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The Clause

The President's Column

David Nadler

Dear BCABA Members:

We had a very active and exciting quarter. On June 9, 2009, the BCABA co-sponsored with The George Washington University Law School a special colloquium on "Contractor Corruption: Next Steps in Anti-Corruption." The distinguished panelists included Laura Kennedy, Senior Vice President and Chief Ethics & Compliance Office for Science Applications International Corporation ("SAIC"); Robert Huffman of Akin Gump and Co-Chair of the ABA Public Contract Law Section's Contractor Compliance Task Force; Frank Albright, Office of the Inspector General for the Department of Defense; and Steven Shaw, Suspension and Debarment Official, U.S. Air Force. The panel was moderated by BCABA Past-President Michele Mintz Brown of SAIC, and Chris Yukins of GWU Law School. The colloquium was standing room only and highly informative. Special thanks to Michele for an excellent job as Chair of the program.

On June 10, 2009, the BCABA co-sponsored the Annual Boards of Contract Appeals Judges reception with the District of Columbia Bar Government Contracts and Litigation Section, and the Federal Bar Association Government Contracts Section. The program included a panel on "What You Need to Know About the American Recovery and Reinvestment Act of 2009." The panel, which was moderated by Susan Warshaw Ebner of Buchanan Ingersoll & Rooney PC, included Chris Yukins of GWU Law School; Al Matera, Director of Acquisition Policy for GSA and Chairman of the Civilian Agency Acquisition Council; Paul Debolt, Venable LLP; and Ita Snyder of GE Aviation. The program was very well received and attended by a number of BCA judges. Special thanks to Susan for organizing such a wonderful program.

Stay tuned for information about upcoming events such as the Trial Advocacy Program, the Executive Policy Forum on September 9, 2009, and our Annual Program on October 22, 2009.

We have also recently engaged a web developer to enhance the BCABA website which will be more user-friendly and content rich. Thanks to Pete McDonald for his leadership on this initiative.
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President's Column (cont'd):

Thanks also to Pete for bringing together another excellent collection of articles for this edition of *The Clause*.

Our next Board meeting will be on September 17, 2009 at the offices of Dickstein Shapiro LLP, 1825 Eye Street, NW, Washington, DC 20006.

Have a great summer!

Best regards,

Dave Nadler
President

**Bored of Contract Appeals
(a.k.a. The Editor's Column)**

by
Peter A. McDonald
C.P.A., Esq.
(A nice guy . . . basically.)

In this issue, Sean Bamford discusses the expansion of the Berry Amendment, a significant but little-noticed development. Judge Ting (ASBCA) then provides very worthwhile guidance on making effective presentations in Board cases, and his observations are useful to even experienced practitioners. And finally, concerning recent events that you may want to be aware of, there's a wonderfully insightful and crisply written article on IFRS (!). Also included are the case materials related to the much-discussed recent *Rothe Development* decision, about which there is apparently much confusion.

The Clause is not copyrighted and will reprint, with permission, previously published and copyrighted articles of interest to government contract practitioners. Of course, we would prefer original articles on government contract law topics but we never get any. And during these troubled times, keep in mind everybody: Don't take all this government contract stuff too seriously. As usual, we again received articles that were unsuitable for publication, such as: "Is Pete an *Illuminati*?"; "COC Application *Denied!!*"; and "Pete's Net Worth Exceeds GM's!!!"



Illusory Progress: The Apparent Expansion of the Berry Amendment to DHS

by
Sean P. Bamford*

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The phrase “trade war” and the specter of the Hawley-Smoot Tariff Act¹ have been bantered about recently due to the inclusion of the “Buy American” clause in the American Recovery and Reinvestment Act of 2009 (the Act).² The fervor died down somewhat after the Senate amended the Buy American clause by requiring that it be applied in a manner that respects international treaties. With all the focus on the Buy American clause, the apparent expansion of the Berry Amendment’s³ textile and clothing restrictions to the Department of Homeland Security, contained in Section 604 of the Act, was mostly ignored.⁴ The Section 604 restriction, although included in the Act, does not merely apply to funds appropriated under the Act, but is intended to apply to all funds appropriated to DHS.⁵

At first blush, it would appear as though Section 604 of the Act expanded the clothing and textile restrictions of the Berry Amendment, which had applied only to the Department of Defense, to DHS. Unfortunately, it is not that straightforward. The expansion created new issues that were not present under the Berry Amendment. These issues were created because the “Berry Amendment expansion” is not really a true expansion, but rather the implementation of a new source restriction that is similar to the Berry Amendment. In most instances, a contractor that is currently in compliance with the requirements of the Berry Amendment for DoD procurements will also be in compliance with the Section 604 restriction for covered DHS procurements. However, there are some differences in coverage, e.g., parachutes and protective equipment, that will raise new compliance issues. Given the fact that DHS has yet to implement the Section 604 restrictions, depending on the approach to implementation it takes, additional compliance issues could arise.

