No. 2008-1171

IN THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

PETE GEREN, SECRETARY OF THE ARMY,

Appellant,

v.

TECOM, INC.,

Appellee.

On Appeal from the Armed Services Board of Contract Appeals in No. 53884

BRIEF FOR *AMICI CURIAE* NATIONAL DEFENSE INDUSTRIAL ASSOCIATION AND CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA IN SUPPORT OF APPELLEE TECOM INC.'S PETITION FOR REHEARING *EN BANC*

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CERTIFICATE OF INTEREST

Pursuant to Federal Circuit Rule 47.4, counsel for *amici curiae* certify:

1. The full name of every party represented in this case by the undersigned counsel is: National Defense Industrial Association; Chamber of Commerce of the United States of America.

2. The name of the real party in interest (if the party named in the caption is not the real party in interest) represented by the undersigned counsel is: N/A.

3. All parent corporations and any publicly held companies that own 10 percent or more of the stock of the parties represented by the undersigned counsel are: None.

4. The names of all the law firms and partners or associates who appeared for the parties now represented by the undersigned counsel in the trial court or are expected to appear in this Court are: Karen L. Manos, Christyne K. Brennan, and Dace A. Caldwell, of Gibson, Dunn & Crutcher LLP on behalf of *amici curiae*, and Robin S. Conrad of the National Chamber Litigation Center on behalf of Chamber of Commerce of the United States of America.

DATED: July 13, 2009

By: _____ by Dace Caldwell
Karen L. Manos
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INTEREST OF *AMICI CURIAE*

Amicus National Defense Industrial Association ("NDIA") is a non-partisan, non-profit organization with a membership that includes more than 1,500 companies and over 71,000 individuals. NDIA has a specific interest in government policies and practices concerning the Government's acquisition of goods and services, including research and development, procurement, and logistics support. NDIA's members, who provide a wide variety of goods and services to the Government, include some of the nation's largest defense contractors.

Amicus Chamber of Commerce of the United States of America (the "Chamber") is the world's largest business federation. It represents an underlying membership of more than three million businesses, state and local chambers of commerce, and professional organizations of every size, in every industry sector, and from every region of the country. The Chamber advocates the interests of the national business community in courts across the nation by filing *amicus curiae* briefs in cases involving issues of national concern to American business.

Together, NDIA and the Chamber as *amici curiae* have a significant interest in the correct resolution of *Geren v. Tecom, Inc.*, 566 F.3d 1037 (2009), because their members, and the government contracting community as a whole, will be left with an erroneous and burdensome standard for determining the allowability of a

contractor's costs of defending a private suit if the Court's errors in *Tecom*—which significantly extended the Court's prior errors in *Boeing North American, Inc. v. Roche*, 298 F.3d 1274 (2002)—are not rectified.

Amici curiae submit this brief pursuant to their accompanying motion for leave to file.

ARGUMENT

I. *Tecom* Inflicts Serious Harm On The Government Contracting Industry.

The split panel's decision in *Tecom* creates an untenable standard for all government contractors whereby costs incurred in the defense of any private suit settled before trial are unallowable unless the contractor can prove that the allegations against it had "very little likelihood of success on the merits." This standard penalizes a contractor who has made the prudent business decision to settle a lawsuit by requiring it to satisfy an arduous burden of proof in a forum that has little or no experience determining the merits of various non-government contract claims, such as the Title VII sexual discrimination claim at issue in *Tecom*. In addition, the new standard further exacerbates the Federal Circuit's

errors in *Boeing*, wherein the Court misapplied Federal Acquisition Regulation ("FAR") cost principles.[1]

The proper resolution of *Tecom* and *Boeing* is of exceptional importance and necessary to ensure that there are clear rules on the allowability of legal costs. Indeed, pursuant to the Defense Procurement Improvement Act of 1985, Congress specifically directed that certain categories of costs, including legal services, be clarified to identify those costs which are unallowable. Pub. L. No. 99-145, § 911, 99 Stat. 583, 682 (Nov. 8, 1985). In response, the FAR cost principles governing legal services were amended to "assure consistent treatment of these costs." *Federal Acquisition Regulation*, 51 Fed. Reg. 12,296, 12,298 (Apr. 9, 1986). Now, however, this Court's jurisprudence in *Tecom* and *Boeing* has completely destroyed the clarity provided by the clear and express language of the FAR.

