Claim Quantum and Audit Issues

Breakout Session #: B06
Timothy Overman & Tanner Courrier

Date: Monday, July 25
Time: 2:30pm–3:45pm
Timothy Overman

- Tim Overman is Managing Vice President of the Dallas office of The Kenrich Group LLC. He has over 25 years of experience in engineering, construction, and litigation consulting. Tim specializes in the investigation of financial, regulatory, causation and project scheduling issues, primarily related to construction and government contracting businesses. Mr. Overman has presented his findings and conclusions in negotiations, mediations, arbitrations, depositions and at trial.

- Mr. Overman has assisted construction and government contracting clients on matters involving: (1) regulatory consulting on allowable costs issues and the allocation of costs to various overhead pools; (2) Truth In Negotiations Act (TINA) consulting related to what costs were billed to the government; (3) False Claim Act consulting related to improper billings to the government; (4) consulting on changed work and delay issues and preparation of Request For Equitable Adjustments (REAs) submissions to various government agencies; and (5) dispute resolution services involving meeting and negotiating with government officials, including auditors, and presentations at mediations, arbitrations and trial.
Tanner Courrier

- Tanner Courrier is a Principal in the Dallas office of The Kenrich Group ("Kenrich"). He is experienced in critical path method ("CPM") schedule analysis and analysis of economic damages, primarily focused in the construction and government contract industries.

- Tanner prepares and analyzes claims arising from a variety of issues including: delays, cost overruns, productivity loss, disruption, force majeure events, design errors and omissions, environmental restrictions, and other impacts. Tanner performs detailed CPM schedule analysis and cost analysis in both preparation and rebuttal of delay and cost overrun claims.

- Tanner works with owners, architects, engineers, construction and government contractors, utility service companies, government agencies, and others. He works with client personnel and counsel to prepare analyses, presentations, and expert reports to assist in various dispute resolution settings including: mediation, arbitration, and trial.

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Table Of Contents

- Overview
- Claims And Damages Theory
- Case Example
- Government Contract Considerations
- Summary And Recommendations
Overview

• Claim: A Written Demand Or Written Assertion By One Of The Contracting Parties Seeking, As A Matter Of Right, The Payment Of Money In A Sum Certain, The Adjustment Or Interpretation Of Contract Terms, Or Other Relief Arising Under Or Relating To The Contract

• Quantum: A Required Or Allowed Amount, Especially An Amount Of Money Legally Payable In Damages

• Audit: An Official Examination And Verification Of Accounts And Records, Especially Of Financial Accounts
Dealing With The Federal Government

• “Contracting with the federal government is like dancing with a gorilla. With very few exceptions, you dance the way the gorilla wants to dance and if you don’t do what the gorilla wants, things can get ugly very quickly”

James F. Nagle
Federal Government Construction Contracts
Avoiding Claim Pricing Issues: Daewoo v. United States

- Development Of Daewoo’s Certified Claim
- Submits REA Of $13.4 Million In “Incurred Damages,” And Additional Costs Of $50 Million Not Yet Incurred
- REA Was Ultimately Denied By The CO
- Daewoo Updated/Repriced The REA And Re-submitted It As A Certified Claim, Which Included A Measured Mile Study Of $42 Million
Daewoo Court Findings

- Problems With The Claim Included:
  - Lack Of Verification Or Investigation Into Inconsistencies In Daewoo’s Supporting Documentation
  - Measured Mile Analysis Was Based On “Arbitrary” Selection Of Productive And Non-productive Penalties

- Court Assesses Penalty Of $50 Million To Daewoo
Table Of Contents

➢ Overview
➢ Claims And Damages Theory
➢ Case Example
➢ Government Contract Considerations
➢ Summary And Recommendations
Requirements For Claims

Liability → Causation → Damages
Liability

• The State Of Being Legally Responsible For Something: The State Of Being Liable For Something

• Something (Such As The Payment Of Money) For Which A Person Or Business Is Legally Responsible

• Someone Or Something That Causes Problems
Types Of Problems

- Changes In Scope Of Work
- Changes In Quality Of Work
- Changes In Time To Perform Work
- Obstacles To Efficiently Performing The Work
WHAT DOES THE CONTRACT SAY!!!
Identification Of Potential Liability Issues