The Berry Amendment and Section 604

Essentially, the Berry Amendment limits the procurement powers of DoD by restricting the purchase of certain commodities, including clothing and certain textiles, to domestic sources. The requirements of the Berry Amendment will differ greatly depending on the article being procured by DoD, e.g., compare natural fabric, which must be wholly manufactured (every step of manufacturing)⁶ in the United States, with synthetic fabric, which must only be wholly manufactured⁷ in the United States if the fabric is utilized in a textile product. That said, by and large, the Berry Amendment requires domestic production of covered articles or components, unless an exception applies. The Section 604 restriction, on the other hand, covers slightly different products and is not as restrictive as the Berry Amendment in some respects and more restrictive in other respects.

The Section 604 restriction has several features that distinguish it from the Berry Amendment. For example, it only applies to the procurement of an item that is “directly related to the national security interests of the United States,” a phrase not defined in Section 604, as opposed to all DHS procurements. Furthermore, protective equipment (including but not limited to body armor)⁸ and parachutes⁹ are specifically covered¹⁰ under the Section 604 restriction, while both items are not fully, specifically, covered under the Berry Amendment.¹¹ Another significant difference is that Section 604 does not limit DHS's procurement of the
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Illusory Progress (cont'd):

covered textile and clothing items to domestic sources. This is because Section 604(k) states that “[t]his section shall be applied in a manner consistent with United States obligations under international agreements.” What this means in layman's terms is that DHS may, depending on how DHS implements the Section 604 restriction and in non-small business set-aside procurements,¹² purchase the covered textile and clothing items from other than domestic sources.

Implementation of Section 604(k)

A. Trade Agreements Act Approach

There are several ways in which DHS could implement the Section 604 restriction to take into account section k of the restriction. The simplest way to implement Section 604 (k) would be to start with the premise that for procurements greater than the threshold set forth in Federal Acquisition Regulation 25.402, the Trade Agreements Act (TAA)¹³ applies. The TAA is the means in which the trade agreements negotiated under the Trade Act of 1974 are approved/implemented,¹⁴ and provides the authority to modify discriminatory purchasing requirements in federal procurements.¹⁵ Under the TAA, as implemented by the FAR, procurements “indispensable for national security” are exempt from the requirements of the TAA.¹⁶ Accordingly, because the Section 604 restriction only applies to procurements “directly related to the national security interests of the United States” DHS could apply the Section 604 restriction only to those procurements of covered articles where the “national security” exception to the TAA applies. Consequently, under this TAA approach, only domestic products would be compliant with the Section 604 restriction, absent the application of an exception. This approach does have some significant weaknesses.

Its greatest weakness, which is grounded in the very language of Section 604, is that it is not clear exactly how a Transportation Security Administration uniform is “directly related to the national security interests of the United States” or “indispensable for national security.” It is unambiguous that Congressman Kissell intended for Section 604 to apply to TSA's purchases of uniforms¹⁷, but the nexus between national security and a TSA uniform is not clear. In fact, U.S. Customs and Border Protection uniforms are more closely tied to national security, but Congress indicated that the “Obama administration [would have to act for Section 604] to cover the Federal Emergency Management Agency, U.S. Customs, Border Protection, and U.S. Immigration Service[procurements][.]”¹⁸ Congress' position that the Obama administration would have to act for these DHS agencies to be covered under Section 604 is misplaced because if the “TAA approach” is followed, these agencies would be covered. In addition, even under the Free Trade Agreement (FTA) approach outlined below, Section 604 would apply; it just would not limit procurements to U.S. manufactured products. It is also apparent that the “national security interests” language and the intersect between Section 604 and the TAA were not fully considered.¹⁹

Another weakness of the TAA approach is that Section 604 does not have a qualifying country exception for chemical warfare protective clothing like the Berry Amendment.²⁰ As a result, DHS, absent the use of the availability exception,²¹ would not be able to purchase the same chemical warfare protective clothing that is purchased by DoD. Therefore, it might not have access to the same crucial technology as DoD. Lastly, applying the “indispensable for national security” exception of the TAA in order to implement Section 604, which is a discriminatory preference law prohibited under the FTAs,²² when there is a process for amending the FTAs to exempt DHS procurements might be considered a less than good faith application of the U.S. FTAs.

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B. Free Trade Agreement/Qualifying Country Approach

Even with its faults, the TAA approach has certain administrative benefits; however, it also does not take into account possible confusion caused by the language contained in the United States' FTAs. For example, there is seemingly no issue with the World Trade Organization Government Procurement Agreement (WTO GPA),²³ which exempts the procurement of a variety of items by the U.S. Coast Guard (for national security reasons)²⁴ and all TSA procurements, and also contains a broad exception for national security related procurements.²⁵ Similarly, the Australia FTA, like the WTO GPA, does not cover procurements by the TSA. But with respect to U.S. Coast Guard procurements, because of “essential security” interests, it does not apply to the procurement of certain items that are covered under the Section 604 restriction.²⁶ In addition, the North American Free Trade Agreement exempts procurements made by the U.S. Coast Guard (for national security reasons), but not those made by any other DHS agency such as TSA.²⁷ Both the Australia FTA and NAFTA, like the WTO GPA, contain an exception for procurements related to national security,²⁸ which would appear to allow for the exemption of purchases covered under Section 604 and would be consistent with the TAA approach outlined above.

