit, Auditor Instructions Regarding Partner GET Treatment, and Navy Acceptance of GET Policies

16. Hawaii audited the JV's GET tax return in March of 1998 (R4, tab 174 at 6427, tab 212 at 6561). At that time, Hawaii's auditor informed the JV that it should not be treating its partners like its other subcontractors. According to the auditor, the partners should not have been paying GET on their revenues from the JV, but the JV should have been paying GET on its revenues for the partners' work. (Tr. 1/151-53) The auditor confirmed those instructions in a letter dated 4 May 1998, where he stated that "[f]or general excise tax purposes, each partner may exclude reporting the gross receipts derived from the joint venture from each of their respective general excise tax return [sic] since the joint venture should file its own general excise tax return" (R4, tab 139). By memorandum dated 12 May 1998, the JV forwarded the auditor's letter and instructions to the partners, explaining that "there is only one layer of tax and that tax is paid by the Joint Venture." Accordingly, the JV instructed the partners not to include GET in future invoices to the JV and to credit the JV for prior GET payments. (App. supp. R4, tab 496)

17. The JV submitted finance and cost accounting policy manuals to the Navy reflecting its policies for payment of GET and seeking its reimbursement from the Navy. The manuals noted that the JV's GET payments would include the liability of its partners. (R4, tab 140 at 6150, tab 141 at 6215) The Navy accepted the JV's GET policies (R4, tabs 218-19).

C. Hawaii's Additional GET Assessment Based on Subcontractor Payments and the JV's Appeal

18. On 8 November 1998, Hawaii assessed the JV $24,394.08, consisting of additional GET, as well as a penalty and interest. The State had rejected the JV's exclusion of some subcontractor payments from its GET tax base. The JV calculated that, when extended through the entire contract, the State's position added $6 million in GET costs. (R4, tab 143; supp. R4, tab 623 at 241518, -568, -581) On 7 December 1998, the JV paid the assessment under protest. It then appealed to Hawaii's Board of Review on 4 February 1999. (R4, tab 142; app. supp. R4, tab 320)

19. In February of 1999, a Navy contract specialist emailed the contracting officer with information about the assessment and appeal. The contract specialist opined that the GET regulations were unclear and that the Navy should support the JV while awaiting the outcome of the appeal. The contract specialist communicated that any resulting penalty and interest should be an allowable cost because the JV had kept the Navy informed of the matter. (App. supp. R4, tab 497) Navy task order price negotiation memoranda signed by the contracting officer accepted the JV's calculation of GET while the appeal was pending, acknowledging that, in the event of an outcome adverse to the JV, the Navy would pay the additional GET and any penalties (R4, tab 219 at 6594-95; supp. R4, tabs 625, 627).

20. On 20 May 1999, the Board of Review held a hearing on the JV's tax appeal that was attended by Navy personnel, including the contracting officer (R4, tab 152 at 6320, tab 212 at 6561; tr. 1/158). Nearly eight months later, on 13 January 2000, the JV communicated to the contracting officer that it estimated a reserve for additional GET tax in case the appeal was denied should be $320,000. In response, the contracting officer requested that such a reserve be established. (App. supp. R4, tab 498) On 15 May 2000, 15 months after the JV had filed its tax appeal, the Board of Review denied it (R4, tab 143 at 6283).

D. The JV's 2000 Appeal and Retention of Certain GET Payments

21. On 6 June 2000, the JV informed the Navy that it intended to appeal the Board of Review's decision, stating that it considered the legal fees that it would incur to be allocable to the project and that it would seek their reimbursement (app. supp. R4, tab 514). The Navy did not object (tr. 1/162). Indeed, a Navy contract specialist recognized in a memorandum to the file that a successful appeal of this GET issue by the JV would benefit the Navy's other Hawaii contracts (R4, tab 148; tr. 3/62, 4/54). Accordingly, the Navy approved an appeal (app. supp. R4, tab 495; tr. 1/148-50, 161-63).

22. On 14 June 2000, the JV appealed the State's additional GET assessment to the Tax Appeal Court of the State of Hawaii, contending that the deductions it had taken from its GET tax base for subcontractor payments were permitted by Hawaii law (R4, tab 143). The Navy agreed to pay legal fees related to that litigation, and paid JV invoices that included them (R4, tab 152 at 6321; app. supp. R4, tab 519; supp. R4, tab 651 at 478204; tr. 1/159, 162).

23. While the JV's appeal was pending, it continued to pay GET as it had been calculating it, excluding most subcontractor costs from its tax base and any associated GET from its Navy invoices. However, on the advice of its counsel, the JV invoiced the Navy for GET associated with its business with a group of aviation subcontractors, while withholding those funds from its GET payments to Hawaii. Thus, with the contracting officer's knowledge, and as recognized in DCAA audit reports, the JV did not pay to

Hawaii all of the GET funding it was receiving from the Navy, retaining the difference in a non-interest bearing account. Both the JV and Navy understood those funds were being retained to pay any additional GET liability if it became necessary, and the Navy acquiesced to the practice. (R4, tabs 171-72, 214, 278; app. supp. R4, tab 451; supp. R4, tabs 661-62, 723; tr. 1/185-91) When DCAA first reported on this retention in 2003, it totaled $598,928 (R4, tab 171 at 6402). By 11 June 2008, it was approximately $1,404,992 (R4, tab 302 at 7240-42).

E. Hawaii Auditor 2001 Correspondence on Partner Treatment

24. In a letter to UXB dated 24 July 2001, the Hawaii tax auditor reversed his position on the JV's partner liability for GET. Notwithstanding his 4 May 1998 confirmation that each partner could exclude reporting its JV receipts, the auditor declared that UXB was required to pay GET on those payments. (Supp. R4, tab 642) However, Hawaii did not assess either UXB or Parsons for GET at that time.

F. Navy and JV Consultations During 2002 and Early 2003

25. On 15 January 2002, 19 months after the JV subcontractor deduction appeal was filed, the JV and Navy, including the contracting officer, met to review its status. Hawaii's Attorney General was working with the State tax authorities to develop a settlement position. In the interim, the JV continued to pay GET based upon its understanding of state law. It was recognized at the meeting that, if the JV failed to prevail, its additional GET liability could be as much as $6 million. However, because Hawaii would likely settle for less, it was agreed at the meeting that the JV should continue the lawsuit. The legal costs had been billed to the Navy. The Navy program manager knew of the possible liability. He had programmed contingency funds, and had also left funds on the various awarded task orders, totaling $500,000, to cover the potential cost. (R4, tab 152; tr. 1/165-68) The Navy reserved funds to cover any additional GET liability until 2003 (tr. 4/72).

26. Another year went by with the matter unresolved. In an email to the JV dated 23 January 2003, the contracting officer raised the "open issue of Hawaii GET." The contracting officer acknowledged that the JV was retaining GET payments from the State until the appeal was resolved. He requested an updated estimate of potential additional liability, including legal fees, interest, and penalties. He also sought an explanation for the delay in settling the dispute. He explained that he sought this information so that he could "be better prepared to explain to [his] customer the potential contractual liabilities they may incur." (R4, tab 154)

27. The JV's February 2003 response to the contracting officer estimated that, based on total contract costs of approximately $310 million, GET liability could reach $12.3 million, or $2.9 million above what the Navy had budgeted. That figure did not

include penalties and interest, which the JV stressed would be billed to the Navy if imposed. The JV also reiterated that the $5.1 million in GET it had paid so far to the State had been calculated based upon its position in the appeal. (R4, tabs 155-56; tr. 1/189-91). It emphasized that, "[a]s per prior agreements, the amount currently paid to the State is different from the amount billed to the Navy, which is different than the amount that will eventually be settled with the State" (R4, tab 156 at 6327).

