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Indirect Cost And Profit Recovery For Increased Wages

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On Dec. 21, 2010, the Civilian Board of Contract Appeals issued an important decision permitting broad recovery under the contract Changes clause for a construction contractor performing a contract subject to the Davis-Bacon Act (DBA). In *W.G. Yates & Sons Construction Co.*,[2] the Board found that a construction contractor was entitled to an equitable adjustment for higher labor costs, including applicable indirect rates and profit, because the General Services Administration modified a contract to retroactively impose a higher DBA wage determination that should have been incorporated when a construction portion of the contract was awarded. The decision confirms a contractor's entitlement to indirect costs and profit if higher wage determinations are imposed under the authority of a contract's Changes clause, instead of under the DBA's Price Adjustment clause (or similar price adjustment clause), which otherwise limits adjustment only to a contractor's actual increase in wage and fringe benefits costs, but does not permit recovery of indirect costs or profit.

Price Adjustments under the DBA or SCA

Contracts subject to the DBA or Service Contract Act are required to include standard Price Adjustment clauses, which provide for a price adjustment when a new Department of Labor wage determination is incorporated into the contract in an option to extend the contract, or upon the contract's anniversary.[3] As reflected in these clauses, if price adjustments are made in the normal course of business to account for revised wage determinations that take effect during the period of performance, the equitable adjustment may include an increase to reflect only the contractor's increased wage and benefits costs related to the higher wage determination; the contractor is not permitted to recover indirect costs or profit related the increase.[4] To that end, the contractor is also prohibited from including in its proposed costs an allowance for any contingency to cover future increases in labor costs that would be reimbursed under the Price Adjustment clauses.

When contracts subject to the DBA or SCA are solicited and awarded, the contracting officer must include the then-current wage determination. If a contract is awarded *without* the required wage determination—i.e., the included wage determination is superseded by a later revision with higher wage or benefits rates—the Federal Acquisition Regulation requires the CO to initiate action to incorporate the required determination in the contract and equitably adjust the price to reflect any changed cost of performance resulting from the incorporation of the wage determination or revision.[5]

In such situations, the prevailing view under services contracts is that a contractor is entitled to recover not only an equitable adjustment for its attendant higher wage and benefits costs, but also its indirect costs and reasonable profit.[6] In many instances, however, COs tend to default instead to using the standard Price Adjustment clauses, as the basis for the contractor's equitable adjustment.[7] Because the Price Adjustment clauses—which are only designed to address future revisions to the *existing wage determination properly incorporated in the contract*—do not permit additional recovery

of indirect costs or profit,[8] an equitable adjustment under a Price Adjustment clause provides an incomplete recovery to contractors in the case of a modification to retroactively require compliance with a revised wage determination.

The Yates *Decision*

In *Yates*, GSA exercised an option in August 2005 to award the construction portion of a contract following an initial design phase.[9] The firm-fixed-price contract included the standard FAR clauses implementing the DBA, and incorporated a DOL wage determination dated August 2004.[10] Although DOL had issued a revised wage determination in July 2005—six weeks *prior* to the August 2005 option exercise—which GSA was required to include in the option pursuant to FAR 22.404-12(a),[11] GSA failed to incorporate it into the contract.[12]

In February 2006, GSA's Procurement Management Review Board conducted a routine audit of the contract that revealed that the higher July 2005 wage determination should have been incorporated into the modification awarding the construction component of the contract.[13] The CO was therefore told to modify the contract to incorporate the revised wage determination retroactively to the time of award in August 2005.[14] Citing the FAR Changes clause at FAR 52.243-1 and the General Services Acquisition Regulation Equitable Adjustment clause as the bases for the modification, GSA issued a bilateral modification to incorporate into the contract the revised wage determination, which directed Yates and its subcontractors to pay the higher wage rates to their employees both prospectively and retroactively to the August 2005 award date for the construction phase.[15]