However, because the WTO GPA, Australia FTA, and NAFTA already have a “carve-out” for U.S. Coast Guard procurements that relate to national security (or in the case of the Australia FTA, the exception is related to the essential security interest of the U.S.), manufacturers from signatory countries of these FTAs could argue that the national security exception does not apply to procurements covered by Section 604 because the national security exception was already taken into account when establishing the Coast Guard “carve out.” The overarching argument for these manufacturers (and any other manufacturers from a country with an FTA with the United States that has similar language) is that if DHS is to be treated like DoD, exempting the application of the FTA when DHS procures the FSCs covered under Section 604 for national security purposes, then the United States must amend the “Schedule of the United States” provided in the FTAs, which list applicable U.S. agencies and FSCs covered under the FTAs.

DHS could choose to address the national security issue by establishing a “qualifying country” list similar to the one at Defense Federal Acquisition Regulation Supplement 225.872-1 and allow DHS agencies to procure Section 604 covered articles from these qualifying countries. If DHS took this approach, it would have to determine if it wanted to account for the differences in DHS coverage in the FTAs. As noted above, the Australia FTA coverage of Coast Guard procurements is different than either the WTO GPA or NAFTA. Therefore, if these differences were taken into account, for example, a Canadian article of clothing would not meet the requirements of Section 604 if it were procured by the U.S. Coast Guard. However, if under the same procurement the article of clothing were manufactured in Australia, it would meet the requirements of Section 604, so long as the procurement was not a small business set-aside.

If an FTA approach were taken, a thorough review of U.S. FTAs would be needed to determine what countries' products and what FSCs would qualify for non-discriminatory treatment when procured by the various DHS agencies. Another related issue that would need to be resolved if an FTA approach is taken would be to determine whether the Section 604(k) language will be implemented: (1) so certain countries' products will be eligible only if the procurement in question is greater than the threshold set forth in FAR 25.402 (given the fact that the U.S.'s FTAs set forth procurement value thresholds, adjusted for inflation, above which the FTAs are applicable)²⁹ or, (2) like the Berry Amendment's chemical warfare protective clothing exception, which specifically exempts from coverage those items produced in identified qualifying countries.

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Under the FTA approach, there would also be some concern that Section 604(k) would be implemented in a manner similar to the qualifying country exception of the specialty metal restriction found at DFARS 252.225-7014 (June 2005) and Alternate 1 (April 2003). Under this exception, the specialty metal restriction does not apply if the specialty metal is “[m]elted in a qualifying country or incorporated in an article manufactured in a qualifying country.” This exception has been criticized by U.S. specialty metal manufacturers because it allows qualifying country manufacturers to have a less difficult time complying with the specialty metal restriction than U.S. manufacturers. DFARS 252.225-7014's qualifying country exception does not apply to U.S. manufacturers, thus a U.S. manufacturer would not comply with the specialty metal restriction if it merely incorporated the specialty metal in an article manufactured in the United States.

A “DFARS 252.225-7014 qualifying country type exception” could be implemented with respect to Section 604 in two ways. The restriction on fabrics, fibers and yarns (Section 604(b)(1)(C)) could be implemented so that an FTA country manufacturer would be in compliance if the covered fabric (including yarns and fibers) was manufactured in an FTA country or incorporated into an article manufactured in an FTA country. However, as noted below, given the fact that the Section 604 fabric restriction does not apply to commercial items, the impact of such language would be minimal. The second way would be simply based on the country-of-origin of the end product. This approach would lead to the bigger issue of what test will be used to determine the country of origin of a product under Section 604. If the Berry Amendment's “every step of the process used to manufacture the covered article” test is applied only to domestic end items, and the U.S. Customs and Border Protection's textile country-of-origin test³⁰ is used for FTA country end products (the test these products as well as U.S products were subject to prior to the passage of Section 604), the country of a good would be: (1)the country where the good is wholly obtained or produced; (2) the country where a specified applicable change in tariff classification occurred; (3) the country in which the good was knitted to shape;(4) the country in which the good was wholly assembled; (5) the country in which the most important assembly or manufacturing process occurred; or (6) the last country in which an important assembly or manufacturing process occurred³¹ This would, like the DFARS 252.225-7014 qualifying country exception, favor FTA country manufacturers over U.S. manufacturers because they could more easily comply with the Section 604 restrictions.

