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Focus

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FEATURE COMMENT: The Most Important Government Contract Disputes Cases Of 2016

In 2016, the U.S. Court of Appeals for the Federal Circuit issued two important decisions that will have a significant impact on the law of Government contract disputes. Specifically, the Federal Circuit has changed the lens through which claims accrual is to be assessed, thus impacting statute of limitations defenses. And the Federal Circuit has confirmed that a contractor's illegal conduct can form the basis for an affirmative Government defense of prior material breach, which precludes contractor recovery. This Feature Comment analyzes these two Federal Circuit decisions, issued in 2016, and provides insights on how they impact the assertion of claims and resolution of Government contract disputes.

Accrual of Claims for Statute of Limitations (*Kellogg Brown & Root Servs., Inc.*, 14-1 BCA ¶ 35,713, rev'd, *Kellogg Brown & Root Servs., Inc. v. Murphy*, 823 F.3d 622 (Fed. Cir. 2016; 58 GC ¶ 194))—In a case involving a contractor claim for reimbursement of subcontract costs, the Federal Circuit held that the Contract Disputes Act's six-year statute of limitations does not begin to run until the amount of the claim (a sum certain) is known or should have been known. In so holding, the Federal Circuit departed from the long-standing analytical construct for determining when claims accrue under the CDA.

Kellogg Brown and Root Services Inc. (KBR), a prime contractor providing logistics support services for the military in Iraq, terminated a subcontractor for default in July 2003. The subcontractor disputed the termination and continued to provide transition services until mid-September 2003, as directed by KBR. After many months of negotiations and litigation, in January 2005, KBR, as part of a settlement agreement, converted the default termination to one for convenience, and agreed to pay the subcontractor a specified amount, plus any other amounts ultimately recovered from the Army.

In August 2006, the subcontractor submitted a certified claim to KBR, and in November 2006 KBR forwarded the claim to the Army with a request for payment. The Army responded in May 2007 that it was KBR's responsibility to negotiate with its subcontractors. KBR submitted a certified claim to the Army on behalf of the subcontractor in 2012, and when the contracting officer failed to render a decision, KBR appealed the deemed denial to the Armed Services Board of Contract Appeals.

At the ASBCA, the Army moved to dismiss the appeal on the ground that the claim was barred by the six-year CDA statute of limitations, 41 USCA § 7103(a)(4)(A). In determining when the claim accrued, the ASBCA relied on Federal Acquisition Regulation 33.201, which provides that a claim accrues on "the date when all events, that fix the alleged liability of either the Government or the contractor and permit assertion of the claim, were known or should have been known." Under FAR 33.201, "for liability to be fixed, some injury must have occurred. However, monetary damages need not have been incurred."

Applying this definition of "accrual of a claim," the Board determined that, since the legal basis for the 2012 claim was entitlement to the costs of performance of the terminated subcontract, the claim had accrued in September 2003 when subcontract performance ended. The ASBCA reasoned that, as of the date the subcontractor ceased performing, KBR was aware of the events that fixed the alleged liability of the Army—namely, that the subcontract was over, the subcontractor disputed the termination, and the subcontractor had incurred performance costs and demanded payment.

The Board concluded that even if the claim had not accrued in September 2003, it certainly had accrued by 2005, when KBR entered into a settlement agreement with the subcontractor. Thus, the assertion of the certified claim in 2012 was untimely. *Kellogg Brown & Root Servs., Inc.*, ASBCA 58492, 14-1 BCA ¶ 35,713.

In analyzing the accrual date, the ASBCA rejected KBR's argument that the 2012 claim arose from a routine request for payment that did not ripen into a claim until the Army denied it in May 2007. Disagreeing with KBR's characterization of its payment request as a "routine" request for payment, the Board determined that KBR's claim arose from the "unforeseen or unintended circumstances" of a subcontract termination, and therefore was a "non-routine" request for payment, which could be asserted as a claim. Finding that KBR's 2012 certified claim was barred by the six-year statute of limitations, the ASBCA dismissed KBR's claim. KBR appealed to the Federal Circuit.

