

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeals of -- )  
 )  
Lockheed Martin Integrated Systems, Inc. ) ASBCA Nos. 59508, 59509  
 )  
Under Contract Nos. DAAB07-03-D-B009 )  
 W15P7T-06-D-E405 )

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OPINION BY ADMINISTRATIVE JUDGE O’SULLIVAN ON APPELLANT’S  
MOTIONS TO DISMISS FOR FAILURE TO STATE A CLAIM

In ASBCA No. 59508, Lockheed Martin Integrated Systems, Inc. (LMIS) appeals from a contracting officer’s final decision (COFD) asserting a \$102,294,891 breach of contract claim against LMIS. In ASBCA No. 59509, LMIS appeals from a COFD asserting a similar claim under a different contract in the amount of \$14,494,740<sup>1</sup>. In both appeals, which have been consolidated, the Board directed the government to file the complaint. Appellant has moved to dismiss both complaints with prejudice for failure to state a claim upon which relief can be granted pursuant to Board Rule 7 and FED. R. CIV. P. 12(b)(6). The government opposes the motions. The Board has jurisdiction under the Contract Disputes Act (CDA), 41 U.S.C. §§ 7101-7109.

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<sup>1</sup> Three related appeals, ASBCA Nos. 60079, 60080, and 60081, have also been consolidated but have been suspended pending the Board’s decision on the motions to dismiss in ASBCA Nos. 59508 and 59509.

## STATEMENT OF FACTS (SOF) FOR PURPOSES OF THE MOTIONS

### The CR2 Contract<sup>2</sup>

1. On 31 January 2003, Army Communications-Electronics Command (CECOM) Acquisition Center<sup>3</sup> awarded LMIS Contract No. DAAB07-03-D-B009, referred to as the CECOM Rapid Response (CR2) contract (ASBCA No. 59508 (59508) compl. ¶¶ 3, 11). The CR2 contract was a multiple award indefinite-delivery, indefinite-quantity (ID/IQ) contract. It included a two-year base period and three two-year option periods. The base period of the contract was 31 January 2003 to 30 January 2005. It was followed by two option periods of 31 January 2005 to 30 January 2007 and 31 January 2007 to 30 January 2009. (*Id.* ¶ 3)

2. The CR2 contract was for services in support of peacetime or contingency operations, including transition to war, either within or outside the theater of operations (R4, tab 1 at 24). LMIS was required to provide various types of personnel including information technology personnel, administrative personnel, engineers, pilots, logisticians, machinists, mechanics, architects, analysts, supervisors, and managers (59508 compl. ¶ 12). The CR2 contract contemplated the issuance of time-and-materials task orders and included on-site and/or off-site fully loaded labor rates for each Lockheed Martin segment and each non-Lockheed Martin subcontractor (*id.* ¶¶ 11, 12).

3. The CR2 contract incorporated by reference the clause at FAR 52.232-7, PAYMENTS UNDER TIME-AND-MATERIALS AND LABOR-HOUR CONTRACTS (DEC 2002) (59508 compl. ¶ 11; R4, tab 1 at 39), which provided in relevant part:

The Government will pay the Contractor as follows upon the submission of invoices or vouchers approved by the Contracting Officer:

(a) *Hourly rate.* (1) The amounts shall be computed by multiplying the appropriate hourly rates prescribed in the Schedule by the number of direct labor hours performed. The rates shall include wages, indirect costs, general and administrative expense, and profit. Fractional

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<sup>2</sup> On a motion to dismiss for failure to state a claim, we consider the allegations of the complaint and documents incorporated by reference. *Matcon Diamond, Inc.*, ASBCA No. 59637, 15-1 BCA ¶ 36,144 at 176,408. In this appeal the complaint incorporates by reference the contract, audit report, and final decision.

<sup>3</sup> The CECOM Acquisition Center has since moved to Aberdeen Proving Ground, Maryland, to be a part of Army Contracting Command – Aberdeen Proving Ground (ACC-APG) (59508 compl. at 1 n.1).

parts of an hour shall be payable on a prorated basis. Vouchers may be submitted once each month (or at more frequent intervals, if approved by the Contracting Officer), to the Contracting Officer or designee. The Contractor shall substantiate vouchers by evidence of actual payment and by individual daily job timecards, or other substantiation approved by the Contracting Officer. Promptly after receipt of each substantiated voucher, the Government shall, except as otherwise provided in this contract, and subject to the terms of (e) below, pay the voucher as approved by the Contracting Officer.

....

(b) Materials and subcontracts. (1) The Contracting Officer will determine allowable costs of direct materials in accordance with Subpart 31.2 of the Federal Acquisition Regulation (FAR) in effect on the date of this contract. Direct materials, as used in this clause, are those materials that enter directly into the end product or that are used or consumed directly in connection with the furnishing of the end product.

(2) The Contractor may include reasonable and allocable material handling costs in the charge for material to the extent they are clearly excluded from the hourly rate. Material handling costs are comprised of indirect costs, including, when appropriate, general and administrative expense allocated to direct materials in accordance with the Contractor's usual accounting practices consistent with Subpart 31.2 of the FAR.

(3) The Government will reimburse the Contractor for supplies and services purchased directly for the contract when the Contractor—

(i) Has made payments of cash, checks, or other forms of payment for these purchased supplies or services; or

(ii) Will make these payments determined due—

(A) In accordance with the terms and conditions of a subcontract or invoice; and

(B) Ordinarily within 30 days of the submission of the Contractor's payment request to the Government.

....

(e) *Audit.* At any time before final payment under this contract the Contracting Officer may request audit of the invoices or vouchers and substantiating material. Each payment previously made shall be subject to reduction to the extent of amounts, on preceding invoices or vouchers, that are found by the Contracting Officer not to have been properly payable and shall also be subject to reduction for overpayments or to increase for underpayments. Upon receipt and approval of the voucher or invoice designated by the Contractor as the "completion voucher" or "completion invoice" and substantiating material, and upon compliance by the Contractor with all terms of this contract (including, without limitation, terms relating to patents and the terms of (f) and (g) below) [relating to assignments and refunds], the Government shall promptly pay any balance due the Contractor. The completion invoice or voucher, and substantiating material, shall be submitted by the Contractor as promptly as practicable following completion of the work under this contract, but in no event later than 1 year (or such longer period as the Contracting Officer may approve in writing) from the date of completion.

### The S3 Contract

4. On 2 March 2006, the ACC-APG awarded Contract No. W15P7T-06-D-E405 to LMIS. This contract is referred to as the Strategic Services Sourcing (S3) contract. It is a multiple award ID/IQ contract with a five-year base period and one five-year option period. The base period of the contract was 2 March 2006 to 1 March 2011. (ASBCA No. 59509 (59509) compl. ¶ 3)

5. The S3 contract also called for a broad range of services to be provided in support of operations, including information technology, administrative, security, instructor, logistician, and electrician (59509 compl. ¶ 12). The contract contains time-and-material, cost, and firm-fixed-priced contract line item numbers (CLINs) (*id.* ¶ 11), and provides fully loaded labor rates for each category of service (*id.* ¶ 12; 59509 R4, tab 1, attach. 007).