- Formal Changes
  - Unilateral Customer Directives
- Constructive Or Informal Changes
  - Customer Suggestions Or Preferences
- Unreasonable Interpretations Of Contract By Customer
- Customer Guidance To Engineers
Requirements For Claims

Liability

Causation

Damages
### Examples Of Causation

<table>
<thead>
<tr>
<th>Change / Cause</th>
<th>Possible Effects</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Increased Scope Of Work</td>
<td>• Increased Labor, Material, Time Of Performance. Decreased Efficiency</td>
</tr>
<tr>
<td>• Increased Quality Requirements</td>
<td>• Increased Inspections And Time Of Performance, Rework</td>
</tr>
<tr>
<td>• Change In Time Of Performance</td>
<td>• Increased Time-Related Costs</td>
</tr>
<tr>
<td>- With Schedule Extension</td>
<td>• Overtime Costs, Additional Management, And Labor Inefficiencies</td>
</tr>
<tr>
<td>- Without Schedule Extension Acceleration</td>
<td>• Delays, Acceleration, And Inefficiencies</td>
</tr>
<tr>
<td>• Obstacles To Efficiently Performing The Work</td>
<td></td>
</tr>
</tbody>
</table>
Requirements For Claims

Liability

Causation

Damages
Recognized Claims And Damages

Theory: “Three Column Approach”

- Critical Path Schedule
- Measured Mile
- Industry Studies
- “Should-Have-Been” Estimates
- Expert Opinion
Claim Methods

Actual Costs

- Total Cost Claim (Entire Overrun)
- Modified Total Cost Claim
- Contractor Inefficiencies
- Not Claimed
- Build Up Claims
- Not Claimed

- Change Orders
- Change Orders
“Sanity Check”

- Overrun
- Claimed
- Not Claimed
- Claimed (Entire Overrun)
- Claimed (More Than Entire Overrun)
Claims Pricing Techniques

- Total Cost
- Modified Total Cost
- Detailed Cost Build-Up

Level Of Detail
Recovery Percentage
Preparation Cost
Total Cost Method Requirements

• Courts/Boards Have Required Contractors To Establish Four Elements Prior To Using The Total Cost Method To Calculate Quantum:
  1. Nature Of Losses Make It Impossible/Impracticable To Determine Them With A Reasonable Degree Of Accuracy (i.e., Other Methods Of Proof Not Available);
  2. Bid Estimate Was Realistic;
  3. Actual Costs Were Reasonable; And
  4. Contractor Was Not Responsible For Additional Costs.
Modified Total Cost Claims

- MTC Claims Are Less Aggressive And Generally More Precise Than Total Cost Claims In That They Account For Some Liability Of The Claimant
- MTCs Are Still Developed Using A Top-down Or Deductive Methodology
- Be Sure To Document And Adequately Support Adjustments Made To The Claim Baseline
Modified Total Cost Approach

• Favored Over Total Cost Approach – More Accurately Quantifies Owner Responsible Costs
  • Original Bid Adjusted For Errors And Omissions
  • Cost Growth Adjusted For Contractor Inefficiencies And Unclaimable Costs
Detailed Cost Buildup Approach

• Highest Recovery Percentage For Claimed Amounts

• Claim Preparation Can Be Time And Resource Intensive

• Difficult To Account For Entire Cost Growth
Observations On The Detailed Cost Buildup Approach

• Customers And Courts Strongly Prefer Detailed Cost Build-Up Method
• Significant Up Front Preparation Effort, But Often The Least Costly Method In The Long Run
• Faster Settlement (Less Customer Resistance)
• Generally Higher Recovery Percentage Than Total Cost Or Modified Total Cost Methods
Approaches To Detailed Cost Buildup

- Discrete Cost Claims
- Delay And Acceleration Claims
  - Field Office Overhead
  - Home Office Overhead
- Cost Escalation
- Maintenance Of Facilities
- Protection Of Work
- Loss Of Efficiency Claims
Table Of Contents

- Overview
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Case Example: Summary

- A State Department Of Transportation ("DOT") hired a contractor to perform roadway construction on a 10 mile stretch of Interstate Highway.
- Firm-Fixed Price Contract with a contract value of $16 Million.
- The project was delayed approximately 2 years.
- The contractor submitted delay claims alleging excessive changes, defective plans, and State DOT’s interference.
- The contractor also submitted several discrete damages claims related to quantity overruns, subcontractor cost overruns, and State DOT requirements.
### Case Example: Damages Summary

