

No. 13-1558

In the Supreme Court of the United States

KELLOGG BROWN & ROOT SERVICES, INC., PETITIONER

v.

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT*

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the government permissibly declined to reimburse certain costs incurred by petitioner during the performance of a contract, on the ground that those costs were unreasonable, where the contract entitled petitioner to reimbursement only for reasonable costs.

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OPINIONS BELOW

The opinions of the court of appeals (Pet. App. 1-53, 228-239) are reported at 728 F.3d 1348 and 742 F.3d 967, respectively. The opinions of the Court of Federal Claims (Pet. App. 54-227, 240-320) are reported at 103 Fed. Cl. 714 and 107 Fed. Cl. 16, respectively.

JURISDICTION

The judgments of the court of appeals were entered on September 5, 2013, and February 3, 2014. Petitions for rehearing with respect to the first judgment were granted in part and denied in part on March 28, 2014 (Pet. App. 321-323). A petition for rehearing with respect to the second judgment was denied on April 21, 2014 (*id.* at 325-326). The petition for a writ of certiorari was filed on June 25, 2014. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner is a government contractor that performed certain logistics support services for the United States Army in Iraq during Operation Iraqi Freedom. Pet. App. 3, 229. Petitioner’s contract with the Army was a “cost-plus-award-fee” contract, pursuant to which the Army generally agreed to reimburse petitioner for the costs of carrying out the contract, including subcontracting costs, and to pay an additional fee based on petitioner’s performance. *Id.* at 4, 229 & n.1.

Petitioner’s contract incorporated by reference the cost-reimbursement principles set forth in the Federal Acquisition Regulation (FAR). Pet. App. 16. Under the FAR, “[a] cost is allowable”—*i.e.*, reimbursable by the government—“only when the cost complies with” certain listed requirements. 48 C.F.R. 31.201-2(a). One of those requirements is “[r]easonableness.” 48 C.F.R. 31.201-2(a)(1).¹

In order to be considered “reasonable,” and thus reimbursable, a cost must “not exceed that which would be incurred by a prudent person in the conduct of competitive business.” 48 C.F.R. 31.201-3(a). “No presumption of reasonableness shall be attached to the incurrence of costs by a contractor,” and “[i]f an initial review of the facts results in a challenge of a specific cost by the contracting officer or the contracting officer’s representative, the burden shall be upon the contractor to establish that such cost is reasonable.” *Ibid.* Whether a particular cost “is reasonable depends upon a variety of considerations and circum-

¹ Although the FAR has been amended slightly since its incorporation into the contract at issue here, those amendments are not material to the question presented. See, *e.g.*, Pet. App. 296 n.16.

stances, including,” but not limited to, “[w]hether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance”; “[g]enerally accepted sound business practices, arm’s length bargaining, and Federal and State laws and regulations”; “[t]he contractor’s responsibilities to the Government, other customers, the owners of the business, employees, and the public at large”; and “[a]ny significant deviations from the contractor’s established practices.” 48 C.F.R. 31.201-3(b); see Pet. App. 17.

2. The decisions below concern two situations in which the government declined to fully reimburse petitioner for its claimed contract costs, on the ground that those costs were unreasonable. The first situation arose out of petitioner’s provision of dining services to the Army at Camp Anaconda, a contractual obligation that petitioner carried out largely through a subcontractor, Tamimi Global Company, Ltd. Pet. App. 2-14. It was later determined that Tamimi had provided kickbacks (including trips and cash) to two of petitioner’s employees, who had been on the committee that awarded the subcontract to Tamimi. *Id.* at 5-6.

The prices charged by Tamimi drew considerable scrutiny from both the Army and the Defense Contracting Auditing Agency (DCAA). Pet. App. 8. Eventually, after allowing petitioner to be heard on the matter, the DCAA concluded that the rates negotiated with Tamimi were nearly three times higher than the rates negotiated with eight similar subcontractors. *Id.* at 131-139. The DCCA accordingly found that “unreasonable costs of \$39.9 million were charged to the government,” and it suspended pay-

ment of \$41.1 million, which included both the payments to Tamimi that had been deemed excessive and the fee petitioner had charged on those amounts. *Id.* at 139 (citation omitted).

The second set of disputed payments arose from petitioner's provision, installation, operation, and maintenance of dining-facility services at another site in Iraq. Pet. App. 229. Petitioner subcontracted that work to ABC International Group. *Ibid.* When the Army modified its requirements to approximately double the number of soldiers who would require services, ABC proposed to approximately triple the prices it was charging to petitioner. *Id.* at 230-231, 237. Although ABC's explanation for the increase was "conclusory and devoid of detail," petitioner did not request any further explanation. *Id.* at 236. In addition, one of petitioner's employees prepared a price-justification memorandum that was "seriously flawed" in its calculation of the baseline price to which ABC's new prices would be compared. *Id.* at 232-233, 236-237. Petitioner's "management was aware of the inadequacies of" that memorandum, yet "still approved [the adjustment] without questioning the higher costs." *Id.* at 236. The DCAA ultimately declined to reimburse \$12,529,504 of those costs. *Id.* at 233.