6. The S3 contract incorporated by reference FAR 52.232-7, PAYMENTS UNDER TIME-AND-MATERIALS AND LABOR-HOUR CONTRACTS (AUG 2005) (59509 R4, tab 1188 at 46),<sup>4</sup> which provided, in relevant part:

The Government will pay the Contractor as follows upon the submission of invoices or vouchers approved by the Contracting Officer:

(a) *Hourly rate.* (1) The amounts shall be computed by multiplying the appropriate hourly rates prescribed in the Schedule by the number of direct labor hours performed. The rates shall include wages, indirect costs, general and administrative expense, and profit. Fractional parts of an hour shall be payable on a prorated basis. Vouchers may be submitted once each month (or at more frequent intervals, if approved by the Contracting Officer), to the Contracting Officer or designee. The Contractor shall substantiate vouchers by evidence of actual payment and by individual daily job timecards, or other substantiation approved by the Contracting Officer. Promptly after receipt of each substantiated voucher, the Government shall, except as otherwise provided in this contract, and subject to the terms of (e) below, pay the voucher as approved by the Contracting Officer.

....

(b) *Materials and subcontracts.* (1) The Contracting Officer will determine allowable costs of direct materials in accordance with Subpart 31.2 of the Federal Acquisition Regulation (FAR) in effect on the date of this contract. Direct materials, as used in this clause, are those materials that enter directly into the end product or that are used or consumed directly in connection with the furnishing of the end product.

(2) The Contractor may include reasonable and allocable material handling costs in the charge for material to the extent they are clearly excluded from the hourly rate. Material handling costs are comprised of indirect costs, including, when appropriate, general and administrative

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<sup>4</sup> The S3 contract also sets forth the clause in full text, with its ALTERNATE II (FEB 2002) (59509 R4, tab 1188 at 57-59).

expense allocated to direct materials in accordance with the Contractor's usual accounting practices consistent with Subpart 31.2 of the FAR.

(3) The Government will reimburse the Contractor for supplies and services purchased directly for the contract when the Contractor—

(i) Has made payments of cash, checks, or other forms of payment for these purchased supplies or services; or

(ii) Will make these payments determined due—

(A) In accordance with the terms and conditions of a subcontract or invoice; and

(B) Ordinarily within 30 days of the submission of the Contractor's payment request to the Government.

....

(e) *Audit.* At any time before final payment under this contract the Contracting Officer may request audit of the invoices or vouchers and substantiating material. Each payment previously made shall be subject to reduction to the extent of amounts, on preceding invoices or vouchers, that are found by the Contracting Officer not to have been properly payable and shall also be subject to reduction for overpayments or to increase for underpayments. Upon receipt and approval of the voucher or invoice designated by the Contractor as the "completion voucher" or "completion invoice" and substantiating material, and upon compliance by the Contractor with all terms of this contract (including, without limitation, terms relating to patents and the terms of (f) and (g) below) [relating to assignments and refunds], the Government shall promptly pay any balance due the Contractor. The completion invoice or voucher, and substantiating material, shall be submitted by the Contractor as promptly as practicable following completion

of the work under this contract, but in no event later than 1 year (or such longer period as the Contracting Officer may approve in writing) from the date of completion.

In relevant part, this clause is identical to that in the CR2 contract.

### The DCAA Audit

7. On 7 January 2014, the Defense Contract Audit Agency (DCAA) initiated an audit of LMIS's incurred costs for task orders issued under three of LMIS's ID/IQ contracts. The audit was focused on incurred costs for fiscal year (FY) 2007. Both the CR2 and the S3 contract were included in this audit. (59508, 59509 compl. ¶ 4) The third contract is not relevant to this dispute.

8. On 14 May 2014, DCAA issued Audit Report No. 6341-2007A10100043. The subject of the audit was LMIS's 15 August 2008 "proposal and related books and records for reimbursement of FY 2007 incurred direct costs and the related application of contractually fixed indirect rates" (59508, 59509 compl. ¶ 6; 59508 R4, tab 4080 at 1). The purpose of the audit was "to determine allowability of direct costs for flexibly priced Department of Defense (DoD) contracts for the period January 1, 2007 through December 31, 2007 (59508 R4, tab 4080 at 1).

9. In the Executive Summary, the audit report stated that

We questioned \$103,272,918 of claimed direct costs attributable to subcontracts and considered \$173,623,920 of additional subcontract costs to be unresolved. The questioned amounts represent costs claimed at the subcontractor level that were questioned within assist audit reports received<sup>5</sup> or as a result of the prime contractor's noncompliance with FAR 42.202, Assignment of Contract Administration, Paragraph (e), Subsection (2). These costs represent amounts incurred by the subcontractors and claimed by LMIS in its FY 2007 incurred cost submission.

(59508 R4, tab 4080 at 4)

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<sup>5</sup> The assist audit reports pertain to LMIS subcontractors and are listed in Appendix 1 to the audit report. (59508 R4, tab 4080, Appendix 1)

## Audit Findings and Final Decision with Respect to Task Orders Issued under the CR2 Contract

10. The audit report questioned \$102,294,891 of subcontractor costs invoiced under the CR2 contract task orders during FY 2007 (59508 compl. ¶ 6). DCAA questioned \$18,545,038 of “claimed direct subcontract costs based on received assist audit support” and questioned \$83,749,853 of “subcontractor costs at the prime contractor level” (*id.* ¶¶ 17-18).

11. With respect to the \$18,545,038 in questioned “claimed direct subcontract costs,” the audit report describes the basis for questioning the costs as follows:

[W]e questioned \$18,545,038 of claimed direct subcontract costs based on received assist audit support for twenty-nine subcontractors under contract DAAB07-03-D-B009 (CR2). The support received consisted of audit reports, audit memorandums, or a rate agreement letter. We questioned costs based on (i) the detailed question [sic] costs in said reports, memorandums, etc.; and (ii) differences between the prime contractor proposed amount and the amount claimed in the said reports, memorandums, etc. The results of the audit assistance incorporated are detailed above by delivery order. Please see Appendix 1, for a list of assist audit support that we have incorporated into this report by reference. The itemized breakout of the questioned costs for each delivery order have not been provided due to the voluminous size; however, are available upon request.

(59508 R4, tab 4080 at 13)

12. LMIS’s response, incorporated into the audit report, stated in relevant part:

DCAA has questioned \$15M aggregated from 8 subcontractors. Of this amount, the largest single item is \$13.9M questioned from the assist audit report from Blackwater. At this time, we are not privy to any specifics as to the nature of the questioned cost and have been advised by Blackwater only that their submission was being audited and that they are currently in the process of negotiating their 2007 submission rates with DCMA.

As a result, LM cannot comment on the questioned subcontractor cost at this time. Pending further release of



the details or feedback from the subcontractors, we will perform the necessary due diligence and assess the need for any resultant adjustments.

....

DCAA has identified \$5M of variances between costs claimed by LM as compared to those reported by our subcontractors across 9 subcontractors. DCAA indicated they could not release to us any detailed figures of the claimed amounts by the subcontractors, because they are considered proprietary information and data not subject to release without the consent of the subcontractor....