The Federal Circuit reversed. In assessing the accrual of KBR's claim, the Federal Circuit focused on the definition of "claim" provided in FAR 2.101, rather than on the definition of "accrual of a claim" in FAR 33.201. Under FAR 2.101, "claim" is defined as "a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain." With this definition in mind, the Court concluded that "a 'claim' for 'the payment of money' *does not 'accrue' until the amount of the claim, 'a sum certain,'… is 'known or should have been known.' "* *Kellogg Brown & Root Servs., Inc. v. Murphy*, 823 F.3d 622, 627 (Fed. Cir. 2016) (citations omitted) (emphasis added). Here, KBR argued (and the Army apparently did not dispute) that it lacked sufficient information to request a sum certain until the subcontractor presented its certified claim to KBR in August 2006.

The Federal Circuit also criticized the Board for finding that the November 2006 request was a "non-routine" payment request that permitted an immediate claim. A subcontract termination is not a per se "unexpected or unforeseen" action. Id. at 627. Finally, the Court noted that the limitations period does not begin to run until mandatory pre-claim procedures are complete, and, here, the Army required that KBR resolve disputed costs with its subcontractor before KBR could present a claim for those costs. Id. at 628. Accordingly, the Federal Circuit reversed the ASBCA decision that KBR's claim was barred by the statute of limitations, and it remanded to the Board for proceedings on the merits.

Key Lessons from KBR: Traditionally, claims accrual has been analyzed with reference to when the proponent knew or should have known the basis of its claim in accordance with the definition of "accrual of a claim" in FAR 33.201. See, e.g., *Raytheon Co. v. U.S.*, 104 Fed. Cl. 327, recon. denied, 105 Fed. Cl. 351 (2012); *Raytheon Co., Space & Airborne Sys.*, ASBCA 57801, 54 GC ¶ 127; 13 BCA ¶ 35,319; 55 GC ¶ 185. For liability to be fixed, some injury must have occurred, but monetary damages need not have been incurred. *Raytheon*, 104 Fed. Cl. at 330 (citing FAR 33.201).

Thus, in prior cases, claims were deemed to have accrued and the statute of limitations commenced to run even where no "sum certain" was known. See, e.g., *Boeing Co*., ASBCA 58660, 15-1 BCA ¶ 35,828 ("there is no requirement that a sum certain be established"); *McDonnell Douglas Serv., Inc.*, ASBCA 56568, 10-1 BCA ¶ 34,325 ("some extra costs must have been incurred before liability can be fixed and a claim accrued, but there is no requirement that a sum certain be established."); 52 GC ¶ 86; *Raytheon*, 13 BCA ¶ 35,319 ("It is enough that the government knows, or has reason to know, that some costs have been incurred, even if the amount is not finalized or a fuller analysis will follow."); *Raytheon Missile Sys.*, ASBCA 58011, 13 BCA ¶ 35,241 ("Accrual of a contracting party's claim is not suspended until it performs an audit or other financial analysis to determine the amount of its damages."); 55 GC ¶ 73. In *KBR*, the Federal Circuit did not address (or even acknowledge) the inconsistency between its holding that the statute of limitations does not begin to run until a sum certain is known and the language of FAR 33.201 that monetary damages need not have been incurred for claim accrual.

In rendering its decision, the Federal Circuit may have been swayed by the practical limitations faced by a prime contractor that asserts a claim against the Government for reimbursement that is dependent on a subcontractor claim. As a practical matter, KBR could not have asserted a claim against the Government for payment of amounts owed to the subcontractor until KBR received sufficient information from the subcontractor as to the amount claimed, which, in this case, was when KBR received the certified claim from the subcontractor.

The Board found that the claim accrued in 2003 when the subcontract work was completed, or in 2005 when the settlement was reached (although it left open the total amount owed the subcontractor). However, KBR was not in a position to request payment from the Government or submit a certified claim at that time because the dollar amount due the subcontractor was unknown. As the Federal Circuit noted, "the Army does not state that the amount of the claim was reasonably known in 2003 or 2005." *Kellogg Brown & Root Servs., Inc.*, 823 F.3d at 627. The Federal Circuit's focus on a sum certain makes sense where there is prime/subcontractor claim dependency, but if applied to other circumstances, the decision will result in the unnecessary extension of the time for asserting claims. If the Federal Circuit considers claims accrual in a different context in the future, the Court might limit application of *KBR*'s sum certain rule to factually similar cases.

