

# Recovery of Litigation and Settlement Costs after Geren v. Tecom, Inc.

---

*Jessica Graham*  
*EVP / General Counsel*  
*Afognak Native Corporation /*  
*Alutiiq, LLC*

# Back in the Old Days

- Those doing business with the Government are governed by the Federal Acquisition Regulations (FAR) and the principles in the Cost Accounting Standards
- Prior to the Tecom decision, contractors could generally recover legal costs associated with third party litigation in their billing rates, provided the action did not involve fraud or other comparable misconduct

# Litigation and Settlement Costs: Pre-Tecom

- Costs only “allowable” under FAR 31.201 if the costs are:
  - Reasonable;
  - Allocable;
  - Consistent with Cost Accounting Standards, GAAP;
  - Comply with the terms of the Contract
  - Not prohibited by FAR 31.205 (which govern specific categories of costs)
- Government historically recognized private citizen lawsuits as part of a contractor’s cost of doing business
  - Thus litigation and settlement costs considered “allowable.”

# Boeing North America Framework for Recovery of Legal Costs (1992 – 2009)

- Boeing case from 1992 set initial framework for recovery of legal costs:
  - Prior to being purchased by Boeing, Rockwell faces a variety of disputes alleging fraud, false claims or serious wrongdoing
  - Shareholders file shareholder derivative suit alleging failure to maintain appropriate internal controls
  - Case settles; legal fees and settlement costs exceed \$4.5M
  - Company seeks to recover fees through inclusion in its G&A rate and through allocation to cost-type contracts

# Boeing Framework, cont.

- Final analysis:
  - If particular cost is not addressed in the FAR, look at the treatment of “similar or related” costs
  - In this case, shareholder derivative action analogized to defending against fraud allegation
  - Bright line rule of no recovery when defending against fraud claim brought by Government
  - In this case, however, since case brought by third-party, court relies on standard used in settlement of *qui tam* actions:
    - Unallowable unless *very little likelihood of success on the merits*
- Most interpret Boeing to apply to settlement of third-party litigation that grew out of fraud, criminal, other serious wrongdoing

# Tecom Summary

- During performance of a military housing maintenance contract at Fort Hood, Tecom is sued for sexual harassment and retaliation under Title VII
- Company denies allegations, but determines it is more cost effective to settle the case rather than try it.
- Because contract is cost reimburseable, Tecom seeks reimbursement of its defense and settlement costs
  - Legal fees incurred: ~\$96,000
  - Settlement: \$50,000 (no backpay)
  - No admission of wrongdoing
  - Estimated trial costs > \$300,000

# Tecom Overview (cont.)

- Defense costs included in G&A
- Settlement cost – treated as direct expense under contract
- Eventually submitted as a formal claim and appealed to ASBCA
- ASBCA: defense costs and settlement payments are allowable costs under the FAR
  - Distinguished 2002 *Boeing* decision on legal costs as not applicable because no allegation of criminal conduct or fraud

# On Appeal to Federal Circuit

- Issue framed as “whether costs of defending and settling a Title VII suit are allowable costs under this government contract.”
- Court focuses on EEOC clause in contract and whether conduct alleged in complaint would have violated this clause
- Court finds *Boeing* applies, and dictates two –step inquiry for evaluating settlement costs
  - (1) if contractor had suffered adverse judgment, would legal costs be allowable?
  - (2) if not, would settlement costs be allowable?

# Tecom Rationale

- Step 1 Answer: Adverse decision would mean contractor violated Title VII, which would amount to a contract violation. Not allowable.
  - Reaches back to 1963 case of Dade Brothers, Inc. v. United States, Court concludes “costs resulting from a breach of a contractual obligation are not allowable costs under the contract.”
  - Touches upon public policy implications – don’t want to put the Government in a position of paying for discriminatory acts

# Tecom Rationale

- Step 2 (how to treat a settlement agreement when an adverse adjudication would not be allowable)
  - Costs only allowable if contracting officer determines that there is “very little likelihood that the [plaintiff] would have been successful on the merits.”
- End Result: Sweeping decision that extends the *Boeing* holding to non-fraud situations, thereby covering almost every case in which the contractor decides to settle instead of litigate to a conclusion
- Ignores historical treatment of these costs as cost of doing business

# How does Tecom affect ADR?

- Government may argue that contractor's decision to use ADR precludes it from later suggesting case had little likelihood of success on the merits
- Settlement beyond litigation costs = merit premium?
- How do you handle confidentiality? FRE 804?  
Evidence of ADR reviewed for reasonability of settlement, but not to assess contractor's liability or defenses?

# So now what?

- Contractors must be prepared to show plaintiff's case has “very little likelihood of success on the merits.”
- Guilty until proven innocent
- Increases need for several specific strategy measures:
  - Close examination of allegations.
    - Anything similar or related to fraud?
    - Anything that could amount to breach of contract?
  - Careful contemporaneous case assessment memo that addresses these points
  - Watch the internal communications (precise analysis is key)
  - Settlement Timing
  - Settlement Language (excluding admissions of wrongdoing; clarifying that settlement is not driven by merits)
  - Recognize audit potential of litigation files
- CODE YOUR LITIGATION COSTS APPROPRIATELY
- Budget implications