G. Hawaii's 2003 Demand that JV Partners Pay GET

28. On 9 May 2003, the JV informed the contracting officer that Hawaii had recently communicated that it was assessing UXB for GET on its share of distributions from the JV, and that Parsons had been advised of an audit. The JV explained that "[t]his question on the tax treatment of the partners is new and is contrary to written direction." Accordingly, it indicated it was including settlement of the tax treatment of the partners in its negotiations. (R4, tab 160)

29. After Hawaii directly assessed it for GET, UXB's president became concerned that any delays billing the Navy could be detrimental because the Navy might deplete its funds in the interim. Accordingly, from May of 2003 onward, UXB invoiced the JV for the GET it was assessed. (Supp. R4, tab 663 at 14608; tr. 3/31) However, the JV did not invoice the Navy for partner GET at that time (tr. 3/31). Additionally, UXB's president opined to an employee of Parsons' parent corporation that payments to the JV's partners for their services were subject to GET (supp. R4, tab 663 at 14607; tr. 3/28).

30. As of 30 May 2003, 46 of 67 contract task orders were physically complete. Another five were over 94% complete, and 86% of total estimated costs had been invoiced. (App. supp. R4, tab 502 at 9550)

H. Settlement Efforts During 2003 through 2004 and the Contract's Increased Rate of Performance

31. On 13 June 2003, the JV forwarded a proposed settlement of the GET dispute to the contracting officer for approval. The JV opined that, if Hawaii accepted the settlement, the total estimated GET liability for the project would be approximately $8.4 million on $320 million in revenue. If the appeal was not successful, and Hawaii prevailed on the subcontractor matter, while the partners prevailed on the newly raised partner GET dispute, then the total liability would be approximately $10.9 million. If Hawaii prevailed on both matters, then total liability would be approximately $15.9 million. The JV explained that all of these figures should be reduced by $7.9 million, which was the amount of GET paid to Hawaii through April, 2003. Though recognizing that interest or penalties could also be assessed, the JV had not included those amounts in its figures. (R4, tab 162) The contracting officer approved the proposal, and the JV submitted it to the State on 20 June 2003 (R4, tabs 163-64).

32. In July, 2003, the Navy increased the pace of contract performance, adding an additional work day each week, which also increased the Navy's rate of expenditures. Between 1 July 2003 and 30 September 2005, the Navy ordered an additional $33,947,058 worth of work on the contract. It consisted of $25,695,934 worth of work in 2003, $7,446,713 worth of work in 2004, and $804,411 worth of work in 2005. That set of orders exhausted most of the contingency funds the Navy had reserved. (Tr. 4/74-77, 160-61; app. sum. ex. at 2)

33. On 19 August 2003, the contracting officer summarized his understanding of the GET issues in an email to the JV. One set of issues related to whether GET deductions were available to the JV on its subcontractor and material transactions. The other primary issue was whether the partners were required to pay GET on their receipts from the JV. The contracting officer repeated the JV's estimates of potential liability under the different scenarios described in the JV's 13 June correspondence. (R4, tab 168) In response, the JV agreed that its estimates of exposure were still accurate, but also noted that "there are countless combinations of outcomes based on final settlement." The estimates "bracket[ed] the possible outcomes." (R4, tab 170) In an email exchange occurring between 20 and 21 October 2003, the Navy recognized that any total GET outcome above $9 million would exceed its "current spending plan" (app. supp. R4, tab 391).

34. On 29 October 2003, the JV submitted an offer to Hawaii to settle all GET disputes through the end of 2002 for $922,051, in addition to GET already paid (R4, tab 177). Total liability under the settlement terms would be $5.9 million on $231.6 million in gross receipts. The JV acknowledged to the contracting officer that it had billed the Navy $7 million for that period, which would lead to a $1.1 million credit for the Navy. As the JV observed to the contracting officer, "[o]bviously, this proposal is the best case." (R4, tab 179) Also on that date, the Navy increased the total estimated cost plus award fee for the contract from $330,000,000 to $355,000,000, which increased the estimated costs by $22,500,000 (R4, tab 44).

35. In a briefing conducted for Rear Admiral Barry McCullough on 5 November 2003, the Navy estimated that 7 to 10 million dollars would remain available for the contract by the end of Fiscal Year 2004. It also recognized that only $9 million had been budgeted for payment of GET, while the potential exposure could reach $16.5 million. Similar acknowledgements were made at another briefing held on 12 January 2004. (App. supp. R4, tab 503 at 168723; supp. R4, tab 658 at 467380-81) Despite the fact that the estimated GET liability could exceed funds available, and that the Navy's reserve funding was depleting, the Navy did not consider stopping work and continued with the project (tr. 4/96-101).

36. On 17 February 2004, Hawaii rejected the JV's 29 October 2003 settlement offer, and counter-offered $3,165,305.14 to settle all GET issues through 31 December 2002 (R4, tab 184).

37. On 4 March 2004, the JV provided an updated report to the contracting officer on the GET issue. It stated that the JV's GET billings to the Navy had totaled $9.4 million through the end of 2003. If it completely prevailed in the GET dispute, then total GET liability for the project would be $9.6 million on $339 million in revenue. If its position on the subcontractor issue failed, but its position on the partner issue prevailed, then total liability would be $11.5 million. If both of its positions failed then total GET liability would be $16.8 million. The JV suggested that poor coordination within the Hawaii state government was delaying resolution. It requested that Rear Admiral McCullough address the matter with the Governor. (App. supp. R4, tab 400)

38. The JV completed physical performance of the contract on Kaho'olawe on 9 April 2004. By that date, the Navy had substantially depleted its reserve contract funds. (Tr. 4/106-09)

39. On 16 April 2004, Hawaii assessed the JV an additional $4.1 million in GET for the period 1998 through 2003 (app. supp. R4, tab 410).

40. On 19 April 2004, in coordination with the Navy, the JV submitted a counter-proposal for settlement to the State in the amount of $1,233,121 (app. supp. R4, tab 410). On 17 May 2004, in coordination with Navy counsel, the JV increased its offer to $1,400,000, which, when added to prior GET payments, would total $9,564,252 on $345,000,000 in contract revenues (R4, tab 196).

41. On 18 May 2004, Navy counsel indicated to a fellow counsel that the Navy was treating the JV's GET dispute as Navy litigation. Also on that date, in response to certain questions from the State, the contracting officer communicated that the Navy intended to cap its payments to the JV at $345,000,000. (Supp. R4, tab 694)

42. On 20 May 2004, the JV notified the contracting officer by letter that it expected to reach the limit of the incremental funding on the contract by 28 May. It warned that "unless significant additional funding" was received by that date the JV would stop all work and begin demobilization. (App. supp. R4, tab 504) There is no indication it stopped work. The next day, the JV committed to the Navy that it would not exceed $344,154,644 in cost and award fee billings (app. supp. R4, tab 516).

