VIA EMAIL

Department of Energy Acquisition Regulation
Attn: Ms. Barbara Binney
U.S. Department of Energy
Office of Procurement and Assistant Management, MA-611
1000 Independence Avenue, SW
Washington, DC 20585


Dear Sir or Madam:

On behalf of the Section of Public Contract Law (“Section”) of the American Bar Association (“ABA”), I am submitting comments on the above-referenced Department of Energy Acquisition Regulation (“DEAR”) notice of proposed rulemaking (“NPRM”). The Section consists of attorneys and associated professionals in private practice, industry, and government service. The Section’s governing Council and substantive committees contain members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.¹

The Section is authorized to submit comments on acquisition regulations under special authority granted by the ABA’s Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the ABA and, therefore, should not be construed as representing the policy of the ABA.²

Mary Ellen Coster Williams, Section Delegate to the ABA House of Delegates, Jeri Kaylene Somers, Budget and Finance Officer, and Candida Steel and Anthony Palladino, members of the Section’s Council, did not participate in the Section’s consideration of these comments and abstained from the voting to approve and send this letter.

1 Mary Ellen Coster Williams, Section Delegate to the ABA House of Delegates, Jeri Kaylene Somers, Budget and Finance Officer, and Candida Steel and Anthony Palladino, members of the Section’s Council, did not participate in the Section’s consideration of these comments and abstained from the voting to approve and send this letter.

2 This letter is available in pdf format under the topic Cost Allowability and Cost Accounting at: http://apps.americanbar.org/contract/federal/regscomm/home.html.
I. INTRODUCTION

On April 1, 2014, the Department of Energy ("DOE") issued the subject NPRM with a proposed rule to amend the DEAR to address contractor business systems. The NPRM and the proposed rule mirror, to a large extent, the Department of Defense ("DOD") business systems rule adopted in final as part of the Defense Federal Acquisition Regulation Supplement ("DFARS") in February 2012.\(^3\) For the DFARS rule, the Section provided comments to both an initial proposed rule\(^4\) (comments provided on March 16, 2010) and a revised proposed rule\(^5\) (comments provided on January 10, 2011). Copies of the Section’s comments to the DFARS initial proposed rule and revised proposed rule are attached to this letter as Exhibits 1 and 2, respectively.

Importantly, in addition to the comments unique to the DEAR rule which we provide below, the Section hopes DOE will consider those comments regarding the DFARS rule that also apply to the proposed DEAR rule. These points were not fully addressed in DOD’s implementation of the final DFARS rule, but it is hoped that the DOE will address these issues as they apply to the proposed DEAR rule. See Exs. 1 and 2. In particular:

- The proposed DEAR rule, like the DFARS rule, appears to go beyond protecting the government’s interest and to impose a punitive withholding system, see Ex. 1, March 16, 2010 Comment Letter, § III.A; and

- The government already has numerous other contractual tools available to protect itself from any actual loss associated with business system deficiencies, see Ex. 1 § III.B. The DFARS rule and the proposed DEAR rule, therefore, are unnecessary.

II. COMMENTS

A. The Proposed Rule Risks Duplicative Government Audits and Disparate Contracting Officer Determinations

The background section issued along with DOE’s proposed rule provides that contractors using the same business system for DOD contracts and DOE contracts should provide the results of DOD’s review of their system to DOE.\(^6\) DOE will then coordinate with DOD concerning “use of the business system” for purposes of the DOE

---

The Section agrees that system determinations should be coordinated between government entities to ensure consistency and avoid redundancies.

The Section further recommends that the proposed rule expressly provide that prior business system adequacy determinations, including determinations under separate DOE contracts and/or DOD contracts, apply equally to subsequent DOE contracts and business systems requirements. Under the proposed DOE rule, contractors operating under multiple DOE contracts would be subject to the same system criteria, and the DOD and DOE business systems review criteria also are largely identical. Applying prior affirmative system determinations ensures that the contractor, DOD, and DOE are not each required to expend resources on duplicative system reviews, system determinations, and corrective action. It would also promote consistent application of contractor business system standards across government agencies. While the Section is not commenting here on the DFARS final rule from 2012, the Section believes that providing for reciprocity of DOE business system determinations to DOD contractors would also likely promote efficiency; the Section accordingly urges DOE to discuss and coordinate with DOD.

B. The Proposed Rule’s Unique DOE Disclosure Obligations Impose Undue Burden and Risk; The Disclosure Obligations Should Be Eliminated or Clarified/Narrowed

DOE’s proposed rule requires contractors to make separate business systems disclosures to the DOE Contracting Officer (“CO”) for four of the five business systems covered by the rule. The Accounting System clause, DEAR 952.242-72, the Purchasing System clause, DEAR 952.244-71, and the Property Management System clause, DEAR 952.245-70, each require the contractor within sixty days of award to provide to the CO documentation establishing that each system meets its respective system criteria. The Cost Estimating System clause, DEAR 952.215–71, requires contractors to submit to the CO, also within sixty days of award, documentation of policies, procedures, and practices describing contractor cost proposals in reasonably sufficient detail for the CO to make a judgment regarding the acceptability of the contractors’ estimating practices.

