



# ACQUISITION LETTER

This Acquisition Letter is issued under the authority of the Senior Procurement Executives of DOE and NNSA. It is intended for use by procurement professions of DOE and NNSA, primarily Contracting Officers, and other officials of DOE and NNSA that are involved in the acquisition process. Other parties are welcome to its information, but definitive interpretations of its effect on contracts, and related procedures if any, may only be made by DOE and NNSA Contracting Officers.

**Subject:** Allowability of Contractor Litigation Defense and Settlement Costs

**References:**

FAR 31.205-47            Costs related to legal and other proceedings.

**When Is this Acquisition Letter (AL) Effective?**

This AL is effective immediately upon issuance.

**When Does this AL Expire?**

This AL remains in effect until superseded or canceled.

**Who Is the Intended Audience For this AL?**

Department of Energy (DOE) and National Nuclear Security Administration (NNSA) Contracting Officers who are responsible for determining the allowability of contractor litigation defense and settlement costs are the audience for this AL.

**Who Is the Point of Contact For this AL?**

DOE Contracting Officers may contact Michael Righi of the Contracts and Financial Assistance Policy Division, Office of Policy, Office of Acquisition and Project Management at (202) 287-1337 or at [Michael.Righi@hq.doe.gov](mailto:Michael.Righi@hq.doe.gov). NNSA Contracting Officers may contact Linda Jordan, Strategic Initiatives Branch, Acquisition Management Division at (202)-586-7446 or at [linda.jordan@nnsa.doe.gov](mailto:linda.jordan@nnsa.doe.gov).

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## **What is the Purpose of this AL?**

This AL provides guidance to Contracting Officers on allowability of contractor litigation defense and settlement costs in light of Secretary of the Army v. Tecom, 566 F.3d 1037 (Fed. Cir. 2009) (<http://www.caafc.uscourts.gov/images/stories/opinions-orders/08-1171c.pdf>) (“Tecom”). The guidance applies to legal costs related to allegations of discrimination where the discrimination is prohibited by the terms of the contract, such as those covered by FAR 52.222-26 (Equal Opportunity), FAR 52.222-35 (Equal Opportunity for Veterans), and FAR 52.222-36 (Affirmative Action for Workers With Disabilities).

## **What Types of Contracts Are Affected By This AL?**

This AL affects all contracts, both management and operating (M&O) contracts and non M&O contracts. Specifically, it affects cost-reimbursement contracts and any other contracts that provide for either reimbursement of contractor legal costs or for consideration of proposed legal costs in establishing the contracts’ prices.

## **What is the Background?**

Tecom addresses the allowability of contractor costs associated with defense and settlement of legal claims brought against a contractor by a third party. Tecom, Inc. was awarded a negotiated cost-reimbursement contract for military housing maintenance. The contract contained various FAR clauses, including FAR 52.222.26 (Equal Opportunity). During the contract period, a former employee sued Tecom under Title VII of the Civil Rights Act of 1964 (“Title VII”), alleging sexual harassment and retaliation for filing a harassment charge. Tecom incurred more than \$96,000 in legal bills defending the case. It settled the plaintiff’s claims for \$50,000. Tecom sought reimbursement from the Army for \$146,000 in defense and settlement costs as a direct cost under the contract. Tecom contended that it had not violated the law; that the former employee’s allegations were false; and that taking the case to trial would have cost approximately \$300,000. The Army Contracting Officer found Tecom’s defense and settlement costs unallowable, and Tecom appealed the decision to the Armed Services Board of Contract Appeals (“Board”). The Board found for Tecom, and the Army appealed to the United States Court of Appeals for the Federal Circuit.

The Federal Circuit reversed the Board and rejected Tecom’s claims that the costs were allowable. In doing so, the court made two rulings, each of which has significance for Contracting Officers’ allowability decisions.

First, the Federal Circuit held that a contractor’s costs associated with an adverse judgment involving claims under Title VII are not allowable: a trial verdict that the contractor violated Title VII means the contractor breached FAR 52.222-26’s prohibition on discrimination on the basis of race, color, religion, sex, or national origin. Because costs are allowable only when they comply with the terms of the contract, and FAR clause 52.222-26 was a term of the contract, costs associated with a Title VII violation (including defense costs and any damages awarded by the court) are unallowable.

Second, the Federal Circuit held more broadly that the rule against reimbursing contractors for discriminatory conduct goes beyond trial verdicts; under Tecom, the rule also applies to settlements in

certain circumstances. The Federal Circuit was concerned that a contractor that violated Title VII might try to avoid application of the rule against allowability by simply settling the matter before a trial verdict in the plaintiff's favor. Thus, the court held that, where a contractor settles a Title VII case before judgment, the costs of litigation are allowable only if plaintiff's claims had "very little likelihood of success on the merits."