Going forward, when a statute of limitations defense is asserted, the critical question will be not when the claimant knew of facts fixing liability, but when a sum certain was or could have been determined. Whether a party can wait to assert a claim until the full financial impact is known or must assert its claim earlier will obviously depend on when a sum certain is known or should have been known, and the statute of limitations begins accruing.

The Federal Circuit decision leaves open how certain a monetary amount must be before claims accrual begins, and how the case law addressing the sum certain requirement for CDA jurisdiction will fit into the claims accrual analysis. For example, a claim stated in an estimated amount does not meet the sum certain requirement for purposes of CDA jurisdiction, but a claim can include estimated or approximated costs if the total overall demand is for a sum certain. See, e.g., *Gov't Servs. Corp*., ASBCA 60367, 16-1 BCA ¶ 36,411.

Will a claim be deemed to accrue when the asserting party has sufficient knowledge to estimate the amount owed? Could a party avoid the commencement of the statute of limitations period by characterizing quantum in internal documents as "in excess of" or "approximately," or using other qualifying language that renders the amount not a sum certain for CDA jurisdiction?

In *Crane & Co.*, CBCA 4965, 16-1 BCA ¶ 36,539, the Civilian Board of Contract Appeals grappled with the impact of the recent *KBR* decision. It stated that the Federal Circuit's decision that accrual does not occur until the claimant requests or reasonably could have requested a sum certain "cannot mean, however, that accrual of a claim under the CDA is uniformly deferred until a contractor has incurred *all costs* that it is going to incur" (emphasis in original).

The impact of this shift in analysis may be most felt in cases involving Government claims for cost disallowances or Cost Accounting Standards violations. Prior case law has established that a Government claim can accrue before completion of an audit or other financial analysis to determine the amount of damages. See, e.g., *Raytheon*, 105 Fed. Cl. 351; *Raytheon Missile Sys.*, 13 BCA ¶ 35,241. The Federal Circuit's decision in *KBR* places the continuing validity of these cases at issue; at a minimum, we can expect that the Government will again defend against statute of limitations challenges to its claims with arguments that it could not determine a sum certain until the full financial impact of its claim was known. Further, since the Federal Circuit's 2014 decision in *Sikorsky Aircraft Corp. v. U.S.*, 773 F.3d 1315 (Fed. Cir. 2014); 56 GC ¶ 403, holding that the statute of limitations is not jurisdictional, it is the contractor that will bear the burden of proving that the Government was able to determine a sum certain at an earlier date. Id. at 1319.

Government Defense of Prior Material Breach (*Laguna Constr. Co., Inc. v Carter*, 828 F.3d 1364 (Fed. Cir. 2016); 58 GC ¶ 264)—In *Laguna*, the Federal Circuit determined that the ASBCA had jurisdiction over the Government's affirmative defense of prior material breach, even though that defense had not been the subject of a CO's final decision. The Federal Circuit's decision in *Laguna* also addresses the ASBCA's jurisdiction to consider an affirmative defense involving fraudulent conduct by the contractor.

In 2003, the Government awarded Laguna Construction Company an indefinite-delivery, indefinite-quantity contract to perform construction services in Iraq. *Laguna Constr. Co., Inc. v. Carter*, 828 F.3d 1364, 1366 (Fed. Cir. 2016). In 2004–2005, Laguna received 16 cost-reimbursable task orders under the IDIQ contract, and awarded subcontracts to various subcontractors. Id. After the work was completed in 2010, Laguna submitted to the Government 14 interim cost vouchers requesting payment of approximately $3 million for taxes on 11 task orders and subcontract charges (totaling $24,000) on two task orders. Id.

In 2012, the Defense Contract Audit Agency rejected certain costs, including the 14 vouchers at

issue. Id. Laguna thereafter submitted a certified claim, seeking to recover approximately $2.9 million in connection with the rejected vouchers. Id. The CO failed to issue a decision on Laguna's claim, and Laguna filed an appeal at the ASBCA asserting that the Government's failure to pay the vouchers was a breach of contract. Id.