Without insight into the values used in making this assessment, it is impossible to comment on the nature or validity of these values. DCAA also did not opine on what the differences may be; however, they also acknowledged that fiscal year timing could be a factor since the auditors did not have direct access to the submissions and relied solely on the values shown in the summary assist reports conducted by other DCAA offices. Based on the available facts, it is unreasonable to conclude that these costs are in any way inappropriate and unallowable.

(59508 R4, tab 4080, app'x 4 at 5)

13. DCAA responded as follows:

We disagree with the contractor's reaction. In regards to the contractor being denied access to the subcontractor's audit results, DCAA is prohibited from disclosing the results as evidenced by the various report restrictions identified [at the beginning of the audit report DCAA noted those subcontractors who objected to release of the assist audits to LM on proprietary data grounds]. Additionally, it is the prime contractor's responsibility to manage its subcontracts. That responsibility includes negotiating access to the subcontractor's specific audit results that pertain to the prime contractor's ability to settle the claim with the Government.

(59508 R4, tab 4080 at 14-15)

14. With respect to the \$83,749,853 of questioned “subcontractor costs at the prime contractor level,” the audit report explains:

[W]e questioned \$83,749,853 of subcontractor costs at the prime contractor level based on FAR 31.201.2, Determining Allowability, Paragraph (a) Subsection (4), which states, “A cost is allowable only when the costs [sic] complies with Terms of the Contract”. The prime contractor is in noncompliance with FAR 42.202, Assignment of Contract Administration, Paragraph (e), Subsection (2) which states, “The prime contractor is responsible for managing its subcontractors.” Since the prime contractor did not properly manage its subcontracts in accordance with the FAR, we questioned the cost accordingly. The contractor failed to maintain necessary documents to substantiate they reviewed (i) resumes to assure for compliance with contract terms, and (ii) timesheets to assure the number of hours invoiced were supported.

Further, the contractor did not provide any records demonstrating that they attempted to cause the subcontractor to prepare an adequate submission or any requests to the Government for assistance if the subcontractor refused. A literal interpretation of FAR 42.202 requires the prime contractor to act on behalf of the Government and serve as both the Contracting Officer (CO) and the Contracting Administrative Office (CAO) for each subcontract that it awards under a Government flexibly priced contract. This includes the requirement for the prime contractor to audit their subcontracts or request audit assistance from the cognizant DCAA office when the subcontractor denies the prime contractor access to their records based on the confidentiality of propriety [sic] data. Since the Government did not have contract privy [sic] with the subcontractors, the Government could not force or compel the subcontractors to comply with the requirements set forth in their contract with the prime.

....

### c. Audit Evaluation

We evaluated subcontractor costs at the prime contractor level, which included evaluating the prime contractor's subcontract management process. This was completed by obtaining the prime contractor's policies and procedures for subcontract management in accordance with FAR 42.202, Assignment of Contract Administration, Paragraph (e), Subsection (2) and evaluating their compliance with them. Based on our review of the contractor's subcontract administration files we determined the contractor failed to maintain necessary documents to substantiate they reviewed (i) resumes to assure compliance with contract terms, and (ii) timesheets to assure the number of hours invoiced were supported. Due to their failure to comply with FAR 42.202, Assignment of Contract Administration, Paragraph (e), Subsection (2) and not properly manage their subcontracts to the extent of auditing them, we are questioning the claimed subcontract costs based on FAR 31.201.2, Determining Allowability, Paragraph (a) Subsection (4), which states, "A cost is allowable only when the costs [sic] complies with...Terms of the Contract".

Further, our audit evaluation determined that the prime contractor did not have proof of submissions or proof of requests for audit for any of the subcontractors we determined did not submit incurred cost submissions. Without an incurred cost submission from the subcontractor, the prime and DCAA are unable to audit their costs claimed. If the costs are not audited, we are unable to determine if the costs are allowable, reasonable, and allocable in accordance with FAR 31, Contract Cost Principles and Procedures. Since it is the prime contractor's responsibility to manage their subcontractors, we determined they are not properly managing subcontractors. Management of the subcontractors is the primary purpose of the LMIS Project Management Office (PMO) and it is the value added service in which they earn their PMO, G&A and profit.

(59508 R4, tab 4080 at 15-16; *see also* 59508 compl. ¶ 17)

15. LMIS's response to this portion of the audit report was extensive. With respect to DCAA's assertion that LMIS failed to maintain necessary documents to substantiate that they reviewed resumes to assure compliance with contract terms and timesheets to assure the number of hours invoiced were supported, LMIS stated:

Through the course of the audit fieldwork, LM has provided its procedures which outline the measures taken by the Program Management Office to ensure oversight of all subcontractors to achieve delivery of all services to the U.S. Government (USG) on time and within budget. This was accomplished on all task orders in question, without exception, as demonstrated by acceptance of services rendered on all task orders. Further, LM has demonstrated its internal controls for ensuring that all costs invoiced were allowable, allocable and reasonable in accordance with the contract provisions. This was evidenced through supporting documentation including competitively awarded cost proposals, rate verifications between billings and contractual rates, and traceability between subcontractors incurred costs on the ledger and billings to the Government. The transaction testing for this audit included reviews of over forty task order contracts, fifty purchase orders, nearly seventy subcontractor invoices, procedural audits for task order management plans, as well as several other sampled transactions of the claimed cost. For all requested items, the costs were fully substantiated with auditable records maintained by LM. It seems DCAA has placed their entire argument that LM did not manage its subcontractors on their finding that LM did not produce subcontractor incurred cost claims. This finding was based on the final data request and response that occurred at the end of the audit. Additionally, it appears DCAA has ignored other audit evidence gathered and has erroneously drawn conclusions without giving due consideration to the full context of the circumstances in question and the steps taken by LM in our subcontractor management process.

(59508 R4, tab 4080, app'x 4 at 3)

16. With respect to DCAA's final data request regarding incurred cost submissions, LMIS quoted its response thereto:

*[We]...will not be able to provide the data requested. As discussed at the entrance conference, we acknowledge the*

*FAR requirements to manage our subcontractors. However, we do not collect incurred cost submissions from them. By the very nature of the incurred cost submissions, they often are developed at a business unit or segment level to substantiate indirect rates. As a result, that is not something we request from our subs due to the broad and proprietary nature of the data. Rather, we flow down the requirements to all applicable subcontracts and advise them of their responsibility to submit to DCAA all applicable schedules for compliance. Our management and due diligence over our subcontractors is related to their cost and performance relative to a specific program, as detailed in the procedures we previously provided.*

(59508 R4, tab 4080, app'x 4 at 3) LMIS further stated that there is no requirement in either the FAR or in the DCAA Audit Manual guidance for subcontractors to submit incurred cost proposals containing sensitive and proprietary business information directly to the prime and that industry practice, recognized by the applicable guidance, has been to make such submissions directly to the government for audit by DCAA. It concluded:

DCAA has not cited any FAR provisions, contract clauses, precedent or case law that counters this position to provide the basis for why they have determined this to be insufficient or a basis to question 100% of the subcontractor costs.