Significantly, the Federal Circuit did not define "very little likelihood of success," but instead adopted the standard based on the FAR's treatment of legal costs associated with contractor defense of third-party False Claims Act suits. In those cases, FAR 31.205-47(c)(2) provides that costs may be allowed where "the contracting officer, in consultation with his or her legal advisor, determines that there was very little likelihood that the third party would have been successful on the merits." This AL provides guidance on how Contracting Officers may best determine whether a plaintiff's claim had very little likelihood of success on the merits.

In sum, the court made two holdings regarding allowability of costs associated with defense and settlement of legal claims brought against a contractor. First, costs associated with defense of a claim alleging actions that violate anti-discrimination prohibitions in the contract are unallowable if a court renders a judgment in the plaintiff's favor. Second, if the contractor settles such a claim before judgment is reached, the costs of defending the claim and of the settlement are only allowable where the Contracting Officer determines that the plaintiff's claim had very little likelihood of success on the merits.

### **What is the Guidance contained in this AL?**

The Federal Circuit's allowability limitations in Tecom apply to all Department contracts, including M&O contracts that provide for reimbursement of legal costs. The limitations apply to legal costs related to allegations of discrimination where the discrimination is prohibited by the terms of the contract, such as those covered by FAR 52.222-26 (Equal Opportunity), FAR 52.222-35 (Equal Opportunity for Veterans), and FAR 52.222-36 (Affirmative Action for Workers With Disabilities).

#### Allowability after Adverse Judgment

DOE will not reimburse contractors for any legal defense costs or damages awards incurred where, following trial, a contractor is found to have engaged in discriminatory conduct where the discrimination is prohibited by the terms of the contract, such as those covered by FAR 52.222-26 (Equal Opportunity), FAR 52.222-35 (Equal Opportunity for Veterans), and FAR 52.222-36 (Affirmative Action for Workers With Disabilities) because those costs are unallowable.

#### Allowability of Settlement-Related Costs

Where a contractor requests reimbursement of legal costs associated with a settlement agreement (including legal defense costs, settlement awards, or both), the Contracting Officer must analyze the facts underlying the plaintiff's claim and determine whether the plaintiff's claims had more than very little likelihood of success on the merits. If the plaintiff's claim had more than very little likelihood of success on the merits, defense and settlement costs related to the claim are not allowable. Where the plaintiff's claim had very little likelihood of success on the merits, the defense and settlement costs

related to the claim are allowable if the costs are otherwise allowable under the contract (i.e., reasonable, allocable, etc.).

The Contracting Officer's decision must be in writing.

In determining whether a plaintiff's claim had very little likelihood of success on the merits (and thus the contractor's legal costs associated with a settlement agreement are allowable), Contracting Officers shall be guided by the following principles:

First, because the Contracting Officer's decision must be based on an assessment of the facts of the claim, the Contracting Officer in consultation with his or her Department Counsel must request the contractor to submit the necessary information to assist the Contracting Officer's decision making. Department Counsel is defined in 10 C.F.R. part 719 as the attorney in the DOE or NNSA field office, or Headquarters office, designated as the contracting officer's representative and point of contact. The contractor must provide a written rationale for asserting that the plaintiff had very little likelihood of success on the merits, including specific supporting information. The rationale should include a description of all claims and procedural actions in the case, and should append a copy of the Complaint and Answers, including title and docket numbers, any pre- or post-Complaint demand letters from plaintiff's counsel, the settlement agreement or proposed settlement agreement, and any other information the contractor wants DOE/NNSA to consider. The Contracting Officer may request any additional information he/she deems necessary to evaluate whether the claim has very little likelihood of success on the merits, including motions for summary judgment and responses to such motions. The contractor is solely responsible for ensuring that it submits in a timely manner all information that the Contracting Officer requests.

Second, in the Contracting Officer's determination as to whether a claim has very little likelihood of success on the merits, the Contracting Officer, in consultation with his or her Department Counsel, and, where appropriate, the Deputy General Counsel for Litigation and Enforcement, or NNSA General Counsel, is to examine claims with an objective view of the facts surrounding the claim. Settlement costs may be determined to be allowable where an objective review of the claim results in a determination that the claim had very little likelihood of success on the merits.

The Federal Circuit in Tecom was concerned about the government reimbursing contractors for conduct where there was significant proof of discriminatory conduct; in other words, the court was focused on the actual, objective conduct of the contractor. Some settlements are appropriate and prudent because, as a matter of fact, it is unlikely that the plaintiff's allegations are true but, for reasons other than the actual, factual merits of the case, there is a risk that a jury might reach a verdict in the plaintiff's favor. While exogenous circumstances not related to the actual facts of a claim or the actual conduct of the contractor may support a decision to settle a claim, such circumstances are not relevant to determining whether the contractor engaged in discriminatory conduct and should not be considered in the objective review of the merits of a claim under this guidance.

Although Department Counsel and, as applicable, the Deputy General Counsel for Litigation and Enforcement, or NNSA General Counsel, provide counsel to the Contracting Officer regarding whether a claim has very little likelihood of success, ultimately, the Contracting Officer makes the final written determination.

Questions and Answers:

**Question 1: What types of contract are affected by this AL?**

Answer 1: This AL affects all cost-reimbursement contracts and any other contracts that provide for either reimbursement of contractor legal costs or for consideration of proposed legal costs in establishing the contracts' prices. For example, this AL affects contracts that include both fixed-price and cost-reimbursable line items where legal costs are included as reimbursable items. This AL also covers time and materials contracts where the materials portion of the contract permits reimbursement of legal costs. This AL affects cost-reimbursement contracts and fixed-price contracts to the extent the costs the AL addresses could be included in the contractors' prices, e.g., sole source firm-fixed-price contracts whose prices are based on the contractors' proposed estimated costs.

**Question 2: Does this AL apply to M&O contracts?**

Answer 2: Yes. This guidance applies to M&O contracts and non-M&O contracts where legal costs are allowed as reimbursable costs or considered in establishing prices. The Department has carefully considered the information submitted by M&O contractors and others regarding this issue and has concluded that the Tecom holding applies to M&O contracts.

**Question 3: Does this AL apply to legal claims brought against a contractor in State court or under State laws?**

Answer 3: Yes. This AL applies to all legal costs related to allegations of discrimination where the discrimination is prohibited by the terms of the contract, such as those covered by FAR 52.222-26 (Equal Opportunity), FAR 52.222-35 (Equal Opportunity for Veterans), and FAR 52.222-36 (Affirmative Action for Workers With Disabilities).

**Question 4: What if a settlement involves claims that, if proven, would demonstrate violation of the requirements of a contract clause prohibiting a contractor from engaging in discrimination in addition to other claims?**

Answer 4: If the settlement involves claims that, if proven, would demonstrate violation of the requirements of a contract clause prohibiting a contractor from engaging in discrimination, such as Title VII claims, affirmative action for workers with disabilities or equal opportunity for veterans, analogous state-law discrimination claims alleging discrimination on the basis of race, color, religion, sex, or national origin, the likelihood of success on the merits analysis will be performed only for the portion of the litigation pertaining to the discrimination claims, not considering any other causes of action included in the case. If the discrimination claims had more than a very little likelihood of success on the merits and settlement payments and associated costs can be apportioned to those claims, the costs (determined by the Contracting Officer) related to the discrimination claims, may be unallowable. Contracting Officers must follow the requirements set forth above regarding consultation with Department Counsel and send information related to the entire settlement to Department Counsel for review. The Contracting Officer will determine what costs are allowable.

**Question 5: Is there a reporting requirement for Department Counsel related to Tecom determinations?**

Answer 5: For purposes of tracking Department-wide litigation efforts, Department Counsel will provide on a quarterly basis to the Deputy General Counsel for Litigation and Enforcement and the NNSA General Counsel a summary of all instances where they have provided advice to Contracting Officers regarding a plaintiff's likelihood of success on the merits in accordance with this AL. Department Counsel will continue to comply with any other requirements concerning headquarters review of settlements, and are invited to consult with the Deputy General Counsel for Litigation and Enforcement or the NNSA General Counsel even where headquarters review is not required.

**Question 6: Does the Tecom holding apply to costs associated with all claims arising under the contract?**

Answer 6: No. The Department will only apply the Tecom holdings to legal costs related to allegations of discrimination where the discrimination is prohibited by the terms of the contract, such as those covered by FAR 52.222-26 (Equal Opportunity), FAR 52.222-35 (Equal Opportunity for Veterans), and FAR 52.222-36 (Affirmative Action for Workers With Disabilities).

**Question 7: Who is Department Counsel?**

Answer 7: Department Counsel, as defined in 10 C.F.R. part 719, is the attorney in the DOE or NNSA field office, or Headquarters office, designated as the contracting officer's representative and point of contact for a contractor for legal management issues.

**Question 8: When the contractor shares documents and other information with Department representatives pursuant to the direction in the AL, does the parties' common interest in the outcome of the litigation protect the communications from disclosure to third parties?**

Answer 8: This issue is addressed in 10 C.F.R. §719.8, which became effective on July 2, 2013. Generally, where the contractor shares such documents pursuant to the direction of the AL and the documents constitute attorney work product and/or involve attorney client communications, it is DOE's view that there is no waiver of privilege of these documents. However, whether the Department's and contractor's interests are sufficiently aligned to prevent waiver of the underlying privilege is an analysis that will be performed by a court of competent jurisdiction if the issue arises.