The proposed rule’s disclosure obligations impose a significant burden and expense on contractors to perform separate DOE self-assessments for each of their business systems and provide an accurate and adequate submission to the CO shortly after each DOE contract award that supports each system’s compliance with the system criteria. It is unclear from the proposed rule whether any business systems cost savings are anticipated that could outweigh the significant costs of unique DOE-only contractor self-assessments and reports, particularly because such reporting will necessarily add an

---

7 Id.
8 The Earned Value Management System clause, DEAR 952.234-71, does not include an express disclosure requirement akin to those for the other four systems.
10 79 Fed. Reg. at 18,433.
additional layer of overlapping system surveillance beyond the contractor’s existing internal control and audit processes. Furthermore, the DOD business systems rule, upon which the DOE rule is based, does not currently contain a similar self-reporting requirement. The requirement that contractors self-report concerning system adequacy imposes significant costs and unique compliance risks, threatening to narrow the available pool of potential contractors willing to compete for DOE contracts.

For these reasons, the Section believes the DOE proposed rule’s disclosure requirements should be eliminated. If any final DOE rule nevertheless requires a contractor disclosure of system compliance, the Section urges that the rule be clarified to assist contractors in applying the “significant deficiency” standard to make determinations of system compliance. The rule also should explain the processes contractors should follow when a business system deficiency is identified.

Additionally, the rule’s disclosure obligation should be narrowed to require only that contractors submit to the CO “documentation” for the CO’s own assessment to determine whether contractor systems meet the applicable system criteria. The rule should further explain what information and documentation (e.g., policies, procedures, and internal system review findings) are adequate to support a CO’s system determination. Finally, and perhaps most importantly, any disclosure obligations also should be coordinated with the DOD rule’s requirements to ensure consistency in administration and reporting and to ensure all systems are treated equally.

The proposed rule also contains an ambiguity regarding Earned Value Management Systems in certain contract categories. Regarding cost or incentive contracts and subcontracts valued at $20 million but not exceeding $50 million, the rule states a policy that “the contractor shall conduct a self-certification review by an entity independent of the contractor personnel assigned . . . and provide self-certifying documentation of its EVMS compliance with ANSI/EIA-748.”[11] The implementing clause makes no reference to such a self-certification review or self-certifying documentation. The ambiguity should be corrected by the removal of policy guidance regarding self-certification that the proposed clause does not require.

C. The Proposed Rule Lacks Adequate Contractor Remedy for Improper Withholds; The Rule Should Provide for Expedited Appeal of Adverse System Determinations and Payment Withholdings

DOE’s proposed rule, like the DFARS business systems rule, does not provide for a contractor appeals process that permits expedited and adequate contractor relief from improper adverse system determinations. Contractors faced with a DOE significant deficiency determination and payment withholding instead must assess

---


appeal options under the Contract Disputes Act (“CDA”) or other relevant jurisdictional authorities. Traditional contractor remedies, however, require a lengthy and expensive appeal process, and contractors will often be unable to gain immediate relief while subject to improper payment withholds. Thus, the Section believes that the DOE business systems rule should be revised to include provisions for expedited review of, and contractor relief from, improper adverse system determinations.

This expedited review and relief mechanism should include a process akin to the agency protest procedures detailed in FAR 33.103, whereby a contractor would be permitted to file a timely appeal with a DOE officer at a level or more above the DOE CO who made the determination. Any payment withhold would be stayed pending resolution of the contractor’s appeal. Alternatively, DOE, like DOD, could create a Business Systems Review Panel to review CO significant deficiency findings and ensure the consistent application of business system criteria, and permit contractors a meaningful and expedited opportunity to appear and advocate before the Business Systems Review Panel in advance of any withhold. Such an interim review step ultimately could prove more efficient and efficacious for both the DOE and the affected contractor, by providing the parties the opportunity to clear up and address concerns as early as possible, prior to proceeding to address the matter through a formal CDA or other form of appeal.

D. DOE Should Clarify, and If Necessary Modify, the Proposed Rule’s Applicability to Contracts with Educational and Research Institutions

DOE’s proposed rule prescribes the inclusion of the clause at 952.242-71, Contractor Business System, which provides the key processes for withholding payments to contractors, in certain solicitations and contracts for projects (other than a management and operating contract) unless an exception applies. The proposed rule requires the use of the clause where the prime contract total value exceeds $50 million or when the total contract value exceeds $10 million and the contracting officer determines it to be in the best interest of the government when the resulting contract will be (1) a fixed-price contract awarded to a “large business” or (2) a “covered contract” and any business-systems related clause is included in the solicitation or contract (e.g., Cost Estimating System Requirements, EVMS, Accounting Systems Administration). The proposed rule defines a “covered contract” to be a contract that is “subject to the Cost Accounting Standards.”