Shortly thereafter, the contractor submitted a proposal seeking an equitable adjustment of approximately $1.4 million to account for the past and future impact of the revised wage determination.[16] The contractor's request for equitable adjustment seeking compensation for the higher wage costs included its actual increased wage costs, plus an allowance for overhead and profit, for the entire contract performance period.[17] Citing the DBA's Price Adjustment clause at FAR 52.222-32 (which the CO acknowledged was not actually incorporated into the contract), and FAR 22.404-12, the CO rejected Yates' request for overhead and profit.[18] The CO also refused to compensate the contractor for any adjustment based on the actual number of labor hours the contractor incurred performing the contract, instead insisting that any equitable adjustment should be based on only the number of labor hours included in the contractor's initial bid (adjusted for any formal change orders on the project). The CO reasoned that because it was a fixed-price project, the contractor would have received payment for only the labor hours assumed in its bid, and the Government would not have been responsible for paying for those hours "had there been no increase in the wage rates."[19] The CO explained,

> If Yates or its subcontractors actually perform the work in fewer hours than proposed, the appropriate contractor benefits from performing efficiently. Conversely, if Yates or its subcontractors actually perform the work using more hours [than] proposed, a liability may [be] incurred from performing less efficiently.[20]

Yates appealed, providing evidence at the hearing that the increased costs for which it sought recovery represented the baseline difference between the wages paid under the contract as awarded and the increased wage rates it was required to pay following adoption of the revised wage determination. The claimed costs were based on the incremental increase in the wage rate, plus labor burden on those increased costs, project management costs, project accountant costs, overhead, profit and bond costs.[21] Yates asserted that the retroactive application of the current wage rate was accomplished by a modification under the contract's Changes clause and, therefore, it was entitled to a price adjustment that reflected its increased cost of performance, including a reasonable amount of overhead and profit.[22]

The Government disagreed, arguing that the proper measure of the contractor's recovery must be limited to costs attributable to the increased wage determination *based on the labor hours estimated by the contractor in its bid*, as opposed to the actual labor hours, and that markups such as overhead and profit are not permitted in calculating adjustments for changes to the DBA minimum wage.[23] The Government reasoned that, in the context of a fixed-price contract, the proper adjustment must be limited to the number of hours

the contractor estimated would be needed to perform the work so as to put the contractor in the same position as it would have been in had it been aware of the revised wage rates in calculating its bid. The Government also reasoned that because FAR 52.222-32 precludes recovery of overhead and profit for complying with a revised wage determination, the equitable adjustment should apply to the wage rates only.[24] The Government further asserted that FAR 52.222-32, which was not included in the contract prior to award, should be read into the contract by operation of law in accordance with the *Christian* doctrine, because it is a mandatory clause and the DBA regulations reflect a significant public procurement policy.[25]

The Board disagreed with each of the Government's positions. First, with respect to the Government's argument that FAR 52.222-32 should be read into the contract, the Board explained that because the award of the construction phase of the contract was a stand-alone contract award (as opposed to the exercise of an option), any limitations on recovery found in FAR 22.404-12 or the Price Adjustment clause would not apply, thus it did not need to reach the question of whether the clause met the criteria for application of the *Christian* doctrine.[26] The Board noted that the clauses on which the Government relied "clearly apply to the exercise of an option to extend the term of a contract," and that "the 'option' here was not to extend the term of an existing contract, but to award or not award" the construction phase, based on a "mutually agreeable scope and price for the construction work."[27] Accordingly, the clause did not apply to the circumstances here in any event.

Second, the Board determined that because the wage revision was incorporated under the auspice of the Changes clause (as opposed to the Price Adjustment clause), Yates was entitled to recover overhead and profit. The Board noted that under the Changes clause, overhead and profit are routinely included in the equitable adjustment "to make the contractor whole" and that, under FAR pt. 31 cost principles, the contractor's increased direct wage and fringe benefit costs must bear their pro rata share of indirect costs allocated under generally accepted accounting principles consistently applied.[28] In so doing, the Board followed the rule established in *Prof'l Servs. Unified, Inc.*, ASBCA 45799, 94-1 BCA ¶ 26580, in which the Armed Services Board of Contract Appeals held that an increased wage determination incorporated after the fact through a modification under the Changes clause entitled the contractor to an adjustment including applicable indirect costs and reasonable profit.[29] In that case, an SCA wage determination revision was retroactively incorporated into a contract after the contract was solicited and issued using an outdated wage determination.[30]