(*Id.* at 4)

17. DCAA responded only to LMIS's disagreement that the responsibility to manage its subcontracts included a responsibility to cause its subcontractors to provide it with an incurred cost submission and to audit the costs claimed therein. As to this issue, DCAA cited to FAR 42.202(e)(2), which states: "The prime contractor is responsible for managing its subcontracts. The CAO's review of subcontracts is normally limited to evaluating the prime contractor's management of the subcontracts (*see* Part 44)," (Subcontracting Policies and Procedures). DCAA then noted the enumerated responsibilities of the CAO at FAR 42.201(a), which include the functions listed at FAR 42.302(a), including the responsibility to determine the allowability of costs suspended or disapproved, direct the suspension or disapproval of costs, and approve final vouchers, and concluded:

Therefore, it was the Government's intent to require the prime contractor to act as both contracting officer

(CO)...and the CAO as stated at FAR 42.201, Contract Administrative Responsibilities, Paragraph (a).

(59508 R4, tab 4080 at 17) Notably, the enumerated responsibilities of the government CO or CAO within FAR Part 42 do not involve receipt or review of incurred cost submissions.

18. On 15 August 2014, the CO issued a COFD based on the audit report and demanded payment of \$102,294,891 (59508 R4, tab 4099; compl. ¶ 7). The COFD stated:

Federal Acquisition Regulation (FAR) 42.202(e)(2) states: “The prime contractor is responsible for managing its subcontractors.” The audit and work of the auditor determined that LMIS did not properly maintain oversight of subcontractors including monthly reviews of costs incurred. This is a breach of the contractor’s duty of performance. It was found that 46 subcontractors did not submit an adequate incurred cost to LMIS (prime contractor). In addition, LMIS did not audit, or request audit assistance from DCAA, on their subcontractors as a prime contractor must do under this contract type.

Additionally, there are differences between the prime contractor proposed amounts and the amounts claimed elsewhere. Added to this are the assist audit reports on 29 subcontractors where costs are questioned by DCAA. This office has read the responses in the exit interview and concurs with the DCAA answers to the prime contractor’s responses. This final decision is based on audits conducted by DCAA during its audit of costs charged to the contract and underlying task orders during Fiscal Year 2007.

(59508 R4, tab 4099 at 1-2) Thus, the CO relied on the audit report in citing LMIS’s alleged failure to “properly maintain oversight of subcontractors,” the alleged failure of 46 subcontractors to “submit an adequate incurred cost to LMIS (prime contractor),” and LMIS’s alleged failure to “audit, or request audit assistance from DCAA, on their subcontractors as a prime contractor must do under this contract type,” as grounds for claiming entitlement to the \$83,749,853 in “subcontractor costs at the prime contractor level” questioned by DCAA.<sup>6</sup> The CO also adopted the audit report rationale with respect to

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<sup>6</sup> DCAA failed to respond to LMIS’s rebuttal of the alleged failure to retain documentation showing it had properly substantiated its billing of subcontract

the additional \$18,545,038 of subcontract costs questioned by DCAA based on assist audit support.

Audit Findings and Final Decision with Respect to Task Orders Issued under the S3 Contract

19. Audit Report No. 6341-2007A10100043 found \$978,026 in questioned costs and \$24,362,355 in unresolved costs under the S3 contract task orders (59508 R4, tab 4080 at 20). DCAA received assist audit support for three subcontractors and accepted the costs as proposed, but noted that other assist audits had not been received in time to be incorporated into the report. The \$978,026 in questioned costs was based on DCAA's evaluation of "subcontractor costs at the prime contractor level" under one S3 task order. The explanation DCAA gave for questioning these costs—LMIS's "failure to properly manage its subcontractors"—was similar to that laid out in SOF ¶ 14 above pertaining to the CR2 Contract costs that were disallowed. (*Id.* at 22-24).

20. On 14 August 2014 the CO issued a COFD claiming entitlement to \$14,494,740 (59509 compl. ¶ 7; 59509 R4, tab 1142). The COFD explanation of the basis for the claim, in its entirety, was:

This letter is in reference to the audit of Lockheed Martin Integrated Systems FY 2007 incurred costs reflected in the DCAA Audit Report No. 6341-2007A10100043 and supersedes the letter issued on August 8, 2014.

DCAA Audit Report 6341-2007A10100043 dated 14 May 2014, had findings against the S3 program of \$978,026 in questioned costs and \$13,516,714 in unresolved costs. Individual orders were listed in the audit. The questioned amounts represent costs claimed at the subcontractor level, inclusive of labor.

Based on the foregoing, it is my decision that Lockheed Martin Integrated Systems (LMIS) is indebted to the United States of America for the amount(s) shown below—

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costs, and the COFD does not mention this allegation at all as a breach or ground for disallowance. While the government has likely abandoned this ground for recovery, we do not find it necessary to decide this issue to resolve the motions to dismiss.

Questioned	\$ 978,026
<u>Unresolved</u>	<u>\$13,516,714</u>
Principle [sic] Amount of Debt	\$14,494,740

(59509 R4, tab 1142 at 1) No explanation was provided for the variance with the audit report as to the amount of unresolved costs, nor was any rationale provided for claiming entitlement to costs that the audit categorized as unresolved.

21. The claim to the \$13,516,714 in unresolved costs, according to the government’s complaint, is based on the same rationale that DCAA relied on in questioning \$978,026 in “subcontractor costs at the prime contractor level.”<sup>7</sup>

The Appeals

22. LMIS filed a timely notice of appeal from the COFD claiming entitlement to \$102,294,891 under the CR2 contract with the Board on 22 August 2014. The appeal was docketed on 25 August 2014 as ASBCA No. 59508.

23. LMIS filed a timely notice of appeal from the COFD claiming entitlement to \$14,494,740 under the S3 contract orders with the Board on 22 August 2014. The appeal was docketed on 25 August 2014 as ASBCA No. 59509.

DECISION

A motion to dismiss for failure to state a claim upon which relief can be granted is appropriate where the facts asserted in the complaint do not entitle the claimant to a legal remedy. *Lindsay v. United States*, 295 F.3d 1252, 1257 (Fed. Cir. 2002). The Board will grant a motion to dismiss for failure to state a claim when the complaint fails to allege facts plausibly suggesting (not merely consistent with) a showing of entitlement to relief. *Cary v. United States*, 552 F.3d 1373, 1376 (Fed. Cir. 2009) (citing *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 557 (2007)).<sup>8</sup> In deciding a motion to dismiss for failure to state a claim, “the court must accept well-pleaded

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<sup>7</sup> The complaint in ASBCA No. 59509 purports to provide the explanation missing from the COFD: “The DCAA audit questioned \$978,026 of subcontractor costs at the prime contractor level based on a determination of allowability under FAR 31.201-2 and appellant’s breach of its duties under FAR 42.202. The costs in the final decision, \$14,494,740, were limited to the task orders where her [the CO’s] office was the cognizant contracting office. (59509 compl. at 4 n.2 (citation omitted))

<sup>8</sup> While the Federal Rules of Civil Procedure do not apply to proceedings before the Board, we may look to them for guidance, particularly in areas not addressed by our own rules. *Dennis Anderson Constr. Corp.*, ASBCA Nos. 48780, 49261, 96-1 BCA ¶ 28,076 at 140,188.



factual allegations as true and must draw all reasonable inferences in favor of the claimant.” *Kellogg Brown & Root Services, Inc. v. United States*, 728 F.3d 1348, 1365 (Fed. Cir. 2013). In this review, “[w]e decide only whether the claimant is entitled to offer evidence in support of its claims, not whether the claimant will ultimately prevail.” *Matcon Diamond, Inc.*, ASBCA No. 59637, 15-1 BCA ¶ 36,144 at 176,407. The scope of our review is limited to considering the sufficiency of allegations set forth in the complaint, “matters incorporated by reference or integral to the claim, items subject to judicial notice, [and] matters of public record.” *A&D Auto Sales, Inc. v. United States*, 748 F.3d 1142, 1147 (Fed. Cir. 2014) (citing 5B CHARLES ALAN WRIGHT & ARTHUR R. MILLER, *Federal Practice and Procedure* § 1357 (3d ed. 2004)).

