

January 13, 2021

Memorandum

To: ABA Public Contract Law Section

From: Sandy Hoe

Re: **2020 Most Important Government Contract Decisions**

Kellogg Brown and Root Services, Inc. v. Secretary of the Army, 973 F.3d 1366 (Fed. Cir. 2020)

Synopsis: KBR sought to recover approximately \$50M it paid one of its subcontractors for delays the subcontractor experienced in delivering support to American troops in Iraq. The Army promised KBR it would provide force protection for KBR's convoys traveling into and through Iraq when making its deliveries. Running convoys from Kuwait into Iraq had proven very dangerous and KBR had already lost personnel.

In the Fall of 2003, the Army directed KBR to deliver and install thousands of so-called "living trailers" to troops by that Christmas. Up to this point in the war, American troops had been sleeping outside on the ground, in tents or in buildings captured from Saddam Hussein. KBR retained a subcontractor and awarded a fixed price subcontract to accomplish the task. The Army, however, failed to provide the promised force protection in time for KBR's subcontractor to deliver on schedule. Subcontractor trucks loaded with living trailers arriving at the Iraq/Kuwait border remained backed up for days and weeks incurring delay costs. At one point, the Kuwaiti government demanded that KBR move the trucks which were blocking the road into Iraq. KBR's subcontractor then leased space to off-load the trailers until they could be on-loaded again when the force protection arrived, all at additional unanticipated cost to the subcontractor.

The subcontractor submitted a claim to KBR for its additional, unanticipated cost of close to \$90M. KBR negotiated the subcontractor down to less than \$50M. However, KBR was not able to get the subcontractor to produce actual cost records to support its claim. After a time, KBR agreed to settle with the subcontractor using a form of price analysis - calculating the cost of delay by agreeing upon a price per day per truck of \$300, negotiated down from an original proposed rate of \$500 per day. The daily rate was multiplied by a number of days of delay to reach the settlement amount.

KBR sought to be reimbursed the settlement amount by the Army under KBR's cost-plus prime contract. The contracting officer found that approximately half, or \$25M was reasonable, and

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that he would consider the other half when KBR provided more support. DCAA then intervened and convinced the contracting officer that KBR should not have paid its subcontractor anything because the subcontract required the subcontractor to produce its actual cost data before any claim could be paid. At that point the contracting officer announced that KBR was entitled to nothing, although it had already paid its subcontractor the \$50M.

KBR appealed the contracting officer's decision to the Armed Services Board of Contract Appeals ("ASBCA"). In a decision in late 2018, the ASBCA held that the Army had not promised to provide force protection on any particular date and that, in any event, it was unreasonable for KBR to settle with its subcontractor without the subcontractor's cost data. Consequently, the cost of the settlement KBR was seeking under its cost-reimbursement contract was unreasonable and, therefore, unallowable.

KBR appealed to the Federal Circuit.

At the Federal Circuit, KBR argued that the ASBCA had erred by finding that the Army had no obligation to provide force protection on any particular schedule when it was the Army that had set the pre-Christmas delivery date for living trailers and the subcontractor had agreed to a fixed price based upon that understanding. Second, KBR insisted that it was not unreasonable to settle the delay claim of its subcontractor when there was clear delay, KBR relied on what essentially was a price analysis which the government often uses in establishing fair and reasonable prices, and the contracting officer initially agreed that at least half of the claimed delay costs were reasonable. KBR also asserted that if the entire \$50M could not be supported as reasonable, KBR should be paid something under a jury verdict because there was clear delay caused by the government.

The Federal Circuit decided 2-1 against KBR.

The majority side-stepped the question of the Army's breach and moved directly into the reasonableness of KBR's settlement with its subcontractor (assuming for this purpose, however, that there had been a breach). As to quantum, the ASBCA and the parties had understood that KBR had the burden of proving the reasonableness of its subcontractor's costs. The majority disagreed, however, saying that the proper question was whether the amount KBR had paid to settle with its subcontractor was reasonable and not whether the subcontractor's costs were reasonable. In KBR's view, this was a significant victory because it made the ASBCA's decision and much of the evidence presented at the ASBCA largely irrelevant.

Unfortunately, however, the majority did not stop there. Rather than remand to the ASBCA to apply the Circuit's holding that the reasonableness of the settlement amount was the issue, not the subcontractor's cost, the majority decided it would determine whether the settlement amount was reasonable. Working only from the Joint Appendix filed by the parties for the appeal (which contained only evidence that covered the issues on appeal), the majority determined that KBR had not presented enough evidence at the ASBCA to prove its settlement with its subcontractor was reasonable.

This was unexpected for two reasons. First, the majority had just held that KBR was not required to obtain cost data from its subcontractor. Yet, the majority faulted KBR for not having put into evidence at the ASBCA cost data very similar to what the majority said the subcontractor was not required to provide. Second, the evidence the majority used to reach its

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quantum determination was incomplete. The Joint Appendix before the Court included only those parts of the ASBCA record relevant to the issues on appeal. KBR had not appealed the ASBCA's quantum decision, only that KBR was not required to obtain cost data from its subcontractor to reach a reasonable settlement. KBR had provided some evidence at the ASBCA to show the reasonableness of the settlement but that evidence was not in the Joint Appendix because KBR sought remand on that issue. Nonetheless, the majority went ahead and rendered its reasonableness decision without the benefit of all the evidence. Once again, KBR received not a penny of what it had paid its subcontractor for the Army's delay.

Judge Newman, in dissent, was quite eloquent (a somewhat prejudiced view, I admit). She could not understand how a contractor who had been pressed into service to deliver living trailers to troops by Christmas in Iraq, and whose subcontractor clearly had been delayed by the government, could end up with nothing despite the additional cost. She wondered with this result how any contractor would want to do business with a customer that treats its suppliers so poorly. Quoting from the concluding paragraph in her dissent:

“At issue is not only the resolution of this case; at issue is the public’s confidence in fair, equitable, and reasonable government dealings with those who are willing to provide their expertise and resources to the nation.”

Lesson: The Federal Circuit of late has taken a hard line on what contractors must show to prove their costs are reasonable and, therefore, allowable. In a 2013 decision, the Circuit affirmed a Court of Federal Claims decision that KBR's settlement with a dining service subcontractor, Tamimi, was unreasonable in part because the KBR negotiator had failed to take full advantage of leverage KBR held over the subcontractor. *Kellogg Brown and Root Services, Inc. v. U.S.*, 728 F.3d 1348 (Fed. Cir. 2013). In another KBR case, the Circuit upheld a Court of Federal claims decision that KBR had been “grossly negligent” in agreeing to pay another dining services subcontractor, without deciding whether costs a contractor incurred “negligently” could be deemed reasonable. *Kellogg Brown and Root Services, Inc. v. U.S.*, 742 F.3d 967 (Fed. Cir. 2014). The Court there found that KBR had failed to fully vet the subcontractor's proposed amount which, on its face, appeared extraordinary.

In both cases, the Court of Federal Claims, supported by the Federal Circuit, effectively stepped into the prime contractor's shoes as if a party to apply its notions of how to negotiate with subcontractors in these three cases. Reasonableness when applied to cost invokes a large number of factors to be considered, as all would agree, including even this factor. However, these KBR decisions indicate that the courts and boards are applying a particularly high standard that is increasingly difficult for prime contractors to meet. It behooves prime contractors with cost-reimbursement contracts to recognize the high burden being placed upon them when they seek to demonstrate that their subcontractor costs are reasonable.