There is little doubt that the TAA approach outlined above is administratively less burdensome and would meet the requirements of Section 604(k), because it takes into account the FTAs by applying them to DHS procurements in a manner consistent with how other federal agencies currently implement these FTAs. However, though fraught with administrative “pot-holes” from a free trade standpoint, the FTA approach is likely more palatable as it is a less-protectionist approach. Furthermore, the supporters of the FTA approach have some support for their position in the language of the various FTAs. That being said, the FTA approach does have the drawback that DHS would likely apply the same COO test to FTA country products that is currently being applied, but would apply a stricter COO test to U.S. products than is currently applied. Although this is not the only issue that DHS will have to resolve, it is an issue that it will have to address immediately as it provides the foundation for the application of Section 604.

Other Exceptions

Section 604 also contains several other exceptions not found in the Berry Amendment. Unlike the Berry Amendment, Section 604 includes a *de minimis* exception for non-compliant fabrics/fibers, which will likely have a limited impact because commercial fabrics (including fibers and yarns) are generally exempt from the Section 604 restriction. The *de minimis* exception might have some impact if an article of clothing happened to only incidentally contain natural or synthetic fibers, because the commercial item exception³² for
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fabric would likely not apply to an article of clothing, the components of which are independently covered to the extent they are the type normally associated with an article of clothing, such as fabric. Furthermore, DHS purchases of an “item of individual equipment” manufactured from or containing fibers, yarns, fabrics, or materials are also exempt if they are a commercial item.³³ The commercial item exceptions are a departure from the Berry Amendment, which covers the procurement of commercial items.³⁴ Like the Berry Amendment, however, the Section 604 restriction, outside of the clothing restriction, does not specifically address if the restriction applies at the component level or whether the restriction applies if the covered article is a component and not an end item being procured. The Berry Amendment has been applied to covered articles that are merely components of an end item. Under the Berry Amendment, for example, parachutes are not covered individually, but the fabric used to manufacture a parachute is covered.³⁵ It is likely that the Section 604 restriction will be implemented like the Berry Amendment, and thus will apply, absent an exception (such as the commercial item exception), at the component level.

Additional Issues to Consider

Obviously, for the reasons stated above, the application of the Section 604 restrictions will lead to a very different result than if the Berry Amendment applied.³⁶ In addition to the implementation of Section 604 (k), there are several other unresolved issues that will have to be addressed prior to August 16, 2009, which is the effective date of Section 604. One of the biggest remaining issues is the overlapping coverage of Section 604(b)(1)(A)-(B), most notably for protective equipment. DHS will have to determine if protective clothing is included in protective equipment. On January 22, 2007, the Defense Acquisition Regulatory Council issued the DFARS PGI 225.7002-1, which provided a non-exhaustive list of FSCs that DoD considers items of clothing. Among the items provided is FSC 8415-Clothing Special Purpose, which covers safety and protective clothing. If DHS follows this approach, it would mean that protective clothing, including all material and components thereof (which are normally associated with an article of clothing) would be covered under the Section 604 restriction, but when purchasing protective equipment, other than clothing, only the end item would be covered. The other approach would be to treat protective clothing and protective equipment identically and thus only the end item, protective clothing, would be covered.

Other broader issues that will have to be addressed by DHS include determining:

- when an item will be considered directly related to the national security interests of the United States;
- whether the terms “reprocessed and reused” which are historically tied to the Wool Products Labeling Act of 1939³⁷ under the Berry Amendment will be tied to the Labeling Act under Section 604;
- how to apply, if at all, existing case law relating to the application of the Berry Amendment to Section 604, e.g., generally, as noted above, if an item is covered under the Berry Amendment then every step of the process used to manufacture the item must occur in the United States;³⁸
- whether Section 604 applies to grant funds provided to states from DHS for the procurement of covered articles directly related to the national security interests of the United States,³⁹ and
- whether DHS should work with DoD in implementing Section 604 so that in those areas where the restrictions are identical they are applied in the same manner.⁴⁰

Given the complexity of these issues, DHS should attempt to issue implementing regulations quickly so that industry can provide its input on the issues addressed above.

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Endnotes

¹ - See 71 P.L. 361, June 17, 1930; 19 U.S.C. §1654.

² - 111 P.L. 5, February 17, 2009.

³ - 10 U.S.C. §2533a.

⁴ - This language was introduced by Congressman Larry Kissell (D-N.C.).

⁵ - It is clear that it was the intent of Congress that Section 604 would be an ongoing restriction and would not merely apply to fiscal year 2009 funds. However, Congressman Bennie Thompson (D-Miss.) noted when Section 604 was introduced that the restriction “should ...be ultimately made permanent during the 111th Congress through the DHS Authorization process.” H.R. Conf. Rep. 111-724 (January 28, 2009). This statement indicates that the Section 604 restriction might not be an ongoing restriction.

⁶ - See *National Graphics*, B-168791, 49 Comp. Gen. 606 (1970).

⁷ - DFARS 225.7002-2(o).