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Discrete Damages Claims</strong></td>
<td></td>
</tr>
<tr>
<td>Quantity Overrun</td>
<td>$500,000</td>
</tr>
<tr>
<td>Subcontractor Cost Overruns</td>
<td>2,400,000</td>
</tr>
<tr>
<td>State DOT Requirements</td>
<td>800,000</td>
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<tr>
<td><strong>Time-Related (Delay) Damages Claims</strong></td>
<td></td>
</tr>
<tr>
<td>Supervision Labor (700 x $2,286)</td>
<td>$1,600,000</td>
</tr>
<tr>
<td>Equipment (700 x $1,100)</td>
<td>770,000</td>
</tr>
<tr>
<td>Other General Conditions (700 x $1,000)</td>
<td>700,000</td>
</tr>
<tr>
<td>Disruption / Loss Of Efficiency Claim</td>
<td>$230,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$7,000,000</td>
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</tbody>
</table>
Discrete Damages: Methodology

- Beyond The Scope Of The Contract (e.g., Owner-Directed Changes, Constructive Changes, etc.)
- Change Order Accounting
- Discrete Cost Codes
- Detailed Cost Buildup
- Modified Total Cost
- Total Cost
Discrete Damages: Common Pitfalls

- Incomplete Or Inaccurate Project Cost Records
- Double Counting Between Claim Elements
- Incorrect Use Of Contract Markup Rates
- Failure To Follow Contract Requirements For Pricing And Submitting Claims
- Failure To Contemporaneously Document Changes/Problems
Discrete Damages Claims: Follow The Contract

- Allowable Claim Methodology – Unit Rates, Negotiated Charge, Time And Materials
- Allowable Markups – Labor Burden, Material Markup, Equipment Markup
- How To Document Costs – Segregated Accounting, Daily Approval Of Work And Resources
- Is Home Office Overhead Allowed And How To Recover
- Notice Requirements – When And How
- Is Interest Allowable
Discrete Damages Claims: Quantity Overrun

Claim Calculation:
Baseline Quantity (C.Y.) 50,000
Actual Quantity (C.Y.) 60,000
Increased Quantity (C.Y.) 10,000
Unit Rate $50.00
Claim $500,000
Discrete Damages Claims: Subcontractor Overruns

- Nature Of Overruns
- Responsibility For Overruns
- Documentation Of Overrun Costs And Timing Of Loss
- Notice Of Overruns
Discrete Damages Claims: Changes By State Agency

- Nature Of Change
- Documentation Of Alleged Direction By State Agency – Verbal Or Written
- Response By Contractor – Formal Notice To No Response
- Notice Of Impacts – Before Or After Work Was Performed
- Documentation Of Impacts – Direct Costs, Delay, Disruption/Loss Of Efficiency
### Case Example: Damages Summary

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<td><strong>Total</strong></td>
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</table>
Time-Related Damages: Methodology

Days Of Compensable Delay \times Daily Site Overhead Rate = Damages
Time-Related Damages: Compensable Delay

1. Identify Actions, Inactions, Or Events Which Caused Delays
2. Quantify Actual Project Delays
3. Determine Liability/Compensable Delay Days
## Critical Path Delay Classification
(Absent Conflicting Contract Language)

<table>
<thead>
<tr>
<th>Cause of Critical Path Delay(s)</th>
<th>Compensable Delay</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Owner</td>
</tr>
<tr>
<td><strong>Single Cause</strong></td>
<td></td>
</tr>
<tr>
<td>Yes -</td>
<td>Yes</td>
</tr>
<tr>
<td>No --</td>
<td>No</td>
</tr>
<tr>
<td>No --</td>
<td>No</td>
</tr>
<tr>
<td><strong>Concurrent Causes</strong></td>
<td></td>
</tr>
<tr>
<td>Yes Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Yes --</td>
<td>Yes</td>
</tr>
<tr>
<td>-- Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

- Yes: Compensable Delay
- No: Non-compensable Delay
## Potential Sources Of Information And Data