The proposed DOE rule includes exceptions for advisory and assistance services and education and training services. The Federal Acquisition Regulation definition of

---

15 79 Fed. Reg. at 18,426 (942.7002). The proposed rule states that “covered contract” is defined “in 942.7001(a),” 79 Fed. Reg. at 18,429 (942.7005), but the definition is at 942.7002.
advisory and assistance services includes certain studies, analyses, and evaluations and engineering and technical services.\textsuperscript{17} But it does not expressly exclude educational and research institutions.

By contrast, DFARS takes a more specific approach regarding excluding educational and research institutions from coverage of its Contractor Business Systems clause, DFARS 252.424-7005. The DFARS rule expressly does not apply to “contracts with educational institutions, Federally Funded Research and Development Centers (FFRDCs), or University Associated Research Centers (UARCs) operated by educational institutions.”\textsuperscript{18}

DOE did not include a similar list of exclusions in DOE’s proposed rule, and the general exceptions that DOE did list may not cover all of the kinds of research or other activities performed by large educational or research institutions under contract with DOE. To prevent any unintended application of the rule, DOE should clarify whether the rule is intended to apply to educational and research institutions. If DOE intends to exclude those or similar institutions excluded under the DFARS rule, it should modify the proposed DEAR rule to include a similar list of exceptions.

\textbf{E. DOE Should Clarify, and If Necessary Modify, the Proposed Rule’s Applicability of Withholdings to Certain Payment Types}

DOE’s proposed rule defines “payment” against which withholding may occur as follows:

(4) For the purpose of this clause, payment means invoicing for any of the following payments authorized under this contract:

(i) Interim payments under—

(A) Cost-reimbursement contracts;

(B) Incentive type contracts;

(C) Time-and-materials contracts; or

(D) Labor-hour contracts.

(ii) Progress payments to include fixed price contracts.

(iii) Performance-based payments to include fixed-price contracts.\textsuperscript{19}

The proposed rule addresses specific types of contracts and payment provisions. It is not clear, however, whether the proposed rule addresses payments on fixed-price contracts where billings occur on an installment or milestone basis. DOE should clarify

\textsuperscript{17} 48 C.F.R. § 2.101.
\textsuperscript{18} 48 C.F.R. § 242.7001.
\textsuperscript{19} 79 Fed. Reg. at 18,436 (952.242–71).
if it intends the withholding to apply to fixed-price contracts that rely on installment or milestone bases as mechanisms for contract financing and billing.

III. **CONCLUSION**

The Section appreciates the opportunity to provide these comments on the proposed rule. The Section is available to provide additional information and assistance as you may require.

Sincerely,

Sharon L. Larkin
Chair, Section of Public Contract Law

cc: Stuart B. Nibley
David G. Ehrhart
James A. Hughes
Jeri Kaylene Somers
Council Members, Section of Public Contract Law
Chairs and Vice Chairs, Accounting Cost and Pricing Committee
Kara M. Sacilotto
Craig Smith
Exhibit 1
March 16, 2010

VIA REGULATORY PORTAL, ELECTRONIC MAIL
And U.S. MAIL

Mr. Mark Gomersall
OUSD (AT&L) DPAP (DARS), IMD
3D139, 3062 Defense Pentagon
Washington, D.C. 20301-3062
Email POC: dfasr@osd.mil

Re: Defense Federal Acquisition Regulation Supplement; Business Systems – Definition and Administration, DFARS Case 2009-D038

Dear Mr. Gomersall:

On behalf of the Section of Public Contract Law of the American Bar Association (“the Section”), I am submitting comments on the above rulemaking Defense Federal Acquisition Regulation Supplement; Business Systems – Definition and Administration. The Section consists of attorneys and associated professionals in private practice, industry, and Government service. The Section’s governing Council and substantive committees have members representing these three segments, to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association’s Board of Governors. The views expressed herein have not been approved by the House of Delegates or the

1 The Honorable Thomas C. Wheeler, a member of the Section’s Council, did not participate in the Section’s consideration of these comments and abstained from the voting to approve and send this letter.
Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.²

I. INTRODUCTION

Over the past two years, contractor business systems have come under increased scrutiny from the Department of Defense ("DoD"), the Senate Homeland Security and Governmental Affairs Committee, and the Commission on Wartime Contracting. Recently, there has been heightened concern over the effectiveness of various DoD components in addressing contractor business system deficiencies and the proper means to compel contractor compliance. The Section understands DoD’s stated purposes underlying this rule, which are to clarify the process for review of business systems and to protect the Government from the risk of unallowable and unreasonable costs resulting from defects in such systems. Nevertheless, for the reasons discussed below, the Section believes the proposed rule is not tailored to address these purposes. As written, the proposed rule is open to legal challenge and is likely to lead to increased litigation and compliance costs. Accordingly, the Section offers these comments to assist DoD with better addressing the purposes of the proposed rule.