For purposes of assessing whether the claim before us states a claim upon which relief can be granted, the primary document setting forth the claim is not the complaint, *per se*, but is either the contractor’s claim or the government’s claim, the latter asserted in a contracting officer’s final decision as required by the Contract Disputes Act, 41 U.S.C. § 7103(a)(3). While the general rule in our appeals is that the appellant files the complaint, even when a government claim is involved, the Board recognizes that in certain cases it will facilitate the proceedings to have the government file the complaint. *See generally Beechcraft Defense Company*, ASBCA No. 59173, 14-1 BCA ¶ 35,592. Thus, in these appeals the government was directed to file the complaint. In analyzing the motion to dismiss for failure to state a claim upon which relief can be granted, we will look not only to the complaint but also to the COFD that actually asserts the claim.

#### I. Claimed Direct Subcontractor Costs (ASBCA No. 59508 only)

The complaint in ASBCA No. 59508 alleges that \$18,545,038 of claimed direct subcontract costs are unallowable “based on received assist audit support for 29 subcontractors under the Contract.” The complaint addresses this portion of the government’s claim in one paragraph, stating only that “DCAA questioned the costs based on: ‘(i) the detailed question cost in [audit reports, audit memorandums, and rate agreement letters]; and (ii) differences between the prime proposed amount and the amount claimed in said reports, memorandums, etc.’” (59508 compl. ¶ 18)

Appellant asserts that the complaint alleges entitlement to these costs “for an unspecified breach of the CR2 Contract and the T&M task orders based on the results of assist audits performed by DCAA” (59508 app. mot. at 16). Appellant asserts that the government claim and complaint is devoid of any factual or legal bases supporting its alleged entitlement save for its vague references to “reports” and “memorandums” (*id.* at 17). Accordingly, appellant argues that the complaint fails to meet the most basic pleading requirements and fails to even plead the elements necessary to state a breach of contract claim (*id.*). Appellant also asserts that it cannot reasonably respond to such vague and ambiguous complaint allegations (*id.* at 16).

The government asserts that its claim for \$18,545,038 is “based on the difference between appellant’s proposed amounts and actual costs under the subcontracts.” The government argues that based on the minimal nature of the requirements for a notice pleading, the government allegation that “based upon [undisclosed] assist audits of LMIS’ subcontractors, LMIS overbilled the government” is sufficient to withstand appellant’s motion to dismiss. (59508 gov’t resp. at 14-15)

“[T]he Board’s rules, like the Federal Rules of Civil Procedure, only require notice pleading.” *UniTech Servs. Grp., Inc.*, ASBCA No. 56482, 10-1 BCA ¶ 34,362 at 169,695. “The main purpose of pleadings under our rules is to frame and join the issues.” *Envtl. Safety Consultants, Inc.*, ASBCA No. 53485, 02-2 BCA ¶ 31,904 at 157,612. Under a notice pleading standard all that is required is that a complaint provide the opposing party “with a ‘fair notice of each claim and its basis.’” *Caldwell v. Argosy Univ.*, 797 F. Supp. 2d 25, 27 (D.D.C. 2011) (citing *Sparrow v. United Air Lines, Inc.*, 216 F.3d 1111, 1118 (D.C. Cir. 2000)); see also *United States for the Use of Argyle Cut Stone Co. v. Paschen Contractors, Inc.*, 664 F. Supp. 298, 302 (N.D. Ill. 1987) (“Notice pleading means simply that in order to state a claim for relief, the plaintiff need only notify the defendant of the theory behind the claims alleged and the basic grounds which support those claims.”).

In considering whether the government has adequately stated a claim for relief, we look to the COFD and the complaint, if there is one. Based on our review, the government’s claim for direct subcontract costs fails to state a claim upon which relief can be granted. The complaint offers no legal theory for its claim of disallowance nor does it provide any allegations of fact. It states conclusorily that there were questioned costs and some variances that entitle the government to disallow subcontract costs. Our pleading standard requires factual assertions beyond bare conclusory assertions to entitlement. The audit report, which was incorporated into the complaint, states that some assist audits questioned costs but does not explain on what grounds (SOF ¶ 11). It also states there were differences between amounts in LMIS’s proposal and costs under subcontracts but provides no facts regarding these differences (*id.*). More importantly, the COFD does not cite a single actual fact, only the audit report’s unsupported conclusions (SOF ¶ 18). Neither the complaint nor the COFD contain sufficient factual (or legal) allegations, accepted as true, to state a claim to relief that is plausible on its face. *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). Accordingly, appellant’s motion in ASBCA No. 59508 to dismiss the government’s claim for \$18,545,038 in direct subcontract costs is granted.

## II. Subcontractor Costs at the Prime Contractor Level<sup>9</sup>

Appellant asserts that the government's complaint in both appeals alleges that LMIS breached its contractual duty under FAR 42.202(e)(2) to manage its subcontractors, and that LMIS breached the CR2 contract by invoicing for costs that are unallowable under FAR 31.201-2(a)(4) (a cost "is allowable only when the cost complies with all of the following requirements: ...(4) Terms of the contract"). Further, the complaints allege that the Army is entitled to recover breach of contract damages in the amount of \$83,749,853 in ASBCA No. 59508 and \$14,494,740 in ASBCA No. 59509 for a total of \$98,244,593. (59508 app. mot. at 8; 59509 app. mot. at 7)<sup>10</sup>. Appellant sets forth the elements of a breach of contract claim, as articulated by this Board and the United States Court of Appeals for the Federal Circuit, and states that the government has failed to allege the necessary elements to establish a breach of contract claim (*id.*).

In particular, appellant asserts that the government has failed to allege the second, third, and fourth elements of a breach (the first being a valid contract between the parties): an obligation or duty arising out of the contract; a breach of that duty; and damages caused by the breach. As to the second element, an obligation or duty arising out of the contract, appellant states that FAR 42.202(e)(2), upon which the government relies for its argument that LMIS breached its duty to manage its subcontractors, is a regulation dealing only with the government's administration of contracts and is not a term of either the CR2 or S3 contracts, and therefore does not create any contractual duty on the part of LMIS (59508 app. mot. at 9-10; 59509 app. mot. at 10). Furthermore, appellant argues that even if it were a part of the CR2 or S3 contracts, FAR 42.202(e)(2) does not impose any of the obligations asserted by the government to have been breached (59508 app. mot. at 10-11; 59509 app. mot. at 11-12).