Meanwhile, in 2010, Laguna's project manager pleaded guilty to conspiracy to defraud the U.S., to conspiracy to pay or receive kickbacks in violation of 18 USCA § 371, and to violations of the Anti-Kickback Act. Id. The project manager admitted that he worked with subcontractors to submit inflated invoices to Laguna for reimbursement by the Government, and that he profited from the difference. Id. at 1367. In 2012, a federal grand jury issued a criminal indictment against three principal officers of Laguna, alleging that they received kickbacks for awarding subcontracts. Id. In 2013, Laguna's executive vice president and chief operating officer, Bradley Christiansen, pleaded guilty to conspiring to defraud the U.S. by participating in a kickback scheme. Id.

After Christiansen's guilty plea, the Government amended its answer in the ASBCA appeal to include an affirmative defense of fraud. Id. On cross motions for summary judgment, the ASBCA ruled that, even if Laguna could show that the Government breached the contract by failing to pay the invoices, Laguna could not recover because of its prior material breach.

As reasoned by the ASBCA, if a party to a contract is sued for breach, it may defend on the ground that there existed, at the time of the breach, a legal excuse for nonperformance. The ASBCA found that Laguna (through its officers' criminal conduct, which was imputed to the company) committed prior breaches of contract by paying kickbacks, thereby breaching its duty to perform in good faith and deal fairly, and breaching the Allowable Cost and Payment clause by inflating vouchers to include kickbacks. The ASBCA held that these prior breaches were material, even though kickbacks were not paid under every task order or under every voucher submitted for payment. The ASBCA concluded that "any degree of fraud is material as a matter of law." *Laguna Constr. Co., Inc,* ASBCA 58324, 14-1 BCA ¶ 35,748 (citation omitted).; 56 GC ¶ 334.

Thereafter, Laguna appealed the adverse ASBCA decision to the Federal Circuit. Laguna first argued that the ASBCA "does not have jurisdiction because the Government's affirmative defense of fraud is a " 'claim' that requires a 'decision of a contracting officer' " under the CDA, in accordance with the Federal Circuit's ruling in *M. Maropakis Carpentry, Inc. v. U.S.*, 609 F.3d 1323, 1327 (Fed. Cir. 2010); 52 GC ¶ 225. The Federal Circuit rejected this argument, stating that the Government's defense "plainly does not seek the payment of money or the adjustment or interpretation of contract terms." 828 F.3d at 1368. Further, the Federal Circuit addressed the Board's jurisdiction over fraud claims, explaining,

> in cases such as this, where the [ASBCA] does not have jurisdiction over the underlying fraud actions—here an Anti-Kickback Act claim—the [ASBCA] has determined that it can maintain jurisdiction over a separate affirmative defense involving that fraud as long as it does not have to make factual determinations of the underlying fraud.

Id. Here, the Federal Circuit continued, the ASBCA "did not have to make any factual findings of fraud because it relied on Mr. Christiansen's July 2013 criminal conviction." Id. at 1369.

Next, the Federal Circuit reviewed the ASBCA's grant of summary judgment in favor of the Government. At the outset of its analysis, the Federal Circuit noted that "[p]rior material breach is a federal common law defense asserted when a party breaches a contract after another party has already breached the same contract." Id. Prior material breach can bar a contractor's breach claim against the Government, even if the Government's later-occurring breach happened without knowledge of the first breach.

The Federal Circuit reasoned: "Nothing in the CDA suggests that Congress intended to displace this federal common law defense, nor is there any sound reason to do so." Id. Thus, the Federal Circuit went on to affirm the ASBCA's decision, stating that it "agree[s] with the [ASBCA's] determination that Laguna committed the first material breach by violating the [contract's] Allowable Cost and Payment clause, which states that a cost is allowable only when it is reasonable and complies with the terms of the contract." Id. at 1371. In so affirming, the Federal Circuit also rejected Laguna's contention that the Government knew of the kickback scheme as early as January 2008 and thereby waived the prior material breach defense. The Court explained that prior to Christiansen's guilty plea in July 2013, the Government "did not have a 'known right' that would have invoked the prior material breach rule." Id.