II. BACKGROUND

On January 15, 2010, DoD issued a proposed rule to amend the Defense Federal Acquisition Regulation Supplement ("DFARS") with request for comments regarding contractor business systems.³ The proposed rule defines contractor business systems as accounting systems, estimating systems, purchasing systems, earned value management systems ("EVMS"), material management and accounting systems ("MMAS"), and property management systems. The proposed rule also would require Administrative Contracting Officers ("ACOs") to implement payment withholding when contractors’ business systems contain deficiencies. DoD categorized the action as not being a significant regulatory action.

For each of the covered business systems, the proposed rule would add or amend a DFARS contract clause that lists the attributes of an acceptable system. The rule would not change the existing requirements for an estimating system, EVMS, or MMAS. Nevertheless, the rule would create new DFARS contract

² This letter is available in pdf format at: http://www.abanet.org/contract/regscomm/home.html under the topic “Cost Allowability and Cost Accounting.”

clauses prescribing requirements for an accounting system and purchasing system. The rule would require a contractor to “establish and maintain acceptable business systems in accordance with the terms and conditions of the contract.” If the Defense Contract Audit Agency (“DCAA”) or other cognizant functional specialist identified system deficiencies, then the auditor would report the deficiencies to the ACO. The ACO would then notify the contractor of the alleged deficiencies and request a response from the contractor. If, after reviewing the contractor’s response, the ACO determines a business system deficiency exists, the ACO would implement a 10 percent withhold on the contractor’s payments. The ACO must implement such a withhold for each system deficiency. Although the proposed rule generally caps the withhold at 50 percent, the proposed rule specifically provides that the ACO may withhold 100 percent of the contractor’s payments under certain circumstances. The ACO would remove the withholds only after the contractor successfully implements a corrective action plan and has “substantially corrected” the system deficiencies.

III. COMMENTS

A. The Proposed Rule Goes Beyond Protecting the Government’s Interest and Imposes a Punitive Withholding System

The stated purpose of the proposed rule is to “clarify the definition and administration of contractor business systems.” DoD states that “internal controls are the first line of defense against waste, fraud and abuse” and that “[w]eak controls increase the risk of unallowable and unreasonable costs on Government contracts.” The Section agrees with these statements, and we believe the entire procurement community would as well. The Section notes, nevertheless, that the word “risk” in its commonly accepted meaning connotes “a possibility” that a hazard may occur. By the same token, a “first line of defense” against a risk assumes that there are second, and perhaps more, lines of defense against the risk.

In fact, this is precisely the case with respect to contractor business systems. Every government contractor confronts a comprehensive and controlling array of administrative, civil, and criminal penalties, certification requirements, and other compliance mechanisms. There are literally dozens of “lines of defense” that cause prudent contractors to treat unallowable and unreasonable costs properly. These

---

4 Id. at 2457.

5 Id.

6 Whether a cost is “reasonable,” of course, is an issue of subjective judgment. Similarly, with the exception of expressly unallowable costs, parties may disagree on the allowability of a given cost.
existing lines of defense, and their daily results, do not appear to have been considered fully in the proposed rule. Instead, the proposed rule assumes that any deficiency in a business system will immediately and irrevocably cause the Government to be overcharged, thereby justifying the withholding of payments to protect the Government from such overcharging.

The Section believes that the proposed rule would be improved by focusing on the stated goals of the rulemaking and methods more precisely crafted to achieve those goals. The Section also believes that the proper purpose of the proposed rule should be to protect the Government against the risk of unallowable and unreasonable costs, without mandating that ACOs impose punitive withholds.\(^7\)

Furthermore, there is significant doubt that the proposed withholding scheme would survive legal challenge. The longstanding rule applied by the boards of contract appeals has been that Government withholding must be reasonably related to the Government’s potential harm.\(^8\) Moreover, the boards recognize that it is inappropriate to withhold costs as a “club to insure [sic] compliance with demands unrelated to the costs suspended.”\(^9\) For a Government-imposed withhold to bear a reasonable relationship to the Government’s potential risk, therefore, the ACO must make a determination of the potential scope of the Government’s risk.

---

\(^7\) Removing discretion from ACOs regarding the extent of the withhold may also encourage ACOs to disagree with DCAA audit findings regarding real but insignificant system deficiencies. This could hamper the Government’s ability to require correction of minor deficiencies. At the same time, it puts ACOs in a difficult position of potentially imposing a grossly unfair withhold or facing potential referral to the DoD Inspector General for ignoring DCAA’s recommendations. See Defense Contract Management Agency Actions on Audits of Cost Accounting Standards and Internal Control Systems at DoD Contractors Involved in Iraq Reconstruction Activities, Department of Defense Inspector General (Apr. 8, 2009).