⁸ - Defense Federal Acquisition Regulation Supplement Procedures, Guidance, and Information (PGI) 225.7002-1, provides a non-exhaustive list of Federal Supply Classes (FSC) that are considered items of clothing for purposes of DoD's Berry Amendment. Included in this list is FSC 8415-Clothing Special Purpose, which covers safety and protective clothing. Safety and protective clothing likely would be considered protective equipment.

⁹ - Small arms protective inserts, which is protective equipment, are not individually covered under the Berry Amendment. H.R. Conf. Rep. 109-360 (December 18, 2005); PGI 225.7002-1(E).

¹⁰ - 73 Fed. Reg. 11354 (March 3, 2008) (stating that the Berry Amendment would have to be amended in order for parachutes to be individually covered under the Berry Amendment).

¹¹ - To the extent the term “protective equipment” covers protective clothing, the Berry Amendment restriction is greater as all material and components normally associated with clothing are covered under the Berry Amendment and only the end item “protective equipment” is covered under Section 604.

¹² - Generally, small business set-aside procurements are exempt from the application of FTAs. See, e.g., NAFTA, Annex 1001.2b, Schedule of the United States, paragraph 1; WTO GPA, Appendix 1, General Notes, paragraph 1; Australia FTA, Section 7, Schedule of the United States, paragraph 1.

¹³ - See Pub. L. 96-39, July 26, 1979, 19 U.S.C. §2501 et. seq.; implemented by FAR Subpart 25.4.

¹⁴ - 19 U.S.C. § 2502(a)(1).

¹⁵ - 19 U.S.C. §2511. This authority includes the authority to designate those countries with free trade agreements with the United States or that meets one of the requirements set forth in 19 U.S.C. §2511(b)(1)-(4) as eligible countries, and thus qualify for non-discriminatory treatment.

¹⁶ - FAR 25.401(a)(2).

¹⁷ - H.R. Conf. Rep. 111-723 (January 28, 2009).

¹⁸ - H.R. Conf. Rep. 111-724 (January 28, 2009).

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Endnotes (cont'd)

¹⁹ - It is likely that Congress believes that the Obama administration would have to act because FEMA, U.S. Customs, Border Protection, and U.S. Immigration Service are not exempt from the World Trade Organization Government Procurement Agreement, like TSA and the U.S. Coast Guard. However, this position ignores the fact that TSA procurements are not exempt from the North American Free Trade Agreement, and thus the Obama administration would also have to act to exempt TSA procurements from the North American Free Trade Agreement.

²⁰ - DFARS 225.7002-2(p).

²¹ - 111 P.L. 5, Sec. 604(c), February 17, 2009.

²² - *See, e.g.*, NAFTA, Article 1003; Australia FTA Article 15.2, paragraph 1, and WTO GPA, Article III.

²³ - WTO GPA, Annex 1.

²⁴ - The Washington Report, Volume XLIII, Number 6 (February 9, 2009) states that DHS already applies the Berry Amendment to the procurement of Coast Guard uniforms.

²⁵ - WTO GPA, Article XXIII.

²⁶ - Australia FTA, Annex 15-A.

²⁷ - NAFTA, Annex 1001.1a-1, Schedule of the United States, paragraph 53.

²⁸ - Australia FTA, Article 22.2; NAFTA, Article 1018.

²⁹ - *See, e.g.*, NAFTA, Article 1001, paragraph 1(c); Australia FTA Article 15.1, paragraph 2(b), and WTO GPA, Article I, paragraph 4.

³⁰ - 73 Fed. Reg. 55860 (September 26, 2008) (the restrictions that are set forth in 19 U.S.C. §3592, as implemented in 19 C.F.R. §102.21, apply when determining the country of origin of a textile product for purposes of the Trade Agreements Act).

³¹ - Under 19 C.F.R. §102.21, the country of origin for a textile product is: (1) the country, territory, or insular possession in which the good was wholly obtained or produced; or (2) the country, territory, or insular possession in which each of the foreign materials incorporated in that good underwent an applicable change in tariff classification. 19 C.F.R. §102.21(c)(1)-(2). If neither of these rules applies, then the country-of-origin of a textile product will be: (1) the country in which the good was knitted to shape; (2) if the good was not knitted to shape, the country in which the good was wholly assembled; (3) if the product was not knitted to shape or wholly assembled in one country, the country in which the most important assembly or manufacturing process occurred; or (4) if the product was not knitted to shape, wholly assembled in one country, nor was there one important assembly, then the last country in which an important assembly or manufacturing process occurred. 19 C.F.R. §102.21(c)(3)-(5).

³² - It is interesting to note that neither the Berry Amendment nor Section 604 states that it applies to commercially available off-the-shelf (COTS) items “notwithstanding Section 35” of the Office of Federal Procurement Policy Act (41 U.S.C. §431(b)(2)). *See* 10 U.S.C.A. §2533a(i); 111 P.L. 5, Sec. 604(g), February 17, 2009. Therefore, an argument can be made that neither the Berry Amendment nor Section 604 applies to the procurement of COTS items.