43. On 28 May 2004, Hawaii rejected the JV's 17 May settlement offer. It counter-offered to settle the JV's GET liability through the end of 2004 for $5,223,488.32, plus $725,721.60 in penalties and interest. (R4, tab 201)

44. On 7 June 2004, Rear Admiral McCullough wrote to the Governor of Hawaii about the GET dispute. Admiral McCullough emphasized that, though the JV was the taxpayer, the taxes would be "in actuality paid by the Navy." He characterized the JV's proposal to pay a total of $9.5 million as "fair and equitable," while the State's demand for $19.1 million, not including penalties and interest, was "troubling." Accordingly, he sought the Governor's intervention. (App. supp. R4, tab 507)

45. In an email to the contracting officer dated 15 June 2004, the JV addressed its billing commitment with the Navy. It agreed to limit its billings to $344.15 million, which included $10 million for GET. However, it also emphasized that "[a]ny settlement over the $10 million comes from additional Navy funds." It then recommended that the Navy de-obligate any excess funds from completed task orders for use on others. (Supp. R4, tab 702) There is no evidence anyone in the Navy objected to the JV's characterization of its commitment.

46. Beginning in July of 2004, and continuing into 2007, the JV and the Navy closed out approximately 54 of the 67 task orders. Recognizing that GET liability, as well as any interest and penalties, remained unresolved, each set of closeout documents provided the amount of GET that had been billed for a task order and, at the Navy's request, provided estimates of additional liability that could arise depending upon the outcomes of the subcontractor and partner disputes. (Tr. 1/168-73; gov't sum. ex. at 4) The Navy de-obligated approximately $1.3 million from overfunded task orders and reallocated the funds for the performance of other task orders (tr. 5/30-36; app. sum. ex. at 1). The Navy project manager chose not to reserve the funds to pay additional GET that might become due as a result of the dispute (tr. 4/140, 164-66).

47. On 4 August 2004, Hawaii and the JV held a settlement meeting that was also attended by Navy counsel. During the meeting, the State discussed, in more detail than it had previously, its position that individual partners owed GET on their receipts from the JV for their services. (R4, tab 206) On 16 August 2004, Navy counsel prepared a memorandum analyzing the partner dispute. Among other things, he memorialized a conversation between himself and the JV where it disclosed to him that the JV had not entered any contracts with its partners for their services. Instead, the JV believed that its partners were contributing human resource assets to the JV. Navy counsel concluded that "a realistic position in favor of [the JV] and the Government [could] be sustained." (Supp. R4, tab 707)

48. On 24 August 2004, Hawaii made another settlement offer, proposing to resolve all of the outstanding disputes, including the partner issue, for $6,700,003 (R4, tab 208).

49. In a memorandum dated 23 September 2004, the Navy noted that the JV's dispute with the State had included both the subcontractor issue and the partner issue,

acknowledged that it had supported the JV and participated in negotiations to resolve the matter, and advocated that a resolution was required (R4, tab 213). Sometime around that date, Navy counsel addressed in his notes the choices presented to the Navy. He concluded that it did not have more than $1.8 million in additional funds under the contract to pay the State's additional GET demands, while the State was seeking $6.7 million. He began considering invoking the contract's LOC and LOF clauses to limit the Navy's liability to the funds available on the contract, regardless of the State's tax assessments or the result of litigation with it. (App. supp. R4, tab 520; tr. 3/128-42) On 27 September 2004, Navy counsel met alone with Hawaii's Director of Taxation to negotiate the GET dispute (R4, tab 208; app. supp. R4, tab 520).

50. All performance of the contract ended in October 2004. Although the Navy had set aside 5% of the contract's funding for contingencies, that fund was spent by October of 2004 for various contract task orders. Less than $1 million in funds was available for the contract by that time. (Tr. 4/152-53) By 2 March 2005, only a net balance of $16,706.94 remained available on the contract (supp. R4, tab 660 at 375030-33).

51. On 1 October 2004, Hawaii repeated its $6.7 million offer (R4, tab 208 at 6527-29). Subsequently, internal communications between Navy counsel observed that the "Navy projected and retained a reasonable amount for reimbursement [of the JV's] remaining unpaid" GET (App. supp. R4, tab 518). The Navy had relied upon that projection when it directed additional clearance work be performed on the island after the contract's original completion deadline. However, the amounts under consideration now exceeded the remaining available funds (*id.)*. Despite the Navy's recognition that it had relied on its own GET projections, its 18 October 2004 response to the JV regarding Hawaii's offer claimed that it had relied upon JV estimates to budget GET and that the State's offer exceeded that amount. The response did not identify specific JV estimates upon which the Navy relied. (R4, tab 217)

52. On 6 November 2004, the JV's counsel provided both the JV and Navy counsel with an assessment of the GET dispute. The JV's counsel estimated that the potential additional liability of both the JV and its partners could exceed $11,600,000. He exhaustively addressed the subcontractor and partner issues, and stressed that the JV had valid arguments to carry its burden in litigation. Nevertheless, he recommended accepting the State's $6.7 million offer. (R4, tab 220) After discussing that analysis with the JV, the contracting officer sent it a letter dated 12 November, stating that the proposal exceeded funds available on the contract and that Navy's "current commitment for reimbursement of GET is contained in the contract task order funded amounts" (R4, tab 255 at 6645).

53. By letter to the contracting officer, dated 22 November 2004, the JV sought the Navy's approval to accept Hawaii's offer, concluding it was "in the best interest of all

parties to avoid the risk and uncertainty of additional exposure" (R4, tab 224). In his 23 November 2004 response, the contracting officer conceded that the JV's GET liability was reimbursable under the contract, but denied the request for settlement approval anyway. The contracting officer claimed that the LOC and LOF clauses permitted the Navy to limit any reimbursement to the remaining available funds on the contract task orders. (R4, tab 225 at 6637-38)

I. JV's 2005 Offer to Hawaii

54. Five months later, by letter dated 25 April 2005, the JV tried again to completely settle all outstanding disputes with Hawaii for the amount of funds remaining on the contract, proposing an additional $1,414,547.48. This would bring total GET payments to the amount allocated by the Navy, which it said was $9,964,252. (R4, tab 246; supp. R4, tab 723 at 67582) The figure reflected the excess Navy GET payments the JV had been retaining, with the Navy's knowledge, to fund a settlement (supp. R4, tab 723 at 7581-82). Hawaii rejected that offer six months later, on 26 October 2005 (R4, tab 254).

J. 2006 Discussions and Proposed Assessment of Parsons

55. In April, 2006, the JV repeated to the contracting officer that its total estimated billings would not exceed $344,171,896. However, it conditioned that statement upon the assumption that the GET dispute settled for the additional $1.4 million it had already billed the Navy and been holding, bringing total GET payments to $9,964,252. The JV emphasized that "[s]hould this settlement of both JV and partner liabilities not be accepted by the State, then [t]he JV and its partners will seek reimbursement from the Navy." (App. supp. R4, tab 723 at 67581-82)

56. In a 3 April 2006 email sent to the contracting officer, Navy counsel again acknowledged that the JV was holding $1.4 million to settle with Hawaii. He advised that the sum, in addition to the amounts paid to Hawaii, now reflected "the sum total of what the Navy recognizes as GET taxes that" were "allowable, allocable and reasonable." He declared that no additional funds would be required because the Navy did not recognize any additional GET liability. He also recognized that the Navy had agreed to pay the legal fees the JV incurred advancing its GET position. Navy counsel accused the JV of only recently disclosing that the GET dispute had any litigation risk, and advised that the Navy would have defenses to any claim that it was liable for any additional GET. (App. supp. R4, tab 519; tr. 3/83-84)

57. In May of 2006, Hawaii offered to settle its GET dispute with the JV for $1.4 million, excluding from its scope the dispute with the partners regarding their liability (R4, tabs 257-58). The JV's letter forwarding that offer to the contracting officer expressed the belief that its efforts to achieve a global settlement of all the issues for

$1.4 million were "unachievable." Accordingly, the JV would prepare a counter-offer addressing all outstanding issues, including the partner dispute. (R4, tab 259) Five months later, on 13 October 2006, the JV sought the contracting officer's approval for a total GET payment of $11,532,056, which was $2,967,754 above the $8,564,302 that had already been paid (R4, tab 263). On 26 October, it forwarded the offer to Hawaii (R4, tab 269). The contracting officer declined to approve the offer on 27 October on the grounds that it exceeded the $1.4 million in additional funds available (R4, tab 267). On 3 November, the JV notified the contracting officer that the State had rejected the offer (R4, tab 269).