Key Lessons from Laguna: *Laguna* will have an impact on the assertion of affirmative defenses of

prior material breach, especially those based on illegal contractor conduct. First, the Federal Circuit's decision dispenses with the requirement for a CO's final decision for a Government claim of prior material breach, thus retreating from precedent. In *M. Maropakis Carpentry, Inc.*, the Federal Circuit held that "a contractor seeking an adjustment of contract terms must meet the jurisdictional requirements and procedural prerequisites of the CDA, whether asserting the claim against the government as an affirmative claim or as a defense to a government action." Id. at 1331. Four years later, in *Raytheon Co. v. U.S.*, 747 F.3d 1341 (Fed. Cir. 2014); 56 GC ¶ 124, the Federal Circuit extended *Maropakis* to Government claims asserted as defenses to contractor claims, holding that a CO's final decision is a jurisdictional requisite for a Government claim even when the Government claim is asserted as a defense.

In *Laguna*, the Federal Circuit expressly rejected the contractor's argument that the Government was seeking a reduction in the amount owed or a change in contract terms, and thus was asserting a claim. Although the Federal Circuit found that the Government's affirmative defense of prior material breach did not meet the definition of a claim—and, therefore, no CO's final decision was required—the Federal Circuit's own reasoning seems to contradict this finding. That is, in affirming the ASBCA's decision, the Federal Circuit explicitly stated that it "agree[s] with the [ASBCA's] determination that Laguna committed the first material breach *by violating the [contract's] Allowable Cost and Payment clause*." 828 F.3d at 1371 (emphasis added).

"Claim" is broadly defined in the FAR as a written assertion by one of the contracting parties seeking "the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to the contract." FAR 2.101. And a breach-of-contract dispute is a classic example of a "claim" that requires a CO's final decision. The Federal Circuit's decision ignores the broad language of the FAR, but responds directly to the contractor's assertion during oral argument that the Government's affirmative defense constituted a claim because it sought "a reduction in the amount owed or a change in contract terms."

Had the contractor argued that the Government's breach-of-contract defense sought the interpretation of contract terms (the Allowable Cost and Payment clause) or relief relating to the contract, the Federal Circuit might have viewed the nature of the Government's affirmative defense differently. And this different perspective might have served to quell the Court's concern that a ruling—that a defense of prior material breach was a claim requiring a final decision—"could improperly bar the Board's jurisdiction where the government raises *any* affirmative defense." Going forward, however, the holding in *Laguna* means that the Board will have jurisdiction to decide an affirmative defense of prior material breach, even if the breach has not been the subject of a CO's final decision.

Second, *Laguna* provides clarification regarding board jurisdiction over affirmative defenses relating to fraud or other illegal contractor activity. Even where the underlying contractor conduct is outside of the CDA (such as whether there has been a violation of the Anti-Kickback Act or the False Claims Act), the boards of contract appeals can consider affirmative defenses that are based on fraudulent or otherwise illegal contractor actions if the board "does not have to make *factual determinations of the underlying fraud*." 828 F.3d at 1368 (emphasis added). Therefore, if a court with proper jurisdiction has adjudicated a fraud claim against a contractor, that finding can be the basis for an affirmative defense that is predicated on that fraud.

The clear import of *Laguna* is that the boards have jurisdiction to resolve affirmative defenses that are based on fraudulent conduct if the defense is established by "factual determinations" of fraud made by a court; but the boards cannot independently make factual findings or adjudicate whether the fraud occurred. *Laguna* involved fraudulent activities that occurred during contract performance and that gave rise to a defense of prior material breach, but the same limit on board jurisdiction should apply equally if the Government alleges that the contract was void ab initio because fraudulent activity before the contract award tainted the contract from its inception.