³³ - There is some overlap between the items covered under Section 604(b)(1)(B) and (b)(1)(D); therefore, a determination will have to be made if the commercial item exception supersedes the (b)(1)(B) restriction. Given the fact that the (b)(1)(B) restriction is more specific it will likely supersede the commercial item exception applicable to the overlapped items covered under (b)(1)(D).

³⁴ - 10 U.S.C. §2533a(i).

³⁵ - 73 Fed. Reg. 11354 (March 3, 2008) (stating that the Berry Amendment would have to be amended in order for parachutes to be individually covered under the Berry Amendment).

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³⁶ - For example, under the Berry Amendment small arms protective inserts, commonly referred to as SAPI plates, are not individually covered, but are likely covered under Section 604(b)(1)(B). Therefore, when DoD procures SAPI plates it merely requires that fabrics (but not the fibers or yarns) used in the SAPI plates be domestic. However, if TSA purchased SAPI plates, on a non-small business set-aside basis, the end item would have to be manufactured in the United States, or a “qualifying country” depending on how Section 604(k) is implemented, but the components, the ceramic plate and synthetic fabric (which, let us assume, is a commercial item) would not be covered. This is but one example of where the application of Section 604 will lead to significantly different results than the application of the Berry Amendment.

³⁷ - 15 U.S.C. §68.

³⁸ - *See National Graphics*, B-168791, 49 Comp. Gen. 606 (1970) (generally, when a fabric and its fibers are covered under the Berry Amendment, the fabric will only be considered compliant if the fibers and the spinning and weaving of the fabric occur in the United States).

³⁹ - Arguably, this restriction would apply to any grant funds provided to states from DHS for the procurement of covered articles directly related to the national security interests of the United States because those funds would be funds appropriated or made available to DHS and there is no requirement that DHS must conduct the procurement.

⁴⁰ - Consistent application of the Berry Amendment has been a problem within DoD, e.g., some DoD agencies read “the materials and components” of clothing language broadly while other read it narrowly, therefore, a concerted DoD/ DHS effort could lead to clearer more consistent implementation and greater contractor compliance.



**Practice Pointers: A Primer
on Effective Presentation of an Appeal
Before the Armed Services Board of Contract Appeals**
by
Administrative Judge Peter D. Ting*

[Note: “Practice Pointers: A Primer on Effective Presentation of an Appeal Before the Armed Services Board of Contract Appeals,” by *Administrative Judge Peter D. Ting, 2009, Procurement Lawyer 44.3, p. 3-6. © 2009 by the American Bar Association. Reprinted with permission.]*

One of the most popular topics practitioners want Armed Services Board of Contract Appeals (ASBCA) judges to talk about is “A View from the Bench.” This curiosity reflects a continuing interest in ways to improve presentation of appeals¹ before the board. Whether you are a seasoned practitioner or appearing before the ASBCA for the first time, this article provides you with some pointers on what you can do to present your case more effectively.

Rule 20 — the only substantive rule of the ASBCA that deals with hearings — states broadly that “[h]earings shall be as informal as may be reasonable and appropriate under the circumstances,” that the parties “may offer such evidence as they deem appropriate and as would be admissible under the Federal Rules of Evidence or in the sound discretion of the presiding Administrative Judge or examiner,” and that “[w]itnesses before the Board will be examined orally under oath or affirmation.” In reality, much more happens in a hearing.

Understanding the Purpose of a Hearing

When both sides of an appeal decide to take their case to hearing, they must have concluded that the appeal, for whatever reason, cannot be settled. To present your case effectively, you must first understand the purpose for a hearing, which is to prove facts. If no material facts are in dispute, then the case presumably can be decided by summary judgment.² If, on the other hand, material facts are in dispute, then the disputed facts must be proved by witness testimony, by documentary or other evidence, weighed by a panel of administrative judges as fact-finders, and decided by them in accordance with applicable legal principles. The purpose for a hearing, then, is to put all your evidence — documentary, testimonial, or otherwise — before the panel of judges to whom the case is assigned so that they can efficiently and effectively evaluate your case.

Opening Statements

Even though an opening statement is not required, most litigants chose to give one. Unlike a jury, having read the contracting officer’s decision and the pleadings, the presiding judge would already be familiar with the underlying issues of the case being heard. A lengthy and detailed opening statement is not necessary. No matter how complicated the case, litigants should limit their opening statements to no more than 10 to 15 minutes.

What you say in your opening statement is not evidence. Thus, it would be premature for you to argue the merits of your case at this point. An opening statement can be used to alert the judge to the specific facts in dispute so that the judge can focus on them as you develop your case. It is also a good idea to give the judge a preview of how you have structured your presentation so that the judge understands how each witness fits into your case. When multiple claims and issues are heard, it is important to let the judge know what evidence goes with what issue or claim. The party with the burden of proof gives its opening statement first, followed by the defending party. The defending party may defer its opening statement until it begins its case.

