Equitable Adjustment or Certified Claim?

For non-commercial items, the standard “changes clause” (FAR 52.243-1) allows a federal agency to alter the terms of the contract under certain circumstances. These changes may be formal changes made by a contract modification or change order, or they can be “constructive changes,” which are informal (usually verbal) alterations. For both types of changes, the contractor can submit a request for equitable adjustment (REA), or change order proposal, and recover the cost of the change, plus a fair profit on the changed work.

In lieu of submitting an REA, contractors can submit “claims” under the disputes clause of the contract, which involve either demands for increased compensation for work performed or disagreements over certain contract terms. Claims have to be certified and supported in accordance with the Contract Disputes Act (CDA), as implemented in the disputes clause, if the amount of the dispute is over $100,000. (For Department of Defense contracts, the REA may also require certification.)

The remainder of this update will describe the factors we recommend all companies consider when deciding whether to submit an REA or a claim to the contracting officer. Each of these actions has certain consequences—use of the right process could increase the amount of compensation recovered.

Costing

The FAR cost principles and a number of important federal court cases issued in the late 1990s recognize three distinct categories of legal, accounting, and consulting costs, which can be incurred by government contractors:

1. Costs incurred in connection with the performance of work under a contract,
2. Costs incurred in connection with the administration of a contract, and
3. Costs incurred in connection with the prosecution of a CDA claim.

Costs that fall within the first and second categories are presumptively allowable and recoverable, if they are also reasonable and allocable to the contracts. Costs in the third category are not recoverable. In classifying a particular cost as either a contract administration cost or a cost incidental to the prosecution of a claim, the Boards of Contract Appeal and courts examine the objective reason why the contractor incurred the cost. If the contractor incurred the cost for the general purpose of materially furthering the negotiation process, such costs should be a contract administration cost, allowable under FAR 31.205-33, even if negotiations eventually fail and a CDA claim is later submitted. On the other hand, if a contractor's underlying purpose for incurring a cost is to promote the prosecution of a CDA claim against the government, then such cost is unallowable under FAR 31.205.33 and FAR 31.205.47.

Case Example

In *Hansford T. Johnson v. Advanced Engineering & Planning Corporation, Inc.*, #CIV.A.03-652-A (D.Ct., E.D.VA., Nov. 17, 2003), the court decided an appeal from the Armed Services Board of Contract Appeals (Board). The appeal went to the District Court because the case involved maritime law, over which the Court of Appeals for the Federal Circuit did not have jurisdiction.

The issue was whether the contractor's submission of an REA could include approximately $270,000 in legal and accounting fees for preparing and submitting the REA to the U.S. Navy. The board previously held the contractor could recover its REA preparation costs because the contractor was not to prepare and submit a CDA claim to the contracting officer.

That conclusion followed from this regulatory definition of a claim found in FAR 33.201: A 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 at a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to a contract…, however, a written demand or written assertion by the contractor seeking the payment of money exceeding $100,000 is not a claim under the Contract Disputes Act in 1978 until certified as required by the act and [FAR 33.207].

The court sustained the board's determination that the costs incurred to prepare the contractor's REA were costs incurred in connection with the administration of a con-
tract because they were incurred specifically “for the purpose of seeking a comprehensive resolution of the entire job order, and not for purposes of promoting the prosecution of a claim against the government [emphasis added].”

To decide the case, the court looked at the contractor’s (AEPCO) purpose in preparing and submitting the REA. It found that AEPCO submitted its REA and the parties continued to negotiate about unresolved issues. The court ruled that the board found substantial evidence to conclude that the preparation costs incurred in connection with the REA were directly attributable to contract administration.

**Moral of the Story**

When changes occur to a contract, either actual or constructive, immediate consideration should be given to preparation of an REA. Whether or not to submit the REA will depend upon a number of factors, including the amount of the REA and the value placed on the relationship with the customer. (A previous “Update” discussed the impact on past performance ratings of submitting claims.)

The cost to prepare the REA—including legal and accounting fees—and other reasonable and allocable costs—should be included as a component of the REA. Likewise, all costs incurred from the time of submission of the REA until final resolution should be separately aggregated because these costs also are potentially allowable and recoverable as part of contract administration. It is only when negotiations reach an impasse or too much time has elapsed that a company should consider converting the REA to a CDA claim.

This easily can be done by sending a letter with the proper claim certification. The CDA claim starts the formal disputes progress (i.e., the contracting officer's final decision). It also starts interest running on the claim (no interest is allowed on an REA). We have found, generally, that the amount of preparation costs recovered through an REA exceeds the interest that would have been recovered had the REA been certified as a claim.

**Final Note**

REAs often are submitted after the contract is completed. Although an argument can be made that such an REA still can include legal, accounting, and other consultants’ costs, it is much more difficult to represent that it is for contract administration when the contract is no longer being performed.

Therefore, we recommend that real-time, high-level attention be given to the issues surrounding submission of an REA. CM

---

**About the Author**

ROBERT G. FRYLING, ESQ., FELLOW, is an attorney at Blank Rome in Philadelphia, Pennsylvania. He is president of the NCMA Greater Philadelphia Chapter. Send comments on this article to cm@ncmahq.org.

---