Finally, the CBCA held that the appropriate basis for any adjustment was the wage increase applicable to the actual number of labor hours, rather than to the proposed number of hours. The Board rejected the Government's argument that this would lead to a windfall for the contractor, who could recover wage increases on labor hours it had not included in its bid.[31] It noted that "[w]hether the planned hours were more or less than the actual hours is immaterial; both parties agree that the actual hours were reasonably devoted to the project. [The contractor] is not asking to be reimbursed anything other than the incremental increase above the rate for which it was responsible to pay its workers under the old determination. Payment of the incremental costs for all hours worked leaves [the contractor's] profit or loss position unchanged" and leaves the contractor "in the same position it would have been but for the revised wage determination."[32] Accordingly, the Board held that Yates was entitled to recover its increased costs, including overhead and profit, for the actual hours worked, whether included in the planned hours or not.[33]

Conclusion

The *Yates* decision reinforces the guidance initially provided in *Professional Services* and extends its rationale to the DBA. Construction contractors and services contractors alike should be aware of their rights when facing retroactive revisions to an applicable wage determination and the enhanced recovery that may be possible under the Changes clause.

❖ Endnotes

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2 *W.G. Yates & Sons Constr. Co.*, CBCA 1495, Dec. 21, 2010.

3 See, e.g., Federal Acquisition Regulation 52.222-32 (Davis-Bacon Act—Price Adjustment (Actual Method)), FAR 52.222-44 (Fair Labor Standards Act and Service Contract Act—Price Adjustment).

4 See FAR 52.222-32(d) ("Any adjustment ... will not otherwise include any amount for general and administrative costs, overhead, or profit"); FAR 52.222-44(d) ("Any such adjustment ... shall not otherwise include any amount for general and administrative costs, overhead, or profit").

5 See FAR 22.404-9(a) (providing that, for contracts subject to the DBA, if a contract is awarded without the required wage determination, the CO shall initiate an action to incorporate the required determination on the contract immediately upon discovery of the error and modify the contract to equitably adjust the contract price if appropriate, or terminate the contract); FAR 22.1015 (providing that, for contracts subject to the SCA, if DOL discovers and determines, whether before or after a contract award, that a CO made an erroneous determination that the SCA did not apply or failed to include an appropriate wage determination in a covered contract, the CO shall, within 30 days of notification by DOL, incorporate the clause at FAR 52.222-41 and any applicable wage determination, and require that the contract price be equitably adjusted to reflect any changed cost of performance resulting from incorporating a wage determination or revision).

6 *Prof'l Servs. Unified, Inc.*, ASBCA 45799, 94-1 BCA ¶ 26580.

7 See, e.g., FAR 52.222-32 (Davis-Bacon Act—Price Adjustment (Actual Method)), FAR 52.222-44 (Fair Labor Standards Act and Service Contract Act—Price Adjustment).

8 See, e.g., FAR § 52.222-32(d) ("Any adjustment will be limited to increases or decreases in wages and fringe benefits as described in paragraph (c) of this clause, and the accompanying increases or decreases in social security and unemployment taxes and workers' compensation insurance, but will not otherwise include any amount for general and administrative costs, overhead, or profit"); FAR § 52.222-44(d) (same).

9 CBCA 1495, Dec. 21, 2010, at 2.

10 Id. at 2–3.

11 FAR 22.404-12(a) provides that, "[e]ach time the contracting officer exercises an option to extend the term of the contract for construction, or a contract that includes substantial and segregable construction work, the contracting officer must modify the contract to incorporate the most current wage determination."

12 *Yates,* CBCA 1495, at 3.

13 Id.

14 Id.

15 Id.

16 Id. at 3.

17 Id.

18 Id. at 4, 6.

19 Id. at 7.

20 Id. at 7–8.

21 Id. at 8.

22 Id. at 9–10.

23 Id. at 8–9.

24 Id. at 10, 11–13.

25 Id. at 13 (citing *G.L. Christian & Assocs. v. U.S.*, 312 F.2d 418, 425 (Ct. Cl.), rehearing denied, 320 F.2d 345, cert. denied, 375 U.S. 954 (1963)).

26 Id. at 13–14.

27 Id. at 13–14.

28 Id. at 14.

29 Id. at 15.

30 *Prof'l Servs. Unified, Inc.*, ASBCA 45799, Dec. 14, 1993, 94-1 BCA ¶ 26580.

31 *Yates* at 10, 15.

32 Id. at 10.

33 Id. at 10, 15.