58. On 17 October 2006, Hawaii issued Notices of Proposed Assessment to Parsons in the amount of $2,329.929.29 in additional GET, interest, and penalties for 1997 through 2004 (app. supp. R4, tab 455).

K. 2007 Final Assessments, Agreements, and Invoices

59. Between 13 and 27 March 2007, Hawaii issued final GET assessments to Parsons in the amount of $2,528,869.08 for 1997 through 2005. They included $592,592.31 in interest, and a $47,081.29 penalty. (App. supp. R4, tab 460).

60. On 9 April 2007, Hawaii issued final GET assessments to UXB in the amount of $3,632,980.04 for 1998 through 2005. They included $984,811.13 in interest, and a $316,802.11 penalty. UXB recorded the assessment as a liability on its financial statement, and billed the JV for it on 14 May. (App. supp. R4, tabs 461, 463; tr. 2/158-64) On 2 August 2007, UXB revised the invoice to add $171,186.02 of GET to the amount sought, bringing the total to $3,804,166.06 (app. supp. R4, tab 475).

61. On 3 May 2007, Hawaii issued Notices of Proposed Assessment for GET to the JV totaling $6,309,421.78 for 1998 through 2004. The assessments included $1,566,870.13 in interest, and a $197,156.47 penalty. (App. supp. R4, tab 462)

62. On 30 May 2007, the JV and Hawaii completed a settlement agreement. The parties agreed that a "dispute ha[d] arisen over the amount of General Excise ('GE') and use taxes payable to the" State. The State "accept[ed] the sum of $1,700,000 in full and final settlement of any and all claims, whether assessed or unassessed, against the JV, for Hawaii general excise and use taxes including interest, penalties and similar charges" arising from the contract. (R4, tab 275) The JV paid the settlement on 31 May 2007 (compl. and amend. answer ¶ 31).

63. On 13 July 2007, Parsons and Hawaii completed an agreement in which the State accepted "$1,865,556 in taxes and $149,244.48 in interest charges as full and final settlement of any and all claims, whether assessed or unassessed, against [Parsons] for GE[T] and use taxes including interest, penalties and similar charges" arising from the

contract (R4, tab 279). Parsons paid the $2,014,800.48 settlement on 18 July 2007 (app. supp. R4, tab 472). Parsons invoiced the JV on 7 August for the amount of the settlement, plus $94,937.40 in additional GET upon the amount sought, bringing the total to $2,109,737.88 (R4, tab 280 at 6944).

64. On 8 August 2007, the JV submitted invoice 107 to the Navy. The invoice sought $6,594,213.85. It consisted of $2,109,737.88 related to Parsons' dispute, $3,804,166.06 related to UXB's dispute, and $295,008.34 related to the JV's dispute. The JV's request was reduced from the $1,700,000 it paid to Hawaii because it was already holding $1,404,992 in GET payments from the Navy that it had not forwarded to the State. The total figure also consisted of $112,425.18 in legal fees, and $272,876.39 in GET added by the JV to the amounts sought. (R4, tab 280) On 31 August, the JV submitted a revised invoice, 107R, containing additional information (R4, tab 285).

65. The Navy rejected the revised invoice on 7 September 2007. According to the Navy, the JV was seeking added costs "not currently in place on the contract." It concluded that "added costs must first be addressed by complete, timely notification and contracting officer approval in the form of revisions to the total estimated contract cost amount and funded contract amounts before invoicing." It therefore relied upon the LOC and LOF clauses to deny payment. (R4, tab 286)

V. The JV's Claim and Appeal

66. On 28 November 2007, the Navy received a certified claim from the JV. In addition to the $6,594,213.85 it had sought in invoice 107R, the JV added additional legal costs in the amount of $21,155.82 for the JV, $41,544.97 for Parsons, and $116,827.64 for UXB, for a total of $6,773,742.28. (R4, tab 291) The Navy did not issue a final decision.

67. This appeal was filed on 21 July 2008.

VI. UXB's Litigation and Settlement With Hawaii

68. In 2008, UXB filed a series of appeals of Hawaii's GET assessments in the Tax Appeal Court. The parties settled on 5 January 2011, with UXB agreeing to pay $721,055.81 in relation to the JV contract. The amount was "designated by the Parties...as payment for all tax liabilities." Payments were made in installments, with the first occurring on 14 January 2011. UXB invoiced the JV for the full settlement on 22 February 2011, plus $495,594.57 in legal fees, and $57,328.57 in GET upon those amounts, for a total of $1,273,978.95. (App. supp. R4, tab 509 at 9203-15) On 7 June 2011, the JV notified both the contracting officer and this Board of UXB's settlement. The JV then lowered its claim from $6,773,742.28 to $4,035,444.61, reflecting UXB's

reduced liability, with a correlating reduction by the JV in the GET it was seeking for the claimed amounts to $181,593.47. (App. supp. R4, tab 509)

DECISION

The JV claims it was entitled to payment of all of the costs claimed, and that the Navy's failure to do so constituted a breach of contract. It seeks the amounts claimed as damages, adjusting for UXB's subsequent settlement and additional legal fees.

I. The LOC and LOF Clauses Do Not Bar Recovery

The Navy rejected Invoice 107R because payment would exceed allotted funds on the task orders, claiming the LOC and LOF clauses relieved it of that obligation (finding 65). Indeed, those clauses restrict the JV's right to payment under this cost plus fixed fee contract by limiting the government's liability for costs that overrun total allotted funds and estimated costs (finding 7). Previously, the Navy moved for summary judgment on that basis. We ruled that the claim exceeded the allotted funds, but denied summary judgment because of remaining genuine issues of material fact, and to address various exceptions to the LOC and LOF clauses raised by the JV. *Parsons-UXB Joint Venture,* ASBCA No. 56481, 11-1 BCA ¶ 34,680. We now rule that the LOC and LOF clauses do not bar the JV's recovery.

Under the LOF clause, the JV agreed to notify the contracting officer if it had reason to believe the costs it would incur on a task order within 60 days would exceed 75% of the allotted funds, and "state the estimated amount of additional funds required to continue performance" (finding 7). FAR 52.232-22. The LOC clause contains similar provisions that were tied to estimated costs rather than allotted funds. FAR 52.232-20. The LOC and LOF clauses are intended to protect both parties to a contract. *See Advanced Materials, Inc. v. Perry,* 108 F.3d 307, 310 (Fed. Cir. 1997). They protect contractors by ending their performance obligations when the funding and cost limits have been reached unless the government approves the incurrence of more costs. They protect the government from paying more than it anticipates unless it chooses to permit additional costs. The parties are to prospectively determine their future dealings. *Titan Corp. v. West,* 129 F.3d 1479, 1482 (Fed. Cir. 1997); *Advanced Materials,* 108 F.3d at 310-11.