As a result of the significant errors created by *Tecom* and *Boeing*, the will of this Court—not the will of Congress or the FAR Council—will effectively force

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[1] A number of scholars and practitioners have strongly criticized the Court's decision in *Boeing*. *See, e.g.*, Stephen D. Knight, *Federal Circuit Cost Decisions Bode Ill For Contractors*, 39 PROCUREMENT LAWYER 1 (2004); Ralph C. Nash & John Cibinic, *Postscript: Allocability and Allowability of Costs*, 16 NASH & CIBINIC REP. 9, ¶ 45 (2002); Ralph C. Nash & John Cibinic, *Allocability and Allowability of Costs: Viva la Différence*, 16 NASH & CIBINIC REP. 6, ¶ 29 (2002); Karen L. Manos, *The Federal Circuit's Decision in* Boeing North American*: Better, But Still Wrong*, 44 GOVERNMENT CONTRACTOR 21, ¶ 203 (2002).

government contractors to take the expensive and uncertain route of litigating a suit in hopes of a successful result in order to recover legal costs—even when settlement would have been in the best interest of the business and its investors, and even when those costs are expressly allowable by the FAR.

II. *En Banc* Determination Is Necessary To Correct This Court's Errors In *Boeing*.

The panel's decision in *Tecom* illustrates the necessity for the *en banc* Court to revisit the Federal Circuit's legal cost allowability jurisprudence—particularly its decision in *Boeing*, which the *Tecom* majority relied upon and extended.[2]

Significantly, the *Boeing* panel ignored the plain language of the FAR cost principles governing legal costs, choosing instead to create its own rule for the allowability of legal costs incurred in the settlement of private suits. The panel did so by looking to FAR 31.204(c) (now at FAR 31.204(d))—a provision that was not cited by Boeing, the *amicus*, or the Government, and that applies only when an item of cost is *not* covered by FAR 31.205. FAR 31.205, however, specifically covers the costs of legal services in FAR 31.205-33. Nevertheless, the panel acted as though FAR 31.205-33 failed to cover such costs, and instead analyzed the legal

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[2] An *en banc* determination is the proper vehicle for the Court to revisit and correct a prior panel decision that has set forth an erroneous standard of law. *See In re Bilski*, 545 F.3d 943 (Fed. Cir. 2008) (*en banc*) (portions of two prior panel opinions "should no longer be relied upon"), *cert. granted*, 77 U.S.L.W. 3442, 77 U.S.L.W. 3653, 77 U.S.L.W. 3656 (U.S. June 1, 2009) (No. 08-964).

costs at issue to determine whether they were "similar" or "related" to costs for the unsuccessful defense of fraud or criminal actions brought by or on behalf of the Government, which are governed by FAR 31.205-47. The panel should never have performed such an acrobatic analysis, which resulted in the Federal Circuit writing new limits on the allowability of legal costs.[3]

The *Boeing* panel also erred by placing the burden on the contractor to prove that the allegations brought against it had "very little likelihood of success on the merits," when the Government bears the burden of proving a cost is unallowable under a cost principle. *See, e.g.*, *Lockheed-Georgia Co.*, ASBCA No. 27660, 90-3 BCA ¶ 22,957 at 115,276, 1990 WL 133163 (Apr. 26, 1990). To make this showing, a contractor will effectively be forced to try the case that it settled, which is contrary to the purpose of settlement and the policy encouraging parties to resolve lawsuits. The panel also burdened contracting officers and the Armed Services Board of Contract Appeals ("ASBCA") with a new task that they are not well-equipped to do—determining the merits of cases involving issues of law in which they have little or no experience.