\(^8\) See Norair Eng’g Corp., GSBCA No. 3539, 75-1 BCA ¶ 11,062 (1975) (“The amount withheld must be justified by reasonable proof of the costs involved” and even if a precise estimate of future costs is not possible, the amount withheld must be a reasonable measure of the contractor’s actual obligations); Columbia Eng’g Corp., IBCA No. 2352, 88-2 BCA ¶ 20,595 (1988) (Board holds that it was arbitrary and capricious for Government to withhold $50,000 when less than $6,000 was owed in Davis-Bacon Act compliance matter; $50,000 withhold was excessive and unsupported by any reliable evidence of the amount actually owed by the contractor).

\(^9\) Martin Marietta Corp., ASBCA No. 31248, 87-2 BCA ¶ 19,875 (1987) (Board rules that it was “unnecessary, therefore arbitrary and capricious” for Government to withhold from billings the entire cost of contractor’s internal audit department during disagreement over whether contractor was obligated to provide certain records under the audit clause of its contract).
The proposed rule, however, treats all alleged business system deficiencies the same, except for deficiencies which “are highly likely to lead to improper contract payments being made, or represent an unacceptable risk of loss to the Government.” The rule fails to recognize that every business system deficiency is unique in terms of the potential risk to the Government. Because, under the proposed rule, the Government withhold is not reasonably related to the Government’s potential harm, the rule likely would not survive legal challenge.

Moreover, there seems little doubt that the proposed rule is punitive. Under the proposed rule, as much as 100 percent of a contractor’s billings may be withheld. It is impossible to conceive of a situation in which the work performed by a contractor could have no value, or that all of the costs charged would be unallowable or unreasonable, or that the risk to the Government from system deficiencies could amount to the total contract price. Thus, there is a significant likelihood that, if challenged, the proposed rule would not pass muster under longstanding board of contract appeals jurisprudence.

B. **DoD Already Has Numerous Other Contractual Tools Available to Protect Itself From Any Actual Loss Associated With Business System Deficiencies**

The Government already has many contractual tools available to it to address unallowable or unreasonable costs charged by contractors as a result of business system deficiencies. The proposed rule offers no guidance on how the proposed withholding will be used in conjunction with these other existing remedies.

For example, the Allowable Cost and Payment Clause, FAR 52.216-7, states that the contractor may be paid only for amounts “determined to be allowable by the Contracting Officer.” If the Government requires an audit of an interim payment to determine compliance with the contract (which would include the obligation under FAR 52.216-7 to charge only “allowable” costs), the Government is not required to make payment on the questioned invoice until that audit is complete. Thus, the Government already has mechanisms under cost-type contracts to withhold the precise amounts by which any billings may include unallowable costs that could result from a business system deficiency.

Similar tools exist with respect to both interim and final indirect rates. Under FAR 42.704, when establishing interim rates, the Government must already

---

10 75 Fed. Reg. at 2462 (DFARS 252.242-7XXX(d)(4)).
adjust for any unallowable costs, thereby preventing any risk of the sort envisioned by the proposed rule.\textsuperscript{11}

Even more tools exist in the case of final indirect rates. Under FAR 52.242-4, the contractor must certify that all of the costs in its final indirect rate proposal are allowable. Under FAR 52.242-3, the contractor agrees to the imposition of penalties if costs in its final indirect rate proposal are expressly unallowable. These penalties are in addition to disallowance of the underlying cost itself. It is important to note that the penalty scheme already contains a significant inducement for contractors to have adequate business systems because FAR 42.709-5(c)(1) mandates that the contracting officer waive the penalty, \textit{inter alia}, if the contractor demonstrates to the satisfaction of the contracting officer that “[i]t has established policies and personnel training and an internal control and review system that provide assurance that unallowable costs subject to penalties are precluded from being included in the contractor’s final indirect cost rate proposals . . .”

In the case of an estimating system, a deficiency will impact the negotiation of the original price. If the defects were known at the time of the negotiation, then they could have and should have been dealt with in the negotiation. If they were not known, then the Government already has a likely remedy to address its actual harm under the Truth in Negotiations Act, which would allow it to recover the amount by which the negotiated price was overstated due to the deficiency.\textsuperscript{12} If

\textsuperscript{11} See FAR 42.704(b) (“In establishing billing rates, the contracting officer (or cognizant Federal agency official) or auditor should ensure that the billing rates are as close as possible to the final indirect cost rates anticipated for the contractor’s fiscal period, as adjusted for any unallowable costs.”).

\textsuperscript{12} Beyond the Truth in Negotiations Act, the DFARS currently gives the Government tools to address estimating systems deficiencies. DFARS 215.407-5-70 provides, in pertinent part:

\begin{quote}
(1) Field pricing teams will discuss identified estimating system deficiencies and their impact in all reports on contractor proposals until the deficiencies are resolved.