The LOC and LOF clauses protect both parties, and neither may employ them unfairly. Thus, failure to give notice and stop work before incurring an overrun does not bar recovery of those costs if the contractor had no reason to believe an overrun was imminent during performance. *See RMI, Inc. v. United States,* 800 F.2d 246, 248 (Fed. Cir. 1986); *Gen. Elec. Co. v. United States,* 440 F.2d 420, 423 (Ct. Cl. 1971). In the case of this contract, where the LOC and LOF clauses applied to individual task orders, failure to give notice would only bar recovery of a particular task order's overrun costs if there

was reason to know of the overrun during that task order's performance (finding 8). *See RMI,* 800 F.2d at 248. Also, because the notice must include a revised estimate of the additional funds necessary to complete performance and the total cost of performing, recovery is not barred unless such an estimate was possible. FAR 52.232-20(c), 52.232-22(c). Finally, the LOC and LOF clauses do not bar recovery when "it would be inequitable for the Government to refuse additional funding." *Gen. Elec. Co.,* 440 F.2d at 423; *see also Johnson Controls World Servs., Inc. v. United States,* 48 Fed. Cl. 479, 486-87 (2001).

The Navy contends that the JV anticipated the entire overrun in May of 2003 and did not provide the required notice, barring its recovery now under the LOC and LOF clauses. The Navy relies upon the opinion expressed by UXB's president that JV payments to its partners were subject to GET, as well as the fact that UXB billed the JV for the partner GET it was being charged out of concern that the Navy would deplete its funds during any intervening delay. Rather than properly notifying it of the overrun, the Navy says the JV did the opposite by agreeing to cap its billings in 2004 without regard to any additional GET. (Gov't br. at 54, 58)

Initially, we note any obligation in May of 2003 to provide notice of an anticipated imminent overrun would have only applied for task orders that were incomplete at that time. As of 30 May, 46 of the 67 task orders were physically complete (finding 30). The record is not clear as to what component of the GET settlement costs apply to incomplete task orders in May of 2003, or would have overrun them at that time.

Additionally, this is not a situation where, as a contractor progressed in its performance, it knew it had incurred costs to the point of an overrun that it failed to communicate to the government. Here, the JV and Navy partnered in the pursuit of a dispute over a category of costs, state taxes, which generated uncertainty about those costs that was known to all.

Aware that it would be paying the GET costs arising from the JV's performance, it was the Navy that first raised with the JV the possibility of reducing them by deducting its material purchase and subcontractor receipts (findings 11-12). The JV had not originally intended to do that (finding 13). Not only did the JV acquiesce to the Navy's desires, after Hawaii rejected the subcontractor deductions the JV pursued litigation against the State over the matter with the Navy's full support and knowledge (findings 14, 18-23, 25-27, 31, 33-35, 37, 40-41, 44-47, 51-53, 55-57). From the beginning, the JV understandably warned the Navy that it would charge it any additional tax, penalties, and interest that the State might ultimately assess, and that the Navy was responsible for the legal fees of the litigation. The Navy never objected to those warnings. Instead, it recognized it would be responsible for additional GET, penalties, and interest, and it paid JV legal fees. (Findings 14, 19, 21-22, 25-27, 35, 44-45, 56) Later, after Hawaii informed the JV that the partners should also be paying GET, the JV

notified the contracting officer of that issue, made clear that it was disputing that matter, and that it expected reimbursement of any resulting liability (findings 28, 55).

The Navy actively participated in the GET dispute, and was fully aware of its implications and consequences. Early on, the Navy contract specialist reported to the contracting officer that the JV had kept the Navy informed about the GET issues (finding 19). The Navy contracting officer also attended the State Board of Review hearing (finding 20). When that action failed, Navy personnel concluded that an appeal from that board benefitted both the project and the Navy's other contracts, and the Navy approved an appeal (finding 21). The Navy's counsel joined the JV in developing settlement offers, attended settlement meetings with Hawaii, and declared that the matter should be treated as the Navy's own litigation (findings 40-41, 47, 49). A Navy admiral even interceded with the Governor of Hawaii about the dispute, conceding that the Navy would actually be paying the taxes, while advocating for a settlement (finding 44).

The JV also consistently informed the Navy about the risk of liability presented by the GET dispute. It initially estimated that the Navy should maintain a $320,000 reserve in case the litigation failed (finding 20). As potential GET liability increased, the JV modified its estimates. In January 2002, it notified the contracting officer that GET exposure could be $6 million in case of an adverse result, prompting the Navy to increase its contingency funding. Nevertheless, the contracting officer agreed that the litigation should continue. (Finding 25) After the contracting officer inquired again in January 2003 about the extent of the Navy's GET exposure, the JV advised that total liability, excluding penalties and interest, could reach $12.3 million (findings 26-27). Again, in June of 2003, while requesting and receiving the contracting officer's concurrence in a settlement proposal to the State, the JV revised its estimate of total exposure to $15.9 million, which included consideration for the newly raised partner GET issue (findings 31, 33). Once more, in March 2004, the JV provided updated estimates to the contracting officer that GET liability could reach nearly $17 million (finding 37). The JV also shared with the Navy's counsel its own counsel's litigation risk assessment (finding 52).

The Navy was clearly warned that potential GET exposure could exceed $16 million, while also aware that any liability above $9 million exceeded what it had planned to spend on GET (findings 33, 35). Nevertheless, the Navy added $22,500,000 to the contract's estimated costs in October of 2003, de-obligated task order funds between 2004 and 2007, and then increased the rate of contract performance between the second half of 2003 through 2005 by exhausting nearly $34 million on additional task order work, without reserving any additional funds to cover its potential increased GET liability (findings 32, 34-35, 38, 46, 50). Instead, it made a conscious decision not to retain any funds beyond what it considered reasonable, and exhausted the remainder on additional clearance work on the island (finding 51).

Contrary to the Navy's contention, the JV did not possess some superior prescience in May of 2003 about the outcome of the GET dispute that it failed to share with the Navy. Though UXB's president had opined that the partners should pay GET, two of the three members of the JV's board were from Parsons. There is no evidence they shared his views (findings 3, 29). In contrast, the JV's counsel reported that its opposition to partner GET had validity, and Navy counsel considered the JV's position "realistic" (findings 47, 52). Crucially, the Navy has not shown that the JV knew any more in May 2003 about how the dispute would end than what it had reported, or that it had reason to believe unfinished task orders were facing an imminent overrun that it could calculate. Additionally, UXB's desire to bill for the partner GET simply reflected its concern that the Navy would do exactly what it in fact did, which was ignore the risk of increased GET liability and exhaust all of its funds on additional task order performance while the GET dispute remained unresolved (finding 29).

The Navy is also incorrect that the JV agreed to cap the Navy's GET exposure. In June, 2004, the JV committed that its billings would not exceed $344.15 million, including $10 million for GET, but also made clear to the Navy that any settlement of the GET dispute over the $10 million would come "from additional Navy funds." The JV reemphasized that point in 2006. (Findings 45, 55)

Given all the facts, the Navy's attempts to claim inadequate notice under the LOC and LOF clauses are simply unfounded. The Navy knew all about the GET dispute and the potential exposure it presented. Indeed, it was the Navy's desire to minimize its GET liability that led to the dispute in the first place. The JV kept the Navy informed of its best estimates of that potential liability. The JV was not obligated to predict the dispute's outcome to be entitled to the additional GET that has now arisen. *See Aerojet—Gen. Corp.,* NASA BCA No. 675-6, 77-1 BCA ¶ 12,295 (holding that the contractor is not required to predict the outcome of legal proceedings that could retroactively increase its costs of performance); *see also ARINC Research Corp.,* ASBCA No. 15861, 72-2 BCA ¶ 9721. Given that the purpose of the LOC and LOF clauses is to permit the parties to prospectively determine their future dealings, the Navy was given all the notice it needed.