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[3] The Court appears to have employed this unfounded analysis in an attempt to conform its holding to the equally erroneous allowability holding of *Caldera v. Northrop Worldwide Aircraft Services, Inc.*, 192 F.3d 962 (Fed. Cir. 1999).

In addition, *Boeing*'s expansion of FAR 31.205-47 to cover "similar" or "related" costs completely ignores the statutory basis for the cost principle, as found in 10 U.S.C. § 2324 and 41 U.S.C. § 256, which are both part of the Major Fraud Act. Those statutes speak to the allowability of legal defense costs where the action *is commenced by the Government* and the contractor is found liable or pleads no contest. Indeed, FAR 31.205-47(c)(2) itself extends beyond the scope of the Major Fraud Act, which was enacted "to protect taxpayers from financing both sides of a lawsuit." *Fluor Hanford, Inc. v. United States*, 66 Fed. Cl. 230, 233 (2005). Where a lawsuit is brought by third-party relators, which the Supreme Court has recognized "are different in kind than the Government," *Hughes Aircraft Co. v. United States ex rel. Schumer*, 520 U.S. 939, 949 (1997), there is no risk that taxpayers will fund both sides of the suit. Because FAR 31.205-47(c)(2) runs beyond the scope of the statutes it implements, it is a "mere nullity," and any reliance the *Boeing* panel placed on it was misplaced. *Manhattan Gen. Equip. Co. v. Comm'r*, 297 U.S. 129, 134 (1936).

For these reasons, Tecom's petition for rehearing *en banc* should be granted so that the Court can revisit and correct the errors in *Boeing*, as well as the new errors created by *Tecom* in reliance on that decision, as discussed below.

III. *En Banc* Determination Is Necessary To Correct This Court's Errors in *Tecom.*

Even if the Court chooses not to correct the errors in *Boeing*, at a minimum, it should address the serious errors committed by the *Tecom* majority.

First, as Judge Lourie recognized in his dissent, the facts in *Tecom* do not justify extending *Boeing* far beyond its holding to reach *all* private settlements. Unlike *Boeing*, the underlying third-party litigation in *Tecom* did not involve direct or indirect allegations of false claims, false statements, fraud or other misconduct against the United States. Dissent at 3-4. *Boeing* was thus irrelevant to the issues in *Tecom*, and the Court's extension of *Boeing* to *Tecom* only compounded the *Boeing* panel's errors.

Second, the *Tecom* majority erred in concluding that costs resulting from breach of a contractual obligation are not allowable costs. In this regard, the panel misread *Dade Brothers, Inc. v. United States*, 325 F.2d 239 (Ct. Cl. 1963). The Court of Claims holding in *Dade* was that the contracting officer properly exercised his discretion to disallow the costs in question, given the nature of the employee allegations of conspiracy and wrongdoing coupled with the findings of the state courts against the contractor. 325 F.2d at 240. *Dade* does not support the view that third-party lawsuits alleging acts that, if proven, would violate the terms of a government contract, create a category of unallowable cost. Indeed, the

allowance in *Dade* of just such costs where the allegations fell short of willful and malicious misconduct refutes any such suggestion.[4]

Third, the *Tecom* majority completely misread the regulatory history of FAR 31.201-2. Its citations to what purport to be the regulatory background of that provision are not that at all, but address the "Allowable Cost and Payment" clause. Op. at 11. The actual regulatory history of FAR 31.201-2 and its predecessors, the Armed Services Procurement Regulation and the Defense Acquisition Regulation, make clear that FAR 31.201-2 does not require that allowable costs be determined by whether the contractor complies with the general terms of the government contract. Rather, the provision was intended to refer to the special contract terms that regulate allowance of costs, in addition to the standard FAR cost principles.[5]

Fourth, the *Tecom* majority erroneously overturned decades of settled law with respect to the allowability of third-party litigation costs and settlement

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4 The contracting officer *approved* reimbursement of the judgment and Dade's associated legal costs related to the portion of the underlying employee litigation alleging violations of the union agreement, but unrelated to the allegations of malice and request for punitive damages.