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Practice Pointers (cont'd):

Documentary Evidence: Rule 4 Documents

The evidentiary phase of the hearing follows opening statements. As the first order of business in this phase, the presiding judge will receive in evidence, on the record, all documents in the Rule 4 file and any supplemental Rule 4 files the parties have submitted to which no objections have been raised. When this is done, the bulk of the documentary evidence that is relevant and pertinent to the case³ should be in evidence, and no further identification or authentication is necessary.

All that is left should be documents to which objections have been raised. Under Rule 4(e), these documents would have been removed or considered removed from the Rule 4 files. Rule 4(e), however, permits the party offering the removed documents to move their admission as evidence during the hearing through witnesses. The number of documents removed from the Rule 4 files on the bases of relevancy, authenticity, or other reasons, should be relatively few. To ensure that these documents are not overlooked, it is a good idea to prepare a list of such documents, and to check them off if and when they are received in evidence during the hearing. Occasionally, documents initially removed may be entered in evidence by stipulation. Generally, however, removed documents are entered in evidence through witness testimony. If it is your intent to elicit testimony from a witness on a document, the document should be admitted in evidence before any testimony is elicited from the witness.⁴

The most effective way to move a document in evidence is to follow a simple three-step process: (1) mark the document for identification; (2) ask the witness to identify the document; and (3) move the identified document in evidence. A document should be moved in evidence immediately after it is identified. There is no reason to wait. Moving several documents in evidence en masse later could cause confusion in the record.

Documentary Evidence: Hearing Exhibits

In addition to Rule 4 documents, summary charts, expert reports, and other demonstrative evidence are generally considered hearing exhibits. Hearing exhibits often require witness testimony to lay a foundation for admission; hence, they are generally offered when the appropriate witness is testifying.⁵ To remove the element of surprise, the board's pretrial order would have required the parties to exchange hearing exhibits prior to the hearing. Hearing exhibits may be moved in evidence following the same three-step process discussed above.

To correspond to the Rule 4(e) checkoff list you already prepared, you can use the original Rule 4 tab designations when offering documents removed from the Rule 4 file. Hearing exhibits may be marked for identification purposes as G-1 or A-1, etc., to distinguish whether the government (G) or appellant (A) offered the exhibit.

Calling Witnesses

Generally, the presiding judge's pretrial order would have required the parties to exchange a witness list in advance of the hearing. The order would have cautioned the parties that witnesses not identified will not be allowed to testify. ASBCA judges are empowered by statute to subpoena the attendance of witnesses.⁶ Once a subpoena is issued, it is applicant's responsibility to have the subpoena properly served, and to ensure the witness's attendance.

Before the first witness is called, the presiding judge would generally ask if the parties wish to invoke the witness exclusion rule.⁷ At the request of a party, the judge will order witnesses excluded from the hearing so that they cannot hear the testimony of other witnesses. While the Rules of Practice of the ASBCA do not
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Practice Pointers (cont'd):

provide for witness exclusion, ASBCA judges follow Fed.R.Evid. 615. That rule, however, does not authorize exclusion of “(1) a party who is a natural person, or (2) an officer or employee of a party which is not a natural person designated as its representative by its attorney, or (3) a person whose presence is shown by a party to be essential to the presentation of the party’s cause, or (4) a person authorized by statute to be present.”

When a witness takes the stand, that witness can be expected to give testimony in two rounds of questioning from each side. The party calling the witness starts out with direct examination, followed by cross-examination by the opposing side. If necessary, the party calling the witness may follow up with redirect examination, followed by re-cross examination by the opposing party. At any stage, the presiding judge may ask questions.

In calling witnesses, some thought should be given to the sequence in which witnesses take the stand. In government contract litigation, the validity of a decision made or an action taken often depends upon a sequence of events. Witnesses should be sequenced so that the underlying facts of your case emerge in an orderly and understandable fashion. Witnesses understandably like to do their part and move on with their lives. It is not unusual for them to ask their counsel to time their appearance to fit their schedules. Not properly sequencing witnesses, however, can lead to an incoherent and disjointed presentation leaving the judge perplexed and the record confused. Also, giving testimony on a document not yet in evidence invites objections from your opponent. For this reason, you should sequence your witnesses so that, to the maximum extent possible, they are not put into a situation of testifying from a document not in evidence.

Using Witness Books

When a witness is expected to testify about numerous topics involving several topics or issues, use of a witness book can be helpful. A witness book is a binder containing all of the Rule 4 and hearing exhibits arranged chronologically by topics on which the witness is to provide testimony. The primary benefit in putting together a witness book is that it inevitably forces you to organize your case. Secondly, the exercise minimizes the chances that you may fail to address a crucial document during a hearing. Experience has shown that using witness books significantly improves the flow of presentation because of the time and effort saved in locating documentary evidence scattered throughout a large Rule 4 file. The use of witness books has cut the duration of hearings in some cases by as much as 50 percent.