(2) The contracting officer responsible for negotiation of a proposal generated by an estimating system with an identified deficiency shall evaluate whether the deficiency impacts the negotiations. If it does not, the contracting officer should proceed with negotiations. If it does, the contracting officer should consider other alternatives, e.g.—

(i) Allowing the contractor additional time to correct the estimating system deficiency and submit a corrected proposal;

(ii) Considering another type of contract, e.g., FPIF instead of FFP;
\end{quote}
these alternatives do not provide sufficient solutions, then the Government should consider modifying or strengthening the current remedies instead of introducing new remedies.

The withholding authority in the proposed rule overlaps with many of these other clauses, and the proposed rule does not consider how these rules will interact. Notably, the proposed rule provides no guidance to ACOs on whether they should impose a 10 percent withhold in addition to taking the same steps they currently are authorized to take to protect the Government's interests. Because the proposed rule gives ACOs no discretion regarding the withhold, it must be assumed that ACOs will take both actions. This could be especially problematic in situations where the discovery of a business system deficiency leads to the immediate discovery of a contract overcharge. In such a situation, the Government customers will almost certainly demand immediate repayment of the overcharges. Yet, the proposed rule would require the Government to continue imposing a withhold even though the overpayments have already been returned. In such cases, the withhold would serve only punitive purposes.

(iii) Using additional cost analysis techniques to determine the reasonableness of the cost elements affected by the system's deficiency;

(iv) Segregating the questionable areas as a cost reimbursable line item;

(v) Reducing the negotiation objective for profit or fee; or

(vi) Including a contract (reopener) clause that provides for adjustment of the contract amount after award.

(3) The contracting officer who incorporates a reopener clause into the contract is responsible for negotiating price adjustments required by the clause. Any reopener clause necessitated by an estimating deficiency should—

(i) Clearly identify the amounts and items that are in question at the time of negotiation;

(ii) Indicate a specific time or subsequent event by which the contractor will submit a supplemental proposal, including cost or pricing data, identifying the cost impact adjustment necessitated by the deficient estimating system;

(iii) Provide for the contracting officer to unilaterally adjust the contract price if the contractor fails to submit the supplemental proposal; and

(iv) Provide that failure of the Government and the contractor to agree to the price adjustment shall be a dispute under the Disputes clause.
C. **The Proposed Rule Includes Incomplete Definitions of Acceptable Business Systems**

For each of the covered business systems, the proposed rule either defines the elements of an acceptable system or applies the new withholding rule to the existing definitions. The proposed rule lists requirements of a compliant system, but the list of requirements is not exhaustive. For example, the accounting system clause states that the contractor’s accounting system “shall be in compliance with applicable laws and ensure the proper recording, accumulating, and billing of costs on Government contracts, including but not limited to providing, as applicable,” 17 enumerated accounting system elements.\(^\text{13}\) By defining “deficiency” merely as a failure to maintain an adequate system, and listing only certain elements of adequate systems, the proposed rule invites controversy over what constitutes a deficient system.\(^\text{14}\) If the proposed rule, as applied, requires ACOs to impose a 10 percent withhold for a minor deficiency in a sub-element of a listed requirement, the Government could soon be withholding funds from most contractors. At a minimum, the lack of clarity will likely result in disputes and litigation over what a contractor must do to avoid a withhold.

D. **The Proposed Rule Provides Inadequate Contractor Processes for ACO 100 Percent Withholds Based on Elevated Government Risk and Inadequate Guidance for ACO’s to Make 100 Percent Withhold Determinations**

As discussed above in Section II, the proposed rule includes various procedures the ACO must follow before implementing a 10 percent withhold. Under the proposed rule, these same procedures do not apply to ACO decisions to withhold 100 percent of payments based on ACO determinations that business system deficiencies “are likely to lead to improper contract payments being made, or represent an unacceptable risk of loss to the Government.” Rather, ACOs may make 100 percent withhold determinations without any contractor comment. Although the Section understands that in these situations alleged system deficiencies present elevated risk to the Government, the Section still recommends that DoD amend the proposed rule to provide some procedures, even if expedited,

\(^{13}\) 75 Fed. Reg. at 2462.

\(^{14}\) When defining the “deficiency” necessary for Withholds under the proposed rule, drafters should consider that DCAA auditors will be applying the proposed rule in the context of DCAA’s definition of “Significant Deficiencies” contained in DCAA Memorandum 08-PAS-043(R) (Dec. 19, 2008), Subject: Audit Guidance on Significant Deficiencies/Material Weaknesses and Audit Opinions on Internal Control Systems.
that would allow contractors to respond to alleged system deficiencies before withholdings are implemented. The Section believes that this contractor input will assist ACOs in making appropriate withhold determinations.