Appellant also asserts that FAR 52.232-7(a) (SOF ¶¶ 3, 6), not FAR 31.201-2, established the government's payment obligation under the CR2 and S3 contracts for direct labor performed by LMIS's subcontractors, according to fixed hourly rates incorporated in the contracts (59508 app. mot. at 12-13; 59509 app. mot. at 13-14). Because FAR 31.201-2 was not incorporated into the contract, appellant concludes, it could not have breached this provision.

Finally, appellant states that the government has failed to allege any causal connection between the alleged breach and its claimed damages. It asserts that the amounts claimed as breach damages roughly equate to all amounts paid to LMIS for

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<sup>9</sup> This term has not been explained by the government. In context, we take it to be the auditor's way of referring to subcontractor costs being disallowed on the basis of an issue with how the prime contractor performed the contract.

<sup>10</sup> ASBCA No. 59509, app. mot. at 7, inadvertently sets forth an incorrect number (\$14,949,740).

subcontractor labor, but there is no allegation that the services were not performed or that they were unacceptable. Rather, the Army accepted the benefit of the services performed, yet now seeks entitlement to nearly all amounts it paid for the services without saying how the claimed damages resulted from the alleged breach. (59508 app. mot. at 14-16; 59509 app. mot. at 15-16)

The government responds that while it did allege in its complaints that appellant breached its duty under FAR 42.202(e)(2) to manage its subcontractors, “the nature of the concern is the fact that appellant billed the government for unallowable costs because it did not properly manage its subcontracts.” It goes on to say that this is an implied duty regardless of the FAR provision. (Gov’t resp. at 7)<sup>11</sup> The government states that LMIS’s “poor management of its subcontractors led it to overbill the government,” and reiterates that its claim arises under an inherent or implied contract obligation which FAR 42.202(e)(2) “recognizes” (gov’t resp. at 10-11). As to appellant’s argument that even were FAR 42.202(e)(2) incorporated in the contract, it does not require a prime contractor to take responsibility for conducting incurred cost audits of its subcontractors, the government merely responds that the specific duties of the responsibility to manage subcontractors are varied and “may include factors such as how the prime contractor chooses to perform the contract, its relationships with its subcontractors, and the performance of those subcontractors” (gov’t resp. at 11). The government does not explain how or why the specific contract duties it alleges LMIS did not perform are inherent duties of the prime contractor under the contracts involved in these appeals (or any U.S. Government prime contract).

The government also argues that FAR 31.201-2 does apply to the CR2 contract because a significant chunk of the questioned costs, including labor costs, were billed to the government under the “material” part of the time-and-materials CLIN or were billed as other direct costs (ODCs) (gov’t resp. at 12). To support this assertion, the government points to LMIS’s FY 2007 incurred cost submission, which the government asserts shows that total billing for task orders under the CR2 contract were \$413,721,927 for FY 2007, but only \$52,420,143 of that amount represents direct labor charges. The government argues that the difference represents charges for material and ODCs, the allowability of which is determined under FAR 31.201 pursuant to the contracts’ respective Payment under Time-and-Materials and Labor-Hour Contracts clauses. (Gov’t resp. at 12) The Board notes that these facts were not set forth in the COFDs or the government’s complaints and LMIS’s FY 2007 incurred cost submission was not incorporated by reference into the complaints.

With respect to the S3 contract, the government without explanation asserts that the claimed damages are \$978,026 (59509 gov’t resp. at 7). While this is the amount

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<sup>11</sup> References to the government response include responses in both appeals unless otherwise noted.

questioned by DCAA, the COFD and the government's complaint in ASBCA No. 50509 both asserted that the claimed amount was \$14,494,470 (SOF ¶ 20; 59509 compl. ¶ 19).

Appellant replies that the government's response is an attempt to rewrite the complaint and assert new claims over which the Board has no jurisdiction (59508, 59509 app. reply at 2). Specifically, it refers to (1) the Army's acknowledgement that FAR 42.202(e)(2) is not a term of the contract and its assertion that it relies instead on a prime contractor's implied duty to manage its subcontracts; and (2) the Army's introduction of new factual matter not alleged in the complaint to argue that a sizeable portion of the costs billed on both contracts were billed on a cost-reimbursement basis as either material or other ODCs and thus subject to FAR 31.201-2 pursuant to the contracts' payment clauses (*see* SOF ¶¶ 3, 6; 59508, 59509 app. reply at 5-7).

For the reasons that follow, we find it unnecessary to decide whether the government in its briefs is asserting a new set of operative facts or simply a new legal theory.<sup>12</sup>

Since the government's claim for "subcontractor costs at the prime level" depends on establishing LMIS's breach of a contractual duty, we begin with the elements of a breach of contract claim. They are: (1) a valid contract between the parties; (2) an obligation or duty on the part of the contractor arising out of the contract; (3) a breach of that duty; and (4) damages caused by the breach. *San Carlos Irrigation & Drainage Dist. v. United States*, 877 F.2d 957, 959 (Fed. Cir. 1989); *Military Aircraft Parts*, ASBCA No. 60009, 16-1 BCA ¶ 36,388 at 177,410; *Northrop Grumman Systems Corporation Space Systems Division*, ASBCA No. 54774, 10-2 BCA ¶ 34,517 at 170,237.

The Army's complaints sufficiently allege the existence of valid contracts (SOF ¶¶ 1-6). We next consider whether the Army has sufficiently alleged the existence of an "obligation or duty arising out of" the contracts. The complaints allege as follows:

- "The contracting officer found that appellant charged the government for improper costs charged to various time and materials task orders issued under the Contract" (59508, 59509 ¶ 13).
- "Appellant breached its duty under FAR 42.202(e)(2) to properly manage its subcontractors" (59508, 59509 ¶ 14).

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<sup>12</sup> "The assertion of a new legal theory of recovery, when based upon the same operative facts as the original claim, does not constitute a new claim." *Dawkins Gen. Contractors & Supply, Inc.*, ASBCA No. 48535, 03-2 BCA ¶ 32,305 at 159,844 (citing *Trepte Constr. Co.*, ASBCA No. 38555, 90-1 BCA ¶ 22,595 at 113,385-86).

- Quoting extensively from the audit report (reproduced in relevant part):

Based on our [DCAA's] review of the contractor's subcontract administration files we determined the contractor failed to maintain necessary documents to substantiate they reviewed (i) resumes to assure for compliance with contract terms, and (ii) timesheets to assure the number of hours invoiced were supported. Due to their failure to comply with FAR 42.202, Assignment of Contract Administration, Paragraph (e), Subsection (2) and not properly manage their subcontracts to the extent of auditing them, we are questioning the claimed subcontract costs based on FAR 31.201[-]2, Determining Allowability, Paragraph (a) Subsection (4), which states, "A cost is allowable only when the costs [sic] complies with...Terms of the Contract".