3. a. Petitioners filed two separate suits in the Court of Federal Claims (CFC) to recover the disallowed costs. Pet. App. 54-227, 240-320. In both cases, the CFC focused on the FAR requirements incorporated into petitioner's contract, and the court required petitioner to prove that its costs were reasonable. *Id.* at 142-149, 296-302. In both cases, the CFC upheld in part the DCAA's decision to deny reimbursement, permitting the government to withhold nearly \$30

million of the Tamimi costs and nearly \$6 million of the ABC costs. *Id.* at 14-15, 233. The CFC also found, on a counterclaim asserted by the government, that petitioner was liable for a civil penalty under the Anti-Kickback Act of 1986 (AKA), 41 U.S.C. 51 *et seq.* (2006), based on its employees' acceptance of kickbacks from Tamimi. Pet. App. 217.

b. The court of appeals largely affirmed the CFC's disposition of the Tamimi case. Pet. App. 1-53. As relevant here, petitioner "agree[d] that [it] is entitled to be reimbursed only for its 'reasonable' costs"; that its contract "incorporated, by reference, the cost principles in the FAR"; and that the FAR's definition of "reasonable" costs "govern[ed]" the court's analysis. *Id.* at 16. Petitioner also "admit[ted] that the language" of the FAR "emphasizes" that "reasonableness depends on a *variety* of considerations, *including* but not limited to those listed in" 48 C.F.R. 31.201-3(b). Pet. App. 17 (internal quotation marks and citation omitted).

Petitioner argued that "cost-reimbursement contracts require only that the contractor gives its 'best efforts' when performing," and that all of a contractor's "costs are payable absent gross misconduct or absent arbitrary action or a clear abuse of discretion." Pet. App. 17-18 (internal quotation marks and citation omitted). In rejecting those contentions, the court of appeals observed that "Section 31.201-3 of the FAR affords the reviewing officer or court considerable flexibility in assessing the reasonableness of costs," and that "[t]he words 'arbitrary,' 'gross negligence,' and 'willful misconduct' do not appear in the text" of that provision. *Id.* at 18. The court also found petitioner's position to be "contrary" to the court's "prior

authority,” in which the court had “reasoned that a cost could be ‘unreasonable’ under section 31.201-3 when ‘the contractor overcharged the government for * * * materials.’” *Ibid.* (quoting *Boeing N. Am., Inc. v. Roche*, 298 F.3d 1274, 1281 (Fed. Cir. 2002)). The court noted that petitioner “offers many pages of non-binding law to illustrate the amount of discretion courts have afforded to contractors.” *Ibid.*; see *id.* at 18 n.12. The court observed, however, that petitioner “offers no binding precedent in defense of [its] position that all risk in cost-reimbursement contracting falls on the Government and does not dispute that [it] is entitled to be reimbursed only for its ‘reasonable’ costs.” *Id.* at 18-19.

Turning to the circumstances of the case before it, the court of appeals concluded that the CFC had “applied the correct standard” from the FAR, and that the CFC’s “analysis was consistent with the regulation’s admonition that the reasonableness of specific costs ‘must be examined with particular care’ when the costs incurred ‘may not be subject to effective competitive restraints.’” Pet. App. 19 (quoting 48 C.F.R. 31.201-3(a)). Reviewing the CFC’s factual findings of unreasonableness for clear error, the court upheld all of them, with the exception of one calculation that the government largely agreed had been incorrect. *Id.* at 20-30.

The court of appeals also concluded that the government was entitled to a larger civil penalty than the CFC had awarded for petitioner’s violation of the AKA. Pet. App. 37-44. Judge Newman dissented from that portion of the decision. *Id.* at 49-53.

c. The court of appeals affirmed the CFC’s judgment in the ABC case. Pet. App. 228-239. In that

case, petitioner again “agree[d] that it is bound by the reasonableness standard” provided in the FAR, 48 C.F.R. 31.201-3(b). Pet. App. 234. In addition to raising arguments that had been rejected in the Tamimi case, petitioner argued in the ABC case that, under the FAR, contractor negligence does not provide a basis for declining to reimburse costs, unless the costs are the result of willful misconduct or a lack of good faith. *Id.* at 235.