Compounding this concern, the proposed rule contains no guidance on when business system deficiencies “are highly likely to lead to improper contract payments” or “represent an unacceptable risk of loss.” Thus, the proposed rule provides ACOs insufficient standards to make 100 percent withhold determinations that will significantly impact contractor cash flow. The Section, therefore, recommends that DoD amend the proposed rule to include more guidance on when business system deficiencies “are highly likely to lead to improper contract payments” or “represent an unacceptable risk of loss.”

E. The Proposed Rule Provides Incomplete Guidance for ACOs to Approve Systems When Deficiencies Previously Have Been Identified

The proposed rule provides incomplete guidance for when ACOs should approve a system for which deficiencies previously have been identified. The proposed rule states that ACOs shall approve such a system when they find that “the contractor has substantially corrected the system deficiencies.” Nevertheless, the proposed rule provides no guidance for ACOs to determine when deficiencies have been “substantially corrected.” The Section suggests that deficiencies will have been “substantially corrected” when the risk to the Government of unreasonable and unallowable costs, due to such deficiencies, has been sufficiently mitigated.

F. The Proposed Rule Should Clarify an Appeals Process

As discussed above, the proposed rule provides for an across-the-board withhold of 10 to 100 percent of a contractor’s payments. For any contractor, such a withhold would quickly add up to significant sums. For small businesses, the withholding could be catastrophic. Because the proposed rule requires withhold without regard to Government risk, much of the withheld money would eventually be returned to the contractor. Yet, the rule states that no Prompt Payment Act interest is due on withheld funds.\(^\text{16}\)

\(^{15}\) 75 Fed. Reg. at 2458 (DFARS 215.407-5-70(h)).

\(^{16}\) Id. at 2462.
It is likely that contractors will contest whether their business system is deficient. In the past, such issues were normally addressed through negotiation to an eventual resolution. The proposed rule leaves no room for that process. Under the proposed rule, if confronted by a contracting officer’s final determination and the potential of a withhold, prudent contractors likely would immediately appeal the withhold pursuant to the Contract Disputes Act. Although the proposed rule states that Prompt Payment Act interest does not accrue on the withhold, interest would accrue on the claim under the Contract Disputes Act if the Government’s position is not sustained. Consequently, the proposed rule would likely lead to the replacement of the existing process of negotiation with immediate litigation, significantly increasing the number of contract disputes that proceed to litigation.

G. Any Rule Should Allow For ACO Discretion To Apply or Not Apply A Withhold

If DoD finds that withholding authority is necessary, the Section believes that the more appropriate approach would be to require the ACO first to make a finding of the potential harm to the Government and then impose a withhold proportionate to that risk. This would be similar to the current contracting officer discretion under FAR Part 42 to waive imposition of the penalties for inclusion of unallowable costs in final indirect proposals if certain mitigating factors exist. This would recognize, for example, that some minor deficiencies will not carry any risk of the contractor charging unallowable costs or will only apply to a small portion of the contractor’s business. This would correct the proposed rule’s overly simplistic answer for the many different potential systems deficiencies – a 10 percent, across the board, withhold -- with an appropriately measured response.

Allowing ACOs to exercise discretion is essential for another reason. The proposed rule’s “one size fits all” approach could actually increase the risk to the Government. In some cases, a 10 percent withhold could grossly overestimate the Government’s potential harm. In other cases, 10 percent might not be enough to protect the Government’s interest. Accordingly, the Section recommends that DoD revise the proposed rule to allow ACOs to exercise discretion in determining risk when making withhold determinations.

---

17 Recent DCAA guidance has eliminated DCAA’s prior “inadequate in part” findings. It can be assumed that DCAA will now report all deficiencies, regardless of scope, as system deficiencies under this rule. This will likely lead to ACOs imposing withholds wholly out of line with the sometimes non-existent risk of unallowable costs.
H. The Rule Imposes Potentially Burdensome Requirements on Small and Mid-Sized Contractors

The requirements for business systems contained in the proposed rule, except for EVMS and estimating system requirements, apply to all contractors and contracts, regardless of size. Further, all requirements apply to a variety of types of contracts. Thus, under the proposed rule, small and mid-sized contractors performing a variety of contracts would be required to implement and maintain the same business systems as those systems implemented and maintained by the largest contractors.

For example, under the proposed rule on accounting systems, contractors must maintain “[a] timekeeping system that identifies employees’ labor by intermediate or final cost objectives.”\textsuperscript{18} This requirement may be potentially burdensome on small and mid-sized contractors entering the federal government marketplace and not having sophisticated systems in place. The Section, therefore, recommends that the proposed rule impose reasonable limitations on the applicability of the requirements for contractor business systems based on the size of the contractor or contract. Such limitations would ensure that the proposed rule does not unduly deter small and mid-sized contractors from participating in federal procurements.