Further, our audit evaluation determined that the prime contractor did not have proof of submissions or proof of requests for audit for any of the subcontractors we determined did not submit incurred cost submissions. Without an incurred cost submission from the subcontractor, the prime and DCAA are unable to audit their costs claimed. If the costs are not audited, we are unable to determine if the costs are allowable, reasonable, and allocable in accordance with FAR 31, Contract Cost Principles and Procedures. Since it is the prime contractor's responsibility to manage their subcontractors, we determined they are not properly managing subcontractors. Management of the subcontractors is the primary purpose of the LMIS Project Management Office (PMO) and it is the value added service in which they earn their PMO, G&A, and profit. (59508, 59509 compl. at 5, ¶ 17)

- "Based on the audit's questioned costs, appellant's FY07 incurred cost submission overstated the actual allowable costs of subcontractor work under task orders by at least \$102,294,891.00/\$14,494,740.00" (59508, 59509 compl. ¶ 19).

Notably, nowhere in either complaint or COFD does the government cite to a contract term giving rise to a contractual obligation or duty. As the government conceded in its briefs, FAR 42.202 is not a term of the contract (gov't resp. at 8).

Our inquiry does not end there, however. The government asserts for the first time in its briefs that there exists an implied contractual duty for a prime contractor to manage its subcontracts: “The government did not allege that FAR 42.202-2(e)(2) is in the contract and appellant breached the contract,<sup>13</sup> rather that appellant breached its inherent duty to properly manage its subcontracts, which led to the government paying for unallowable costs” (gov’t resp. at 7). In that one sentence, the government summarizes the essence of its claim, which is that LMIS’s breach of a contractual duty to manage its subcontractors led it to breach the contract by submitting claims for subcontract costs that were unallowable because LMIS breached its contractual duty to manage its subcontractors. Thus, *ipso facto*, if LMIS did not breach a duty to manage its subcontractors, it did not submit unallowable costs for payment, and if it did not submit unallowable costs for payment, it did not breach the contract.

We now turn to the duty that LMIS is alleged to have breached. Even though the government has conceded that FAR 42.202 is not a term of the contract, we find it to be relevant to this inquiry because the audit report, the COFDs, and the complaints (in other words, 100 percent of the documents that articulate the government’s claim in both appeals), all rely on FAR 42.202 in describing the duty that LMIS allegedly breached.

DCAA articulated the duty in two different ways. First, the audit report contains the statement that “[t]he contractor failed to maintain necessary documents to substantiate they reviewed (i) resumes to assure for compliance with contract terms, and (ii) timesheets to assure the number of hours invoiced were supported” (SOF ¶ 14). This reference is clearly to billings for subcontract direct labor hours, which were billed pursuant to the contracts at fixed, fully-loaded labor rates incorporated into the contracts (SOF ¶¶ 2, 5).<sup>14</sup>

Second, the audit report states:

Further, the contractor did not provide any records demonstrating that they attempted to cause the subcontractor to prepare an adequate submission or any requests to the Government for assistance if the subcontractor refused. A literal interpretation of FAR 42.202 requires the prime contractor to act on behalf of the Government and serve as both the Contracting Officer (CO) and the Contracting Administrative Office (CAO) for each subcontract that it awards under a Government

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<sup>13</sup> This statement is technically true, although the Army did allege that “[a]ppellant breached its duty under FAR 42.202(e)(2) to properly manage its subcontractors” (59508, 59509 compl. ¶ 14).

<sup>14</sup> As we have previously noted, this ground for recovery may have been abandoned.

flexibly priced contract. This includes the requirement for the prime contractor to audit their subcontracts or request audit assistance from the cognizant DCAA office when the subcontractor denies the prime contractor access to their records based on the confidentiality of propriety [sic] data.

(SOF ¶ 14) Thus the audit report clearly states that LMIS as a prime contractor had a duty under FAR 42.202 (under a “literal interpretation”) to act in the shoes of the CO and CAO with respect to its subcontractors, which duty included the duty to audit its subcontractors or actively seek assistance from DCAA for those that might resist being audited by their prime contractor. This putative obligation would presumably apply to all billings under the contract based on actual subcontract costs incurred (vs. billings based on fixed hourly rates).<sup>15</sup>

The COFDs and complaint allegations add nothing to what is stated in the audit report. They simply refer to or quote from it.

We examine first the alleged contractual duty to manage subcontractors. In this respect, FAR Part 42.202(e), Secondary Delegations of Contract Administration (as in effect when the contracts were awarded—FAC 97-4, effective 4 April 1998), provides that (1) COs or CAOs may request supporting contract administration from the CAO cognizant of the contractor location where the services are required; and (2) cautions that supporting contract administration normally should not be used for subcontracts since the prime is responsible for managing its subcontracts and the CAO’s role is normally limited to evaluating the prime’s management of the subcontracts pursuant to FAR Part 44, Subcontracting Policies and Procedures. FAR Part 44 focuses on the role of the ACO in reviewing and consenting to the award of proposed subcontracts and requires the use of the clause at FAR 52.244-2, SUBCONTRACTS. The August 1998 version of that clause, with its ALTERNATE I (AUG 1998), was incorporated in the CR2 contract by Modification No. P00002 on 17 September 2003 (59508 R4, tab 91), and in the S3 contract, with its ALTERNATE I (JAN 2006) (59509 supp. R4, tab 1188 at 46). This clause describes the circumstances in which a contractor is required to obtain the CO’s consent to

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<sup>15</sup> The contracts’ payment clauses in subparagraph (b) provide that: “(1) The Contracting Officer will determine allowable costs of direct materials in accordance with Subpart 31.2 of the Federal Acquisition Regulation (FAR) in effect on the date of the contract” (SOF ¶¶ 3, 6). The CR2 contract appears to contain only time-and-materials and firm-fixed-price CLINs, with fixed ODC rates (59509 R4, tab 1 at 2-12), so it is unclear to what extent billings under that contract could have been based on costs incurred. The S3 contract contains cost, time-and-materials, and firm-fixed-price CLINs (59509 supp. R4, tab 1188 at 3-4).



subcontract and the information to be submitted to the CO in seeking consent; prohibits cost plus a percentage of cost subcontracts; requires contractors to notify the CO if a subcontractor's claim may result in litigation or if a lawsuit is filed by a subcontractor; and reserves the government's right to review the contractor's purchasing system. The subcontracts clause does not impose any express responsibility on the prime contractor to manage subcontracts after they are awarded.

Nor do FAR Parts 42 and/or 44 impose any specific responsibilities on LMIS to manage its subcontractors, foremost because they were not incorporated by reference in either the S3 or the CR2 contract. But even if they had been, by their plain terms they do not impose the duties that DCAA, the CO, and the government in this appeal allege were breached. For instance, the alleged duty to maintain documents to substantiate that the contractor reviewed resumes to assure compliance with contract terms and timesheets to assure the number of hours invoiced were supported exists, but not as described by the government. The duty stems not from FAR 42.202(e) or any implied contract duty, but from FAR 52.232-7, the Payments under Time-and-Materials and Labor-Hour Contracts clause, which in subparagraph (a) requires the contractor to substantiate its billings by evidence of actual payment, individual timecards, or other approved substantiation at the time of billing, and in subparagraph (e) requires the contractor to submit to an audit at the CO's request at any time before final payment on the contract (SOF ¶¶ 3, 6). There is no allegation in these appeals that LMIS did not comply with the requirements of FAR 52.232-7 which, we observe, does not require the contractor to maintain these kinds of substantiating records until DCAA is finished conducting incurred cost audits seven or so years after the costs were first billed and paid.