The court of appeals acknowledged that its decision in the Tamimi case had not resolved all questions concerning the line between reasonable and unreasonable costs. Pet. App. 236. The court concluded, however, that it “need not address to what extent, if any, cost reasonableness under cost-reimbursement contracts may include costs arising out of negligent mistakes, because [petitioner] was grossly negligent as determined by the [CFC].” *Ibid.* Accordingly, the court held that petitioner “d[id] not satisfy the standard [petitioner itself] advance[d].” *Ibid.*

4. The court of appeals denied rehearing en banc in both cases. Pet. App. 321-323, 325-326. It granted panel rehearing in the Tamimi case, however, to amend a portion of its opinion not at issue here. *Id.* at 321-324.

ARGUMENT

Petitioner contends (Pet. 18-28) that the government was required to reimburse it for its disputed costs despite its failure to establish that those costs were reasonable. That contention lacks merit. The decision below is consistent with well-settled law and does not warrant this Court’s review.

1. Provisions of the FAR, incorporated into the contract at issue here, specified that petitioner’s costs

were reimbursable by the government only if they satisfied a “[r]easonableness” requirement. 48 C.F.R. 31.201-2(a)(1); see pp. 2-3, *supra*. The FAR defines a “reasonable” cost as one that, “in its nature and amount, does not exceed that which would be incurred by a prudent person in the conduct of competitive business.” 48 C.F.R. 31.201-3(a). The fact that a cost was actually incurred creates no presumption that it is reasonable, *ibid.*; the FAR provides a nonexhaustive list of factors to be considered in determining reasonableness, 48 C.F.R. 31.201-3(b); and the burden is on the contractor to prove the reasonableness of a cost that is challenged by the government, 48 C.F.R. 31.201-3(a).

The approach required by the FAR, and incorporated into petitioner’s contract here, is both sensible and prudent. As the former Court of Claims observed nearly five decades ago, although cost-plus-award-fee contracts “insulate contractors against risks they could not be expected to bear without setting up extraordinary reserves for contingencies,” a “key drawback[], from the Government’s standpoint, * * * [is] that the contractor ordinarily has little or no financial inducement to economy and efficiency.” *United States Steel Corp v. United States*, 367 F.2d 399, 408 (1966). Accordingly, even at that time, “[i]n many areas, a heavy overlay of governmentally-blessed tests of ‘legitimacy,’ ‘reasonableness’ and ‘allocation’ ha[d] grown up by statute, administrative action, and judicial decision.” *Ibid.* (some internal quotation marks and citation omitted). Without a limitation of that sort, contractors would be free to disregard sound business principles and to pay whatever a subcontractor or other provider might demand, secure in the

knowledge that even profligately incurred expenses would ultimately be paid by public funds. The government legitimately sought to avoid that undesirable result by incorporating a reasonableness requirement into the FAR and by incorporating that requirement into petitioner's contract.

2. In the court below, "[b]oth parties agree[d] that [petitioner] is entitled to be reimbursed only for its 'reasonable' costs," and that the definition of "reasonable" provided in 48 C.F.R. 31.201-3 "govern[ed] the assessment of the reasonableness of [petitioner's] costs." Pet. App. 16. The court of appeals applied that framework to the circumstances here and determined that many of petitioners' costs were unreasonable and therefore not reimbursable. *Id.* at 20-30, 233-238. The court of appeals' application of those particular regulatory and contractual requirements to the facts of these cases does not warrant this Court's review. See Sup. Ct. R. 10 ("A petition for a writ of certiorari is rarely granted when the asserted error consists of * * * the misapplication of a properly stated rule of law.").

Petitioner contends (*e.g.*, Pet. 18) that restricting reimbursement to reasonable costs is contrary to settled law. The petition, however, contains no meaningful discussion of the FAR provisions, incorporated into the contract and relied upon by the court of appeals, that unambiguously required petitioner to prove that its costs were reasonable in order to obtain reimbursement. See 48 C.F.R. 31.201-2, -3. Nor does the petition discuss previous judicial decisions that are consistent with the decisions below. See, *e.g.*, *Boeing N. Am., Inc. v. Roche*, 298 F.3d 1274, 1281 (Fed. Cir. 2002) ("[A] contractor's cost of materials * * *

may be unallowable if it is unreasonable.”) (citing 48 C.F.R. 31.201-2, -3); *Marquardt Co. v. United States*, 822 F.2d 1573, 1578 (Fed. Cir. 1987) (applying regulations that incorporate the FAR to conclude that claimed costs were unreasonable where contractor “d[id] not accord with the prudence required in dealing with the Government and the public at large”); *Ace Constructors, Inc. v. United States*, 70 Fed. Cl. 253, 275 (2006) (discussing reasonableness requirement), *aff’d*, 499 F.3d 1357 (Fed. Cir. 2007); *George Sollitt Constr. Co. v. United States*, 64 Fed. Cl. 229, 245-246 (2005) (same); *Thermalon Indus., Ltd. v. United States*, 51 Fed. Cl. 464, 472 (2002) (same).