IV. CONCLUSION

The Section appreciates that contractor business systems have come under increased scrutiny from Congress and DoD in the past years. These comments seek to identify several areas where the Section believes the proposed rule could benefit from further analysis and clarification. The Section respectfully requests that DoD consider the issues identified in these comments in developing a revised DFARS rule that better matches the rule’s stated goals while ensuring fair payment to contractors.

\textsuperscript{18} 75 Fed. Reg. at 2462 (DFARS 252.242-7YYY(c)(9)).
The Section is available to provide additional information or assistance as you may require.

Respectfully submitted,

Karen L. Manos,
Chair, Section of Public Contract Law

cc: Donald G. Featherstun
Carol N. Park Conroy
Mark D. Colley
David G. Ehrhart
Allan J. Joseph
John S. Pachter
Michael M. Mutek
Patricia A. Meagher
Council Members, Section of Public Contract Law
Chairs, Accounting Cost and Pricing Committee
Kara M. Sacilotto
Exhibit 2
VIA REGULATORY PORTAL, ELECTRONIC MAIL, and U.S. MAIL

Defense Acquisition Regulations System
Attn: Mr. Mark Gomersall
OU5D (AT&L) DPAP/DARS
Room 3B855, 3060 Defense Pentagon
Washington, DC 20301–3060
Email POC: dfars@osd.mil

Re: Defense Federal Acquisition Regulation Supplement
Business Systems – Definition and Administration

Dear Mr. Gomersall:

On behalf of the Section of Public Contract Law (the “Section”) of the American Bar Association (“ABA”), I am submitting comments on the above-referenced rulemaking: Defense Federal Acquisition Regulation Supplement; Business Systems – Definition and Administration, DFARS Case 2009-D038, 75 Fed. Reg. 75550 (Dec. 3, 2010).¹ The Section consists of attorneys and associated professionals in private practice, industry, and Government service. The Section’s governing Council and substantive committees have members representing these three segments, to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

¹ The Honorable Thomas C. Wheeler, a member of the Section’s Council, did not participate in the Section’s consideration of these comments and abstained from the voting to approve and send this letter.
The Section is authorized to submit comments on acquisition regulations under special authority granted by the ABA’s Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the ABA and, therefore, should not be construed as representing the policy of the ABA.²

I. INTRODUCTION

On January 15, 2010, the Department of Defense (“DoD”) issued a proposed rule (the “Initial Proposed Rule”) to amend the Defense Federal Acquisition Regulation Supplement (“DFARS”) with request for comments regarding contractor business systems.³ The Section provided comments to the Initial Proposed Rule in a March 16, 2010 letter, a copy of which is attached to this letter as Exhibit 1. On December 3, 2010, DoD issued a revised proposed DFARS business systems rule (the “Revised Proposed Rule”), again requesting comments.⁴ The Section provides these additional comments on the Revised Proposed Rule.

II. COMMENTS

The Section appreciates DoD’s efforts to revise the Initial Proposed Rule in response to comments submitted by the Section and other interested parties. In particular, the Section acknowledges as a positive development DoD’s removal from the rule of the potential 100 percent withholding provision based on elevated Government risk. In addition, the Section appreciates the addition of thresholds designed to limit the impact of the rule on small and mid-sized contractors. Although these revisions are positive developments, the Section continues to believe that the rule, even as revised, is open to legal challenge and is likely to lead to increased litigation and compliance costs.

The Section’s continuing concerns are outlined in more detail in our March 16, 2010 submission (Exhibit 1). Although this letter incorporates our prior

---

² This letter is available in pdf format at: http://www.abanet.org/contract/federal/regscomm/home.html under the topic “Cost Allowability and Cost Accounting.”


comments in full, it does not restate them here. We reiterate those comments and
wish to draw attention to the following issues, in particular:

- The Revised Proposed Rule goes beyond protecting the
  Government’s interest and imposes a punitive withholding system;
- DoD already has numerous other contractual tools available to
  protect itself from any actual loss associated with business system
deficiencies. Furthermore, based on the existing regulatory regimes
related to these business systems, the Revised Proposed Rule is
unnecessary; and
- The Revised Proposed Rule includes incomplete and ambiguous
  definitions of acceptable business systems.

II. CONCLUSION

The Section appreciates DoD’s efforts to revise the business systems rule
and commends DoD for several positive revisions. In finalizing the DFARS
business systems rule, the Section respectfully requests that DoD further consider
the issues identified in this letter and discussed more fully in the Section’s initial
March 16, 2010 comments.

The Section appreciates the opportunity to provide these comments and is
available to provide additional information or assistance as you may require.

Respectfully submitted,

Donald G. Featherstun
Chair, Section of Public Contract Law

Attachment

cc: Carol N. Park Conroy
Mark D. Colley
Sharon L. Larkin
David G. Ehrhart
Council Members, Section of Public Contract Law
Chairs, Accounting Cost and Pricing Committee
Kara M. Sacilotto