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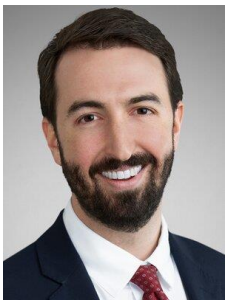
Fed. Circ. Ruling Helps Clarify When Gov't Clawback Is Timely

By **Evan Sherwood and Peter Hutt** (February 20, 2024, 5:31 PM EST)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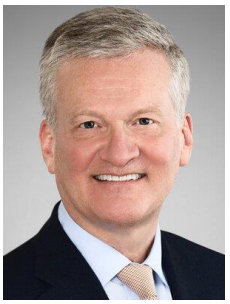
Peter Hutt

A recent decision from the Federal Circuit provides an important reminder that the government can lose its ability to disallow costs if it waits too long to assert a claim.

The U.S. Court of Appeals for the Federal Circuit's Jan. 24 decision in Strategic Technology Institute, Inc. v. Secretary of Defense explored whether a government claim for indirect cost disallowance and penalties was timely filed within six years after the contractor submitted its final incurred cost proposals, or ICPs.[1]

The case was ostensibly a win for the government, because the court found that its claim was timely. However, the decision also provided a victory for contractors, because the court's discussion of the law shows that a government claim for disallowance and penalties should accrue no later than the date of a contractor's ICP.

The decision thus helps to provide a backstop against stale government claims filed more than six years after a contractor submits its ICP.

What Happened in Strategic Technology

Strategic Technology Institute, or STI, performed cost-reimbursement contracts in 2008 and 2009. Under the default rule in Federal Acquisition Regulation 52.216-7, its ICPs were due six months after the end of those fiscal years — i.e., in June 2009 and June 2010, respectively.[2]

STI did not submit its proposals until September 2014, after the Defense Contract Audit Agency noticed the contractor's omission and asked for them.[3]

The Defense Contract Audit Agency then conducted an audit, and the contracting officer at Defense Contract Management Agency issued a final decision in November 2018 that unilaterally established lower rates based on allegedly unallowable costs in the ICPs, and demanded payment of roughly $1.1 million, plus penalties and interest.[4]

On appeal before the Federal Circuit, STI apparently did not argue that its costs were allowable. Instead, STI asserted that the government's claim was too late under the Contract Disputes Act, which provides that a "claim by the Federal government against a contractor relating to a contract shall be submitted within 6 years after the accrual of the claim."[5]

STI argued that the government's claim accrued when STI failed to submit its final incurred cost proposals in June 2009 and June 2010. In short, STI contended that the government had to disallow its costs no later than June 2015 and June 2016, respectively, and that the government's November 2018 claim was, therefore, untimely.

In its opinion, the Federal Circuit rejected STI's statute of limitations defense, holding that the government's claim for unallowable costs and penalties did not accrue until "the submission of STI's cost rate proposals in September 2014."[6]

The court explained that, under FAR 33.201, a claim accrues when "all events ... that fix the alleged liability ... of [a] contractor ... were known or should have been known."

Because the government's claim was "disputing the costs included in STI's final proposals," the court found that the government's claim could not accrue before the contractor filed those proposals with the government. The court found that without the proposals, "the government "had no basis to assert that the specific, final billed costs were not allowable under the contract."[7]

The court observed that other potential government claims, such as a claim for breach of contract based on STI's failure to submit an ICP, could have accrued earlier. But the government had not pursued those claims, so they were not at issue.

Takeaways for Contractors

Timeliness can provide a complete defense.

Strategic Technology serves as a reminder that the government can lose its claim by waiting too long to file. While the contractor's timeliness defense was ultimately rejected by the court, the decision underscores that the government cannot rest on its rights during a multiyear audit.

The court's decision observes that the government did not pursue other claims, such as a breach claim, ostensibly because those claims were untimely when the government initiated the claim process in 2018.

The ICP alone can start the six-year claim period clock.

The Federal Circuit found that the "event that fixed STI's liability is the submission of inadequate cost proposals, not STI's failure to submit proposals on time."[8]

Although the court found in favor of the government on the facts, its finding is favorable for contractors in general because it shows that a government claim for cost disallowance should generally accrue no later than the date on which a contractor submits its ICP.

In some cases, the government has argued that the six-year statute of limitations might start after the ICP is submitted, depending on events during the Defense Contract Audit Agency's audit of the ICP.

But the Strategic Technology decision noted that the government can always "audit the documentation it does have" and determine whether costs are supported on the basis of that documentation.[9] Thus, the key fact was that the government had received the ICP and could begin its audit process.

Tellingly, the Federal Circuit quoted the Armed Services Board of Contract Appeals' January 2022 decision, which had commented that the six-year clock on the government's disallowance claim does not begin "until the contractor submits the incurred cost proposal and makes available sufficient audit records."[10]

The Federal Circuit then proceeded to articulate a narrower statement of the law, showing that the claim period did not depend on what documentation the contractor had made available after submission of the ICP.

In short, if the government asserts a disallowance or penalties claim more than six years after receiving a contractor's ICP, the contractor should closely evaluate whether the claim is untimely under the logic of Strategic Technology.

The knew-or-should-have-known standard controls, but is called into question.

The Federal Circuit reaffirmed its long-standing precedents applying the knew-or-should-have-known standard to determine when a claim accrued. That rule is based on FAR 33.201, which the court described as the governing principle.

However, STI questioned whether that rule should apply, because it does not appear in the plain language of the Contract Disputes Act. According to STI, the U.S. Supreme Court's 2019 precedent-setting decision in Rotkiske v. Klemm may prevent courts from applying a claim discovery rule not stated in the applicable statute.[11]

The Federal Circuit declined to address this argument, on the view that it would not change the outcome of its decision. It remains to be seen whether litigants pursue similar arguments in the future.

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[1] Strategic Technology Institute, Inc. v. Sec'y of Def., __ F.4th __, No. 2022-1763, 2024 WL 253316 (Fed. Cir. 2024).

[2] Id. at *1.

[3] Id. at *2.

[4] Id.

[5] 41 U.S.C. §7103(a)(4)(A).

[6] Strategic Technology Institute, 2024 WL 253316, at *4.

[7] Id.

[8] Id. at *3.

[9] Id. at *5.

[10] Id. at *3 (quoting Strategic Technology Institute., Inc., ASBCA No. 61911, 22-1 BCA ¶38027 (Jan. 6, 2022)).

[11] Id. at *3 n.2 (citing Rotkiske v. Klemm, __U.S. __, 140 S. Ct. 355, 360-61 (2019)).