Finally, it would also be inequitable to employ the LOC and LOF restrictions to bar recovery. At the outset, the JV could have acceded to Hawaii's demands and paid the additional GET the State sought. It could have then invoiced the Navy for the increased GET contemporaneously with its performance of the associated task orders, while funds were still available, avoiding any overruns. However, immediately paying the State's higher GET assessment and billing it to the Navy would have reduced the total funds available to the Navy to acquire the JV's services on the island (tr. 6/202-03).

Instead, in an effort to reduce the Navy's GET liability, and with its full support, the JV appealed the State's assessment of higher GET taxes, while, with some exceptions, only charging the Navy its lower GET calculation. It also disputed the

State's attempt to impose GET upon its partners. (Findings 18-23, 28) The Navy knew that if the outcome of those disputes were adverse it would be presented a belated GET bill for the increased liability (findings 14, 19, 25-27, 31, 33, 35, 37, 41, 44-46, 49, 55). Rather than maintaining a reserve, as the JV had discussed, the Navy exhausted virtually all of the contract funds on additional task order performance (findings 20, 32, 34-35, 50-51). It then devised the strategy of relying upon the LOC and LOF clauses to avoid paying any additional GET that arose after it exhausted its funds (findings 49, 51, 53, 56-57).

Ultimately, the JV's challenge to Hawaii benefitted the Navy. Rather than paying GET bills that might have totaled over $16 million had they gone unchallenged, the JV lowered the total GET liability below $14 million (findings 15, 62-63, 68). Nevertheless, the Navy declared the delayed GET bill an overrun barred from payment by the LOC and LOF clauses. The Navy's reliance upon the clauses under these circumstances is inequitable.

II. The JV Claim Arising From Its Subcontractor Deduction Settlement

Having concluded that the limitations of the LOC and LOF clauses are inapplicable here, we address whether the actual amounts claimed by the JV were allowable. First, the JV seeks $295,008.34 in reimbursement of its own GET costs arising from its settlement of the subcontractor deduction dispute (app. br. at 48). Reimbursement under this cost plus award fee contract is governed by the Allowable Cost and Payment Clause, which, in turn, refers to the cost principles for contracts with commercial organizations contained in FAR Subpart 31.2 (finding 7). Under those principles, costs are to be paid when they are reasonable, allocable, and allowable. FAR 31.204(a); *see also Geren v. Tecom, Inc.*, 566 F.3d 1037, 1040 (Fed. Cir. 2009). State taxes are typically deemed to be allowable. FAR 31.205-41. Here, the Navy agreed that GET was recoverable by the JV, and reimbursed it over $9.9 million of GET over the life of the contract (findings 11-15, 17, 53). The $295,008.34 the JV now seeks is simply the additional GET arising from the settlement of the subcontractor dispute (findings 18, 64). The question presented then is whether some specific grounds dictate that this additional GET is not recoverable.

The Navy suggests that it has already paid the portion of the JV's settlement that might be allowable. Though the JV's total subcontractor GET settlement was $1,700,000, with the consent of the contracting officer the JV had been holding $1,404,992 previously paid to it by the Navy for GET. Thus, its claim is only for the additional balance of $295,008.34. (Findings 23, 62, 64). The Navy contends that since roughly 28% of Hawaii's original GET assessment of $6,309,421.78 was for interest and penalties, the final $1,700,000 settlement payment to Hawaii should be broken down the same way. Thus, the Navy claims that approximately $1,225,000 of the settlement should be characterized as taxes and the rest as interest and penalties. The Navy argues

that interest and penalties are not allowable, and that the JV already held more than sufficient funds to pay the tax portion of the settlement. (Gov't br. at 60, 69, 73-74, 78)

The Navy bears the burden of establishing that costs are unallowable. *Westech Int'l, Inc.*, ASBCA No. 57296, 11-2 BCA ¶ 34,822 at 171,346. The settlement agreement states that Hawaii "accept[s] the sum of $1,700,000 in full and final settlement of any and all claims, whether assessed or unassessed, against the JV, for Hawaii general excise and use taxes including interest, penalties and similar charges" arising from the contract (finding 62). Though it describes the types of claims that are being settled, the agreement does not characterize any portion of the payment to constitute penalty or interest. Significantly, the settlement agreement between Parsons and Hawaii over its partner GET expressly states that a portion of the settlement payment constitutes interest, indicating that when Hawaii intended to label a settlement payment it did so specifically (finding 63). Under these circumstances, the Navy has not proven that any portion of the $1,700,000 constitutes interest or penalty. Accordingly, the $295,008.34 sought by the JV in settlement of the subcontractor GET dispute is an allowable cost under the contract.

III. The JV Claim Arising From Its Partners' Settlements

The JV also seeks the GET costs its partners incurred performing the contract. It seeks the $1,865,556 GET settlement that Parsons paid to Hawaii, plus the additional $149,244.48 in interest it paid (findings 63-64; app. br. at 48). It also seeks the $721,055.81 GET settlement that UXB paid to Hawaii (finding 68; app. br. at 48).

A. Partner GET

The JV was unpopulated, meaning it performed the contract with its partners' employees. The parties therefore consistently followed a course of performance in which they treated the partners' contract performance costs as the JV's allowable costs. The JV invoiced partner costs to the Navy, which it paid. DCAA approved that practice on numerous occasions, which was in accordance with established precedent. (Findings 4, 9-10) *See McKissack+Delcan JV II,* B-401973.2 *et al.*, 2010 CPD ¶ 28 (Comp. Gen. Jan. 13, 2010). Given that the GET Hawaii charged to the JV was an allowable contract cost, GET charged to the partners should be an allowable contract cost as well, and reimbursable by the Navy like the other partner costs it paid.

The Navy maintains otherwise. Notwithstanding the fact that it reimbursed the JV for partner costs throughout performance of the contract, the Navy now claims it was not really required by the contract to do so. It observes that the JV registered as a partnership in Hawaii and therefore is legally separate from its partners (gov't br. at 50). It argues that, because the JV did not execute express subcontracts with its partners for their services, which it characterizes as a breach of contract, the JV was not obligated to pay its partners' costs and therefore those costs are not allowable costs of the JV (gov't br. at 51,

60-62; tr. 6/162). In essence, under the Navy's view, the partners were performing for free.

The Navy's contentions are incorrect. Although the contract initially identified the partners as subcontractors, the Navy and JV deleted them from the subcontractor list pursuant to a bilateral modification in 2001 (finding 9). Thus, the absence of subcontracts was not a breach of contract. That deletion, along with the fact that the Navy never sought proof of subcontracts before paying partner costs, demonstrates that the Navy did not consider the existence of subcontracts to be a contractual condition of payment. Instead, as DCAA agreed, the Navy was satisfied that, by their very nature, the partners' costs performing their unpopulated joint venture's contract were allowable costs. (Finding 10) The Navy's position that subcontracts were required to justify its payment of partner costs is newly minted for this litigation. However, the parties' interpretation of the contract during performance, before a dispute arose, is demonstrative of their contractual intent. *Max Drill, Inc. v. United States,* 427 F.2d 1233, 1240 (Ct. Cl. 1970).