Since *Laguna* was decided, the Government has increased its requests to stay proceedings at the ASBCA pending the outcome of court litigation relating to fraud, and the ASBCA has made clear that "[n]othing in *Laguna* mandates that the Board suspend appeals indefinitely whenever the government has merely filed a fraud case elsewhere that might establish an affirmative defense." *Kellogg, Brown & Root Servs., Inc.,* ASBCA 57530, et al., 16-1 BCA ¶

36,544. And, where a stay is requested by the Government, the ASBCA will normally consider (1) whether the facts, issues and witnesses in both proceedings are substantially similar; (2) whether the ongoing litigation or investigation could be compromised by proceeding with the ASBCA matter; (3) the extent to which the proposed stay could harm the contractor; and (4) whether the duration of the request is reasonable. *Pub. Warehousing Co.*, ASBCA 58088, 2016 WL 7401223 (Dec. 8, 2016) (granting stay of ASBCA action for one year).

Third, *Laguna* clearly establishes that antecedent material breach is a viable affirmative defense, even if the later breach happened without knowledge of the first breach. Since most claims pursued at the boards of contract appeals are contractor claims, the common law prior material breach rule will likely be invoked by the Government; however, there may be instances in which the contractor can assert the defense in response to a Government claim.

Fourth, in *Laguna*, the dollar amount of the kickback was not relevant to determining whether the breach was material. The ASBCA reasoned that "any degree of fraud is material as a matter of law," and the fact that kickbacks were not paid under every task order or voucher did not render the fraud any less material. The Federal Circuit similarly did not consider the amount by which vouchers were inflated by kickbacks, or consider whether every voucher or task order was affected, but it concluded that "government contracts tainted by kickbacks are hurtful" because the Government "would be 'saddled with' an unreliable subcontractor, 'which undermines the security of the prime contractor's performance.' " 828 F.3d at 1371. Thus, material breach can occur even if the dollar impact of the illegal conduct is only a small portion of the contractor's claim.

Fifth, a prior material breach can result in forfeiture of the entire claim. Importantly, in *Laguna*, the prior material breach barred the contractor's recovery on its *entire* claim for payment under all 14 task orders, even though the subcontract payments claimed by the contractor (which were inflated due to kickbacks) were a small portion ($24,000) of the contractor's $2.9 million certified claim, and related to only two of the 14 task orders. The ASBCA ruled—and the Federal Circuit agreed—that the prior breaches were material, even though kickbacks were not paid under every task order or under every voucher submitted for payment.

Thus, illegal conduct can form the basis of a defense to payment even if there is no relationship between the improper conduct and the reimbursement claimed. This material breach can result in the complete forfeiture of the amount otherwise due the contractor. In selecting the forum for appeal, contractors often consider the risk of proceeding at the U.S. Court of Federal Claims, where the Government may assert counterclaims for fraud. However, after *Laguna*, a board appeal also could result in contractor forfeiture of all amounts claimed if the underlying conduct has been determined fraudulent by a court of competent jurisdiction.

Sixth, the ASBCA found that Laguna's project manager and vice president of operations were acting as employees and operating under the contract when they paid kickbacks, and therefore the criminal conduct was imputed to Laguna. The Federal Circuit agreed that the Board properly determined that the criminal acts could be imputed to the contractor because "both employees were operating under the contract and within the scope of their employment." Neither the ASBCA nor the Federal Circuit addressed whether the seniority of the employees was relevant to an analysis of whether the criminal conduct should be imputed to the organization. And in *Laguna*, the employees were senior level—the project manager and the vice president of operations. Although contractors may be able to argue in future cases that *Laguna* should apply only to instances where senior level employees engage in criminal conduct, the holding in *Laguna* is not so limited, and a broad reading is consistent with FAR 9.406-5, which provides that any employee's criminal or seriously improper conduct may be imputed to the contractor when the conduct occurred in connection with the individual's performance of duties for or on behalf of the contractor.

Going forward, contractors should expect the Government to assert with increasing frequency the affirmative defense of prior material breach—especially in cases in which fraudulent contractor conduct is involved. As *Laguna* illustrates, such a defense does not necessarily require the Government to assert an affirmative CDA claim against the contractor first. Moreover, if the Government successfully invokes the affirmative defense of prior material breach, the result typically will be contractor forfeiture of the amounts otherwise due.

Conclusion—The two decisions described in this Feature Comment are the most important

Government contract claims decisions decided in 2016. These two Federal Circuit cases address key issues for the assertion of claims and affirmative defenses in appeals at the boards of contract appeals.

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