5 *See Contract Cost Principles*, 34 C.F.R. § 414.201, 14 Fed. Reg. 683, 683 (Feb. 16, 1949); *Contract Cost Principles and Procedures*, 24 Fed. Reg. 10644, et seq., (Dec. 24, 1959); DAR § 15-201.2, *Factors Affecting Allowability of Costs*, published in 32 C.F.R. Part 32 (July 1, 1984).

expenses.[6] One of the clearest statements of the rule that has applied to government contractors for many years was set forth in *Hirsch Tyler Co.*, ASBCA No. 20962, 76-2 BCA ¶ 12,075 at 57,985-86, 1976 WL 2021 (Aug. 23, 1976), which involved a claim of employment discrimination, similar to the sexual harassment claim in *Tecom*. The ASBCA articulated the rule as follows:

> [W]e conclude that an ordinarily prudent person in the conduct of competitive business is often obliged to defend lawsuits brought by third-parties, some of which are frivolous and others of which have merit. In either event, the restraints or requirements imposed by generally-accepted sound business practices dictate that, except under the most extraordinary circumstances, a prudent businessman would incur legal expenses to defend a litigation and that such expenses are of the type generally recognized as ordinary and necessary for the conduct of a competitive business.

Id.[7] Similarly, in *Hayes International Corp.*, ASBCA No. 18447, 75-1 BCA ¶ 11,076, at 52,723-25, 1975 WL 1647 (Jan. 28, 1975), the ASBCA allowed legal costs related to the defense of a suit for employment discrimination. Hayes entered into a consent decree, and the Government claimed that the litigation cost should be disallowed, citing *Dade*. The ASBCA distinguished *Dade*, finding that there

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6 As early as 1943, the Comptroller General recognized that third-party litigation costs and settlement expenses were allowable if necessary to properly conduct business. 23 Comp. Gen. 439 (Dec. 15, 1943).

7 *See also Ravenna Arsenal, Inc.*, ASBCA No. 17802, 74-2 BCA ¶ 10,937, at 52,067-68, 1974 WL 1612 (Oct. 31, 1974) (costs deemed allowable where the contractor had made a prudent business decision to settle rather than litigate two complaints of Title VII employment discrimination).

was no court determination of willful or malicious conduct nor a "firm basis" to conclude that Hayes had violated the Civil Rights Act of 1964. *Id.* at 52,724. It found the costs were of the type generally recognized as ordinary and necessary for the conduct of the contractor's business.

Fifth, in addition to being contrary to law, the *Tecom* majority's extension of *Boeing*'s "very little likelihood of success on the merits" test to third-party litigation is contrary to public policy. As Judge Lourie stated in his dissent:

> Determining the likelihood of success in a law suit is not so easily done. If it were, we would not have so many suits, appeals, and reversals of decisions in our legal system generally. . . . I therefore recoil from judicially extending that difficult-to-apply likelihood of success rule beyond its current borders.

Dissent at 4-5. The application of this outcome-determination test to private party litigation will only discourage settlement, require contractors to incur additional costs and time (intended to be avoided by settlement) to prove the settled suit had very little likelihood of success, and compel contracting officers to make judgments on issues of law in which they have little or no experience.

CONCLUSION

In light of the foregoing, the Court should grant Tecom's petition for rehearing *en banc*.

Respectfully submitted this 13th day of July, 2009.

By _____

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I hereby certify that two true and correct copies of the foregoing Brief For *Amici Curiae* National Defense Industrial Association and Chamber of Commerce for the United States of America in Support of Appellee Tecom Inc.'s Petition for Rehearing *En Banc* were served on counsel for Tecom, Inc. and Pete Geren, Secretary of the Army, on this date by overnight delivery, addressed as follows:

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