Moreover, the parties' recognition during performance that the JV partners' costs performing the contract were allowable JV costs is consistent with the nature of a joint venture, the JV agreement, and the applicable law. A joint venture is an association of partners established by contract to carry out a single business activity for joint profit, "combining their efforts, property, money, skill and knowledge." *Sadelmi Joint Venture v. Dalton,* 5 F.3d 510, 513 (Fed. Cir. 1993) (quoting *Lentz v. United States,* 346 F.2d 570, 575 (Ct. Cl. 1965)); *see also Shinn v. Edwin Yee, Ltd.,* 553 P.2d 733, 736-37 (Haw. 1976) (explaining that, in Hawaii, a joint venture is a contractual undertaking to carry out a single business activity that contemplates some contribution of money, property, effort, knowledge, or skill). Essentially, it is a partnership created for a limited purpose. *Sadelmi,* 5 F.3d at 513. Indeed, Hawaii considers a joint venture to be a partnership, and generally applies the rules governing the creation and existence of partnerships to joint ventures. *Fujimoto v. Au,* 19 P.3d 699, 727, 743 (Haw. 2001); *Shinn v. Edwin Yee*, 553 P.2d at 736.

As was the case here, a joint venture often allocates its responsibilities between its partners, and each partner may act as its agent in furtherance of the joint venture's business. *Sadelmi,* 5 F.3d at 513; Haw. Rev. Stat. § 425-112(1) (1999); *Fujimoto v. Au,* 19 P.3d at 741-42 (quoting *Eastern Iron & Metal Co. v. Patterson,* 39 Haw. 346, 356-58 (1952)). Although, like a partnership, a joint venture is legally distinct from its partners, each partner is jointly and severally liable for the joint venture's obligations. *Pine Prods. Corp. v. United States,* 945 F.2d 1555, 1560 (Fed. Cir. 1991); Haw. Rev. Stat. § 425-117 (1999); *Fujimoto,* 19 P.3d at 741-42. The JV's partners confirmed those liabilities here in their joint venture agreement, and provided that the JV's acts were binding and conclusive upon both of them (finding 3). Additionally, in Hawaii, a partnership is statutorily obligated to reimburse or indemnify its partners for payments made, or

liabilities incurred, by them in the ordinary course of the partnership's business, unless the partnership agreement provides otherwise. Haw. Rev. Stat. §§ 425-103(a), 425-120(c) (1999). The JV agreement expressly provided that the JV would pay invoices submitted to it by the partners for JV "costs paid or incurred by them" (finding 4). Given these responsibilities, it is clear under the law that when the JV's partners incurred costs performing the JV's contract, they were acting as its agents in furtherance of both its business and their own obligations as partners. Hawaii law obligated the JV to reimburse the partners for those costs. Accordingly, the JV, DCAA, and Navy were correct during contract performance that the JV partners' costs performing the contract with the Navy were the JV's allowable contract costs.[1]

The Navy also suggests that *Information Systems & Networks Corp. v. United States,* 437 F.3d 1173 (Fed. Cir. 2006), relieves it from paying taxes imposed upon Parsons and UXB (gov't br. at 72). *Information Systems & Networks* involved the income taxes paid by a subchapter S corporation's sole shareholder on dividends paid to her. The court held that those taxes were not allowable under a cost reimbursement contract with the corporation because the corporation was itself exempt from paying income taxes. In *Information Systems & Networks,* the corporation's payments of dividends to its shareholder were not for contract performance.

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[1] The Navy also relies upon the absence of subcontracts between the JV and its partners to separately seek dismissal of this portion of the appeal for lack of jurisdiction, relying upon the doctrine articulated in *Severin v. United States,* 99 Ct. Cl. 435 (1943) (gov't mot. to dismiss dtd. 9 Sept. 2011). In *Severin,* a prime contractor sought from the government damages sustained by its subcontractor as a result of government acts, though the subcontractor had released the prime from such liability to it. The court held that, because its jurisdiction was limited to suits by the prime contractor, the only recoverable damages could be those actually suffered by the prime contractor. Given that the subcontractor had released the prime, it had no damages. *Severin,* 99 Ct. Cl. at 443-44. Today, the *Severin* doctrine is narrowly construed. *E.R. Mitchell Constr. Co. v. Danzig,* 175 F.3d 1369, 1370-71 (Fed. Cir. 1999). It permits prime contractor actions against the government, passing through subcontractor damages, unless the government proves the prime is not conditionally liable to the subcontractor for whatever it can recover from the government. *W.G. Yates & Sons Constr. Co. v. Caldera,* 192 F.3d 987, 990-92 (Fed. Cir. 1999). *Severin* is inapplicable here. The JV is liable to its partners, Parsons and UXB, for their costs performing the JV's contract. Accordingly, we deny the motion to dismiss. The JV's opposition to this motion requested that sanctions be imposed upon the Navy for advancing a frivolous argument (app. opp'n dtd. 21 Sept. 2011). That request is denied.

Here, GET is directly imposed upon gross revenues of business activities, including revenues from the performance of this contract, and the Navy agreed that GET constituted an allowable contract cost by paying nearly $10,000,000 to the JV for it during contract performance. The Navy also recognized that allowable contract costs included the partners' costs performing this contract. (Findings 10-15) Logic dictates that the partners' GET is an allowable contract cost directly related to the performance of the contract. Unlike *Information Systems & Networks,* the partners are not being reimbursed their income taxes, they are being reimbursed for a cost of contract performance.

The Navy also claims the JV must first pay its partners' GET costs to them before it can recover those costs from the Navy. It cites the contract's invoice billing requirement that "costs...be substantiated by evidence of actual payment prior to billing" as its primary support. (Gov't br. at 68, 70; finding 7) The JV is an association established by the partners to perform this contract that was entirely capitalized by them (findings 2-3). Under the government's argument, the JV could not seek payment of its partners' GET costs until its partners first paid the money to the JV so that the JV could then pay it back to them. The Navy never required the JV and its partners to participate in this pointless exercise before previously reimbursing it for millions of dollars worth of partner costs (finding 10). Nor is the Navy's interpretation of the clause correct. The clause simply calls for costs to be substantiated by evidence of payment. The partners' GET settlement costs were the JV's costs. Parsons paid its settlement, and the record shows that UXB made the first installment of its settlement (findings 63, 68). The Navy does not contest that UXB paid the remaining installments. That is all that was required.

B. Navy Contentions That UXB's Costs are a Contingency

The Navy also contends that the JV's recovery of UXB's GET is barred by FAR Part 31.205-7(b), providing that "[c]osts for contingencies are generally unallowable for historical costing purposes." Because UXB continued to contest Hawaii's GET assessment after the JV submitted its claim to the Navy, the Navy argues that the UXB portion of the claim was a contingency that it need not pay. (Gov't br. at 69; findings 64, 68) However, by continuing to litigate its GET liability, UXB benefitted the Navy, reducing its GET liability from the $3,632,980.04 assessed upon it by Hawaii to $721,055.81 (findings 60, 68). Assuming without deciding that UXB's GET costs were once a contingency, they are now fixed and therefore owed by the Navy to the JV.

C. Parsons' Interest Claim

The Navy also opposes the award of interest and penalties assessed against the partners (gov't br. at 73). Nothing in UXB's final agreement with Hawaii characterizes any portion of its $721,055.81 settlement as interest or penalties. Nor does the Navy suggest the agreement supports such a reading. In fact, the agreement provides that the

amount shall be "designated by the Parties...as payment for all tax liabilities" (finding 68). As already noted, Hawaii's settlement agreement with Parsons did include $149,244.48 in interest (finding 63).