Petitioner’s discussion (Pet. 22-23, 25-27) of FAR provisions that are not at issue here, and do not directly address the question of cost reasonableness, does not cast doubt on the application of 48 C.F.R. 31.201-2 and 48 C.F.R. 31.201-3 to the circumstances of this case. It is irrelevant, for example, that the government may enter into a cost-reimbursement contract only when the contractor has an adequate accounting system. 48 C.F.R. 16.301-3(a)(2). That requirement supplements, rather than supersedes, the FAR provisions limiting reimbursement to costs that are reasonably incurred, 48 C.F.R. 31.201-2, -3.

Petitioner cites (Pet. 23-24) various CFC and Armed Services Board of Contract Appeals (ASBCA) decisions as evidence of a supposed “traditional understanding that all costs are reimbursable as long as they were incurred within the scope of the contract.” Those decisions likewise do not address the issue of cost-reasonableness in these circumstances and do not supersede the FAR provisions at issue here. See *Best Foam Fabricators, Inc. v. United States*, 38 Fed. Cl.

627, 640 (1997) (discussing reimbursement for allegedly nonconforming work following constructive termination for convenience); *United Techs. Corp v. United States*, 27 Fed. Cl. 393, 400 (1992) (discussing reimbursement where work was defective); *Morton-Thiokol, Inc.*, ASBCA No. 32,629, 90-3 BCA ¶ 23,207 (similar). The issue of what costs a contractor may recover when its work is deemed inadequate is different from the question presented here, which concerns a contractor's asserted right to pass through to the government costs that are unreasonably high and are the result of a failure to exercise ordinary business prudence.

3. Petitioner suggests (*e.g.*, Pet. 1) that the CFC and Federal Circuit have created a “new, ‘considerable flexibility’ rule” that vests government contracting officers with expansive discretion to disallow costs after the fact. That characterization reflects a misunderstanding of the decisions below.

In the court of appeals, petitioner argued that, in a cost-plus-award-fee contract, “costs are payable absent gross misconduct or absent arbitrary action or a clear abuse of discretion.” Pet. App. 18 (internal quotation marks and citation omitted). In rejecting that argument, the court observed that “Section 31.201-3 of the FAR affords the reviewing officer or court considerable flexibility in assessing the reasonableness of costs,” and that “the words ‘arbitrary,’ ‘gross negligence,’ and ‘willful misconduct’ do not appear in the text” of that provision. *Ibid.* That statement does not adopt an uncabined rule of “considerable flexibility” for contracting officers. Rather, it simply recognizes that determining the reasonableness of a particular cost requires a context-specific inquiry, and that the

particular factors relevant to that inquiry will necessarily vary according to the circumstances. The FAR reflects the same principle by providing that the reasonableness factors it sets forth are not exclusive. See 48 C.F.R. 31.201-3(b).

Petitioner predicts (Pet. 28-33) that the decisions below will substantially impede government contracting. That prediction is unfounded and provides no sound basis for this Court's review. As discussed, the courts below simply applied well-settled cost-reasonableness principles to the facts here, finding in favor of the government in part and in favor of petitioner in part. Petitioner provides no actual evidence to support its hypotheses (see Pet. 31-32) that the decisions below will cause government contracting officers to disallow costs more aggressively or will lead lower courts to find costs unreasonable in other cases.²

Petitioner suggests (Pet. 29-31) that private entities will refuse to enter into cost-plus-award-fee contracts with the government if they are unable to recover costs that contracting officers and courts deem unreasonable. That contention is belied by petitioner's own decision to enter into a cost-plus-award-fee contract that provided for reimbursement only of reasonable costs. Pet. App. 16-19. To be sure, entities that are unwilling or unable to police their own costs

² The suggestion of petitioner's amicus (Nat'l Def. Indus. Ass'n Amicus Br. 10-21) that the decision below indicates a much stricter degree of reasonableness review is likewise unfounded. ASBCA decisions recognizing that reasonableness review is generally deferential (*id.* at 14-15) do not suggest that the lower courts erred in their application of the regulatory reasonableness standard to the particular facts here.

might regard the decision below as a disincentive to government contracting. But to the extent the decision discourages the formation of cost-plus-award-fee contracts with entities whose costs are likely to be unreasonable, that is a natural and intended consequence of the regulatory framework. If the decision more broadly reduces the willingness of private entities to form cost-plus-award-fee contracts with the government, in a manner that significantly hinders the government's ability to procure goods and services, the government can address that problem by changing its contracting practices.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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