The other benefit of using witness books is that it helps you and the fact-finders in marshalling evidence. Since witness testimony from a transcript can be directly cross-referenced to specific documents collected in a witness book, proposed findings in your post-hearing briefs and fact-finding by the board can be made quickly without spending time and effort, once again, to find the pertinent documents in a large record. Since the most time-consuming aspect of briefing⁸ and deciding your case relates to fact-finding, use of witness books expedites the resolution of your case.

Not every case or every witness needs a witness book. The decision on whether to prepare one should be made on a case-by-case or witness-by-witness basis. Witness books are considered attorney work product, and for that reason need not be provided to your opponent unless and until a witness is called.⁹ If you decide to use witness books, make sure that your witness, your opposing counsel, and the presiding judge are each provided a conforming copy.

Expert Testimony

Disputes before the ASBCA often involve scientific, technical, or other specialized knowledge. With
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Practice Pointers (cont'd):

respect to testimony by experts, the board generally follows the Federal Rules of Evidence (FRE).¹⁰ The FRE “assigned to the trial judge the task of ensuring that an expert’s testimony both rests on a reliable foundation and is relevant to the task at hand.”¹¹ The trial judge’s general “gatekeeping” obligation applies not only to testimony based on “scientific” knowledge, but also to testimony based on “technical” and “other specialized knowledge.”¹² the judge’s gatekeeping inquiry must be sufficiently tied to the facts of a particular case.¹³ Absent abuse of discretion, the judge has broad latitude to decide whether to admit or exclude expert testimony.¹⁴ Generally, expert testimony on issues of law is inadmissible.¹⁵ This means that while an expert may opine on an issue of fact, he or she may not give testimony stating ultimate legal conclusions based on those facts. Expert testimony, therefore, must be carefully circumscribed so that it does not usurp the role of judges in applying the law to the facts.

Typically, an ASBCA judge’s pretrial order would have required the parties to exchange written expert testimony, in question-and-answer or to exchange written expert reports, at least a month or more before a hearing. The pretrial order also would have required that all experts’ curricula vitae be exchanged along with a written expert testimony report. At the hearing, the party calling an expert would offer the witness as an expert, have the pre-filed written testimony report identified and admitted, and then ask any supplemental questions deemed necessary, before turning the expert over for cross-examination. This procedure saves time at the hearing. More importantly, requiring an exchange of written expert testimony reports beforehand enables parties to be better prepared. Having studied the expert’s testimony and taken the expert’s deposition in advance makes the tasks of cross-examining the expert and presenting contrary evidence at hearing more effective.¹⁶

If you decide to call an expert witness, you should make sure that your expert is qualified by knowledge, skill, experience, training, or education, or some combination of the foregoing, in the specific subject matter or area involved,¹⁷ that the expert testimony is based upon reliable principles and methods, and that the testimony does not intrude into conclusion of law reserved for judges.

Rebuttal and Surrebuttal

Before you close your case-in-chief, take a moment to check whether you have inadvertently omitted any proof you want in evidence. When both parties close their cases-in-chief, the hearing enters the rebuttal phase. Trial judges have the discretion to limit the scope of rebuttal testimony/evidence to that which is directed to rebut new evidence or new theories proffered.¹⁸ As one commentator has noted, “a rebuttal is necessary only because, on a plea of denial, new subordinate evidential facts have been offered or because, on an affirmative plea, its substantive facts have been offered or because, on any issue whatever, facts discrediting the proponents witnesses have been offered.”¹⁹ Surrebuttal is proper where (1) rebuttal testimony raises a new issue, which broadens the scope of the case, and (2) the proffered surrebuttal testimony discredits the essence of the rebuttal testimony.²⁰ Or, as Wigmore put it, two sorts of evidence are proper on rejoinder: “evidence explaining away the effect of new facts brought forward by the proponent in rebuttal, and evidence impeaching the witness testifying in rebuttal.”²¹

Closing Statements

Except in Rule 12.2 cases (small claims processed under the board’s expedited procedure), where decisions are rendered sometimes from the bench by a single judge, closing statements are rarely given. Since the parties will be given the opportunity to submit post-hearing briefs, providing a closing statement is often unnecessary and serves no real purpose.

On rare occasions, a party may decide to waive submission of its post-hearing brief. If you so choose, *(continued on next page)*

Practice Pointers (cont'd):

be aware it could work to your detriment. First, even though an appeal is heard by one judge, it is decided by a panel of at least three judges.²² By waiving your post-hearing brief, you will be giving up your opportunity to persuade the other judges on the panel the merits of your case. Secondly, by waiving your post-hearing brief, you will be giving up your opportunity to reply to your opponent's brief. Unrebutted