The general records retention requirement of FAR 52.215-2, AUDIT AND RECORDS—NEGOTIATION (JUN 1999), incorporated by reference into the CR2 contract (59508 R4, tab 1 at 38) but not the S3 contract (59509 supp. R4, tab 1188), is set forth in subparagraph (f) of the clause and requires contractors to retain records for three years after final payment or any shorter or longer period required by FAR Subpart 4.7 or another clause of the contract. The government has not alleged that LMIS did not comply with any applicable records retention requirements.

The other duty alleged by DCAA and the government generally in these appeals to have been breached by LMIS is a duty to cause its subcontractors to submit incurred cost submissions directly to LMIS for audit, and request audits from DCAA if the subcontractors refuse. This duty is not to be found in any express term of the contract; nor is it to be found in FAR Parts 42 or 44. DCAA in its audit report opined that “[a] literal interpretation of FAR 42.202” requires the prime contractor to act as both CO and CAO for each subcontract it awards and this includes the requirement to audit subcontracts (SOF ¶ 14). DCAA alleged this duty was violated by LMIS's failure to produce “proof of submissions or proof of requests for audit” for subcontractors DCAA had determined did not submit incurred cost submissions (*id.*).

However, the Board's reading of FAR Part 42 reveals no requirement (literal or implied) that a prime contractor act as both CO and CAO with respect to its subcontracts. Moreover, as we noted in SOF ¶ 16, the enumerated responsibilities of the CO and CAO in FAR Part 42 do not involve receipt or review of incurred cost submissions. That duty is reserved to DCAA or other cognizant audit agency by FAR 42.201.

Finally, we address the government's argument in its response brief that our decision in *Bichler Co.*, ASBCA No. 30680, 89-1 BCA ¶ 21,320, *recon. denied*, 89-2 BCA ¶ 21,806, establishes the existence of a prime contractor's implied duty to manage its subcontracts. We reiterate here that the issue to be decided in these appeals is not whether a prime contractor has a generalized duty to manage its subcontracts. The issue is whether LMIS under the two contracts at issue in these appeals had the particular duties alleged by the government: to (1) retain documentation substantiating its 2007 invoices for subcontract direct labor hours; and (2) retain documentation showing it had caused its subcontractors to make incurred cost submissions and either audited those submissions or called on DCAA to audit those who refused to submit, so that the documentation could be reviewed by DCAA when it conducted its audit of FY 2007 incurred costs in 2014.

Our decision in *Bichler* is inapposite to the issue presented in these appeals. The government cites the decision for the proposition that this Board recognizes "the inherent or implied duty of a prime contractor to manage its subcontractor" (gov't resp. at 11), but the decision dealt with the propriety of a termination for default under a default clause providing that a delay in delivery was excusable only if it arose from causes beyond the control of and without the fault of either the prime contractor or any of its subcontractors or suppliers. 89-1 BCA ¶ 21,320 at 107,510. The Board found that the subcontractor was primarily responsible for the prime contractor's failure to deliver but, pursuant to the Default clause, this fact did not make the default excusable. *Id.* at 107,511. The Board then observed in its initial decision that the prime contractor had not established that it was entirely free from fault. *Id.* at 107,511-12. This observation was made within the context of the express terms of the default clause included in the contract and did not refer in any way to an implied duty.

The government further asserts that in its decision on reconsideration in *Bichler*, the Board characterized appellant's conduct as a "failure to actively manage its subcontract" and "sloppy with respect to its obligations as a prime contractor" (gov't resp. at 12), but this is a surprisingly patent mischaracterization of the decision. The government had moved for reconsideration of the portion of the Board's decision sustaining the appeal as to the government's claim for return of progress payments it had paid directly to the subcontractor, because the government had acted in violation of its obligations under the plain language of the progress payments clause and the payments were not authorized. The Board stated in part:

[T]he facts alleged by the Government with respect to appellant's failure to actively manage its subcontract with GEM to insure that GEM was performing the contract in accordance with its contract with appellant...were considered by the Board in sustaining the Government's termination of the contract for default.

However, while appellant may have been sloppy with respect to its obligations as a prime contractor, this does not relieve the Government of its obligations to properly issue progress payments in accordance with the contract terms and to administer the progress payment program in accordance with the regulations to insure against overpayments and losses.

89-2 BCA ¶ 21,806 at 109,706 (Emphasis added) The *Bichler* decision is clearly grounded in the express terms of the contract and provides no support for the government's arguments regarding inherent or implied duties.

We hold that the government's claim for "subcontractor costs at the prime contractor level" fails to allege a valid duty or obligation on the part of LMIS that arises from either the CR2 or the S3 contract, either express or implied, and therefore fails to state a claim for relief that is "plausible on its face." Whether the government's claim is characterized as one for breach of contract or for improperly billed unallowable costs, it depends on the government's assertion of a valid contractual duty that was breached by LMIS. In this case, we are presented with a claim based on a legal theory, originated by an auditor, that LMIS, as a prime contractor, had a contractual duty to retain for purposes of an incurred cost audit the same documentation that it used to substantiate its billings during the course of performance of the contract and, moreover, had a duty to initiate audits of its subcontractors' incurred costs and be able to prove during the course of an incurred cost audit that it did so.

LMIS's "breach" of these non-existent duties is the government's only basis for asserting that the subcontract costs for which it has reimbursed LMIS are unallowable costs. The government does not allege that LMIS did not adequately substantiate its billings during performance of the contract, or that the subcontract services were not provided to its satisfaction, or that the costs billed were not incurred by LMIS. Rather, it has gone forward with a claim for over \$100,000,000 that is based on nothing more than a plainly invalid legal theory

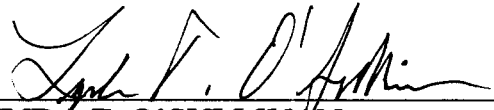
Because we find that LMIS's motion to dismiss the government's claim for "subcontractor costs at the prime level" should be granted due to the government's

failure to assert a valid contractual duty that could be breached, we do not reach LMIS's argument that the government has failed to allege the necessary causal connection between the alleged breach and the damages claimed, nor its affirmative defense that the government's claim accrued at the time it paid the invoices in 2007 and is therefore barred by the Contract Disputes Act's six-year statute of limitations.

CONCLUSION

We grant appellant's motions to dismiss ASBCA Nos. 59508 and 59509 for failure to state a claim upon which relief can be granted. The appeals are dismissed with prejudice.

Dated: 20 December 2016



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LYNDA T. O'SULLIVAN  
Administrative Judge  
Armed Services Board  
of Contract Appeals

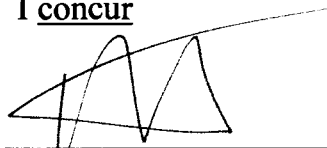
I concur



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MARK N. STEMLER  
Administrative Judge  
Acting Chairman  
Armed Services Board  
of Contract Appeals

I concur



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RICHARD SHACKLEFORD  
Administrative Judge  
Vice Chairman  
Armed Services Board  
of Contract Appeals

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA Nos. 59508, 59509, Appeals of Lockheed Martin Integrated Systems, rendered in conformance with the Board's Charter.

Dated:

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