<table>
<thead>
<tr>
<th>Schedules</th>
<th>Project Records</th>
<th>Correspondence</th>
<th>Fact Witnesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>• RFP</td>
<td>• Contract</td>
<td>• Letters</td>
<td>• Interviews</td>
</tr>
<tr>
<td>• Bid</td>
<td>• Change Orders</td>
<td>• E-mails</td>
<td>• Depositions</td>
</tr>
<tr>
<td>• Contract</td>
<td>• Status Reports</td>
<td>• Memos</td>
<td>• Affidavits</td>
</tr>
<tr>
<td>• Project Updates</td>
<td>• Cost/Quantity Reports</td>
<td>• Phone Logs</td>
<td>• Other</td>
</tr>
<tr>
<td>• Other</td>
<td>• Other</td>
<td>• Other</td>
<td></td>
</tr>
</tbody>
</table>
## Time-Related Damages: Examples

<table>
<thead>
<tr>
<th>Contractor</th>
<th>Owner</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Extended Field Overhead</td>
<td>• Lost Profit/Rent</td>
</tr>
<tr>
<td>• Extended Home Office Overhead</td>
<td>• Extended Financing Costs</td>
</tr>
<tr>
<td>• Price Escalation</td>
<td>• Extended Management Costs</td>
</tr>
<tr>
<td>• Extended Financing Costs</td>
<td>• Liquidated Damages</td>
</tr>
<tr>
<td>• Acceleration Costs</td>
<td></td>
</tr>
</tbody>
</table>

- 42
Field Office Overhead: Examples

- Project Manager
- Project Administration
- Scheduling Staff
- Project Accounting
- Data Processing
- Small Tools
- Final Clean Up
- Site Trailers
- Office Equipment
- Temporary Power
- Telephones
- Drinking Water
- Warehouse
- Site Safety
Field Office Overhead: Cost Issues

- Field Office Overhead Is Often Claimed As A Cost of Delay. The Most Common Method Of Calculating Field Overhead Claims Is By Use Of A *Time Related* Daily Rate
- *Activity Related* And *One-Time* Field Overhead Costs Should **Not** Be Included In a Daily Overhead Rate To Calculate Increased Costs As A Result Of Delay

**FIELD OVERHEAD COST COMPONENTS**

- Time Related
- Activity Related
- One-Time

$\text{Calculation of Daily Delay Rate}$
Sustaining Personnel

- Certain Direct Charge Personnel Perform Work As A Function Of Time
- Program Extension Can Cause A Direct Increase In The Cost Of Sustaining Personnel
- In Order To Identify Time-Related Personnel:
  - Focus On Program Roles Not Individuals
  - Critically Evaluate Which Roles Must Continue In Order To Maintain The Program
Equipment Costs – Cost Components

• **Ownership Costs** - Charges For **Depreciation** Of Acquisition Costs, As Well As Overhauling, Insurance, Financing, Taxes, And Storage Of Equipment

• **Operating Costs** - Expenses The Contractor Faces By Turning The Equipment “On.” Charges Include Routine Equipment Maintenance, Fuel, Lubrication, Tires, Tracks, And Tool Attachment Repair
Case Example: Damages Summary

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<td>Total</td>
<td>$ 7,000,000</td>
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</table>
Example Causes Of Disruption

- Changed Work
- Rescheduling Of Planned Work
- Excessive Overtime To Avoid Schedule Slippage
- Less Than Optimal Work Sequencing
- Changes In Manufacturing Or Design Work Methods
- Excessive Rework
- Loss Of Learning
Example Causes Of Disruption (Continued)

- Customer Delays
- Unnecessary Starts And Stops To Contract Activity
- More Loss Of Learning
- Underutilization Of Work Force
- Loss Of Economies Of Scale
- Acceleration
- Excessive Overtime
- Congestion In The Work Place
- Resequencing Of Work Performance
Productivity Claims – Methodology

- Project Specific Studies (e.g., Measured Mile)
- Project Comparison Studies
- Specialty or General Industry Studies
- Cost Basis (e.g., Total Unit Cost, Modified Total Cost)
- Productivity Impact on Schedule (i.e., Schedule Impact Analysis)
Measured Mile Example

<table>
<thead>
<tr>
<th>Impact Period</th>
<th>Un-Impacted Period</th>
<th>Impacted Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.13 MH/LF</td>
<td>1.0 MH/LF</td>
<td>1.36 MH/LF</td>
</tr>
</tbody>
</table>