The JV contends that Parsons' interest payment is recoverable because "the Navy was aware of and concurred with the JV's nonpayment of the GET costs at issue..." (app. br. at 94). However, the contracting officer's concurrence in Parsons' non-payment of the additional GET sought by Hawaii is not enough for the JV to recover the resulting interest. Under FAR 31.205-41(a)(3), to recover interest incurred due to the non-payment of a tax, the non-payment must have been "at the direction of the contracting officer or by reason of... [his] failure...to ensure timely direction after a prompt request." A "direction" is more than mere concurrence. In this context, it is an "act of guidance," an "order," or an "instruction on how to proceed." BLACK'S LAW DICTIONARY 492 (8th ed. 2004). The JV has not demonstrated that it was guided, ordered, or instructed by the contracting officer to require Parsons to withhold GET payments, or that Parsons' non-payment was because of the contracting officer's failure to provide direction to the JV after it made such a request. Accordingly, the FAR dictates that the JV may not recover Parsons' interest settlement.

IV. Legal Fees

The JV also seeks $133,581 in legal fees it incurred contesting the subcontractor GET, $41,544.97 in fees incurred by Parsons, and $495,594.57 in fees incurred by UXB (app. br. at 48). Unlike interest, FAR 31.205-41(a)(3) allows "the reasonable costs of any action taken by the contractor...with the concurrence of the contracting officer" to challenge a tax. Given, as we have found, that the contracting officer approved of the pursuit of the GET disputes with Hawaii, the reasonable costs are recoverable under FAR 31.205-41(a)(3). Indeed, the Navy previously paid JV legal fees arising from the GET dispute (finding 22).

The Navy does not contest that the JV incurred these additional fees, or contend that they are unreasonable charges for the legal work performed. Instead, it simply claims that it was unreasonable for the JV to continue to incur fees after its counsel advised it to settle the GET disputes in November 2004 for $6.7 million (gov't br. at 76-77). However, the Navy also rejected that settlement (finding 52). Additionally, the mere fact that the JV and its partners chose not to settle at that time is not itself evidence that subsequently incurred legal costs are unreasonable. The Navy ignores the fact that the GET settlements that the JV and its partners ultimately achieved totaled less than $4.5 million (findings 62-63, 68). Indeed, the settlements, plus the legal fees and additional amounts sought, are less than $6.7 million (findings 62-64, 68). Given these circumstances, there was nothing unreasonable about continuing to negotiate.

The Navy also argues that any legal fees incurred by the JV related to its partners' GET disputes are unallowable because the JV had no obligation to incur such costs (gov't br. at 77). The Navy has not shown that any of the JV's fees were for its partners' disputes. However, even if they were, such fees would not be unreasonable given our finding that the partners' GET costs arising from contract performance were the JV's costs.

V. GET on Recovery

The JV seeks $94,937.20 in additional GET Parsons applied to its settlement with Hawaii, and $57,328.57 in additional GET UXB applied to both its settlement with Hawaii and to its claim for legal fees (findings 63, 68). The JV then seeks $181,593.47 in additional GET it applies to its total recovery, including legal fees (finding 68).

Because the JV is not entitled to recover the $149,244.48 in interest paid by Parsons, the GET on Parsons' recovery must be recalculated to reflect that reduction. Also, the fact that Parsons does not seek GET on its legal fee recovery, while UXB and the JV do, raises the question whether GET is due on those amounts. The JV has not demonstrated that a recovery of legal fees constitutes business revenues subject to GET in Hawaii, or that it charged the Navy GET on the previous legal fees the Navy paid. Accordingly, we deny the claim for GET upon UXB's and the JV's recovery of legal fees.

VI. Additional Navy Contentions

The Navy makes some additional technical arguments in opposition to recovery. It maintains that, because Invoice 107R was a request for interim payment under FAR 52.216-7(a), rather than a final payment under FAR 52.216-7(h), the Navy is not liable for breach damages for denying it (gov't br. at 55).[2] The Navy suggests that its denial of a request for an interim payment is really just a delay in payment, limiting damages to interest for the delay. It then contends that the FAR bars such interest. It also argues that as long as its contracting officer acted in good faith denying a request for an interim payment, the denial cannot constitute a breach of contract. (Gov't br. at 56-57)

FAR 52.216-7(a) requires the government to "make payments...when requested as work progresses...not more often than once every 2 weeks, in amounts determined to be allowable by the Contracting Officer in accordance with...subpart 31.2." FAR 52.216-7(h) requires payment of any balance of allowable costs upon approval of an invoice or voucher completed by a contractor, and its compliance with all contract terms. Here, the Navy did not merely delay paying the claimed amount based upon some

[2] This contention was also included in the Navy's 9 September 2011 motion to dismiss, which we deny.

technical distinction between these two provisions. It denied liability entirely, wrongfully contending it was not contractually obligated to pay the amounts sought based upon the LOC and LOF clauses (findings 65-66). Indeed, it has no intention of ever paying the requested amount, even if it were included in a request for final payment, demonstrating such a request would be futile (tr. 6/175-77, 179, 185). The Navy lacks any colorable basis under the contract for denying payment to the JV. Whether the JV's claim is legally characterized as a claim for breach, or just for payments due under the contract, the Navy is liable for it.

The Navy also contends that Invoice 107R was untimely under FAR 52.216-7(a), essentially claiming that the JV should be faulted for waiting to invoice for the increased GET until after it settled with Hawaii (gov't br. at 53). However, nothing in the provision places a time limit upon requests for payment.

Finally, the Navy contends that the contract's task order close-out documents, de-obligating funds for use on other task orders, release this claim or constitute an accord and satisfaction (gov't br. at 65). A release is a contract in which a party abandons or relinquishes a claim or right that could be asserted against another. An accord and satisfaction is the discharge of a claim arising from the acceptance of an alternative performance as full satisfaction of the claim. *Holland v. United States,* 621 F.3d 1366, 1377 (Fed. Cir. 2010), *cert. denied,* 132 S. Ct. 365 (2011). The close-out documents do not meet either definition. Instead, they expressly estimate the additional liability that could arise from the GET dispute and note that the claim remains outstanding. They neither relinquish this claim, nor do they accept alternative performance in satisfaction of it. Also, the JV was clear when it suggested the task order funding de-obligations that the Navy remained obligated for any GET settlement exceeding $10 million. (Findings 45-46)

CONCLUSION

For the reasons given, the appeal is sustained in part consistent with this decision. The JV is entitled to recover $295,008.34 in reimbursement of its own GET settlement. It is also entitled to recover the principal amount of $1,865,556 paid by Parsons in settlement, plus the appropriate GET that will be paid by Parsons on that amount. The JV is entitled to recover $721,055.81 that UXB paid in settlement, plus the appropriate GET that will be paid by UXB on that amount. The JV is also entitled to recover the appropriate GET it will pay on the total of the above recovery. Separately, the JV is entitled to recover $133,581 in legal fees it incurred, $41,544.97 in legal fees Parsons

incurred, and $495,594.57 in legal fees UXB incurred. The JV is also entitled to interest on the amount of the award under 41 U.S.C. § 7109. We remand to the parties the calculation of the final award consistent with this decision.

Dated: 1 August 2013

MARK A. MELNICK
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

JACK DELMAN
Administrative Judge
Acting 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. 56481, Appeal of Parsons-UXB Joint Venture, rendered in conformance with the Board's Charter.

Dated:

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