Budget 0.75 MH/LF
Impact 0.36 MH/LF
# Measured Mile Example

## Claim Calculation:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Linear Feet Installed In Period 3</td>
<td>22,751</td>
</tr>
<tr>
<td>&quot;Should Have Been&quot; MH/LF</td>
<td>1.00</td>
</tr>
<tr>
<td>&quot;Should Have Been&quot; MHs</td>
<td>22,751</td>
</tr>
<tr>
<td>Actual MHs</td>
<td>30,671</td>
</tr>
<tr>
<td>Claimed MHs</td>
<td>7,920</td>
</tr>
<tr>
<td>Actual Labor Cost Per MH</td>
<td>$25.93</td>
</tr>
<tr>
<td>Labor Claimed</td>
<td>$205,357</td>
</tr>
<tr>
<td>Markups (12%)</td>
<td>24,643</td>
</tr>
<tr>
<td>Claim</td>
<td>$230,000</td>
</tr>
</tbody>
</table>
Table Of Contents

➤ Overview
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Cost Recovery Issues On Claims

Disclosing Cost Information

- Cost Information Under CAS And / Or FAR Part 31
- Cost Information Assuming CAS And FAR Part 31 Do Not Apply
  - Direct Costs Only
  - Disclosure Of Indirect Cost Rates
  - Disclosure Of Typical Profit Rates
  - Inclusion Of Expressly Unallowable Costs
- Establishing That Contractors Books And Records Should Be Relied Upon
  - Prior Government Audits (e.g., DCAA, DCMA, IRS, EPA, DHS, Etc.)
  - Audited Financial Statements
  - Lending Covenants
  - Special Purpose Audits Of Claimed Costs
  - Reliance On The Work Of Others
  - Work Papers
Claim Audit Issues

- Unsettled Contract Changes With Lower-Tier or Upper-Tier Contractors (e.g., Undefinitized Changes, Other Requests for Equitable Adjustments)
- Auditing Of Subcontractors Who Are Also Competitors (e.g., Obtaining Cost Or Pricing Data, DCAA Audits, 3rd Party Audits)
- Dealing With DCAA Audit Reports
  - Extensive Qualifications Or Limitations
  - “We Do Not Consider . . . To Be Acceptable As The Basis For The Settlement Of A Fair And Reasonable Amount.”
  - Extensive Delay In Conducting Audit
Claim Audit Issues

Interpretation of FAR 31.201-2(d)

A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a Claimed cost that is inadequately supported.
Claim Audit Issues

Reliance on Copies

“The Contractor] did not maintain original source documentation for all transactions selected for testing . . . [S]upport provided included documentation received by [the Contractor] in an electronic format (invoices received via email). . . . [W]e are unable to evaluate [the Contractor’s] process for maintaining the integrity of documents received electronically. Accordingly, we were unable to determine whether reliance could be placed on the copies provided and relied on during our audit.”

Example DCAA Audit Report
Table Of Contents

- Overview
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Summary And Recommendations

- What Does The Contract Say?
  - Notice Requirements
  - Documentation Of Costs
  - Allowable Rates & Factors
  - Allowable Claim Components: Home Office Overhead, Interest
- Technical Requirements
- Scope Of Work
Summary And Recommendations (Continued)

- Identify Problems And Changes
- Adequately Document Liability
  - What Was Planned?
  - What Was The Change?
  - Who Made The Change?
- Provide Notice Of Delays And Damages Associated With Changes
- Identify Causation Of Delays And Damages
Summary And Recommendations (Continued)

- Detailed Cost Build-Up (Change by Change) Generally Results in Fastest and Best Settlement
  - Use Change Order Accounting To Track The Cost Incurred Due To Each Change
  - Perform Thorough Technical And Legal Evaluation To Determine The Legal Requirements Of The Contract
  - Identify Causation
  - Audit All Claim Values: Rates, Factors, Quantities, Markups, etc.
- Avoid Common Claim Pricing Pitfalls
Questions
Contact Information

• Timothy Overman
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  • Phone: (214)-954-1512

• Tanner Courrier
  • Email: tcourrier@kenrichgroup.com
  • Phone: (469)-893-1043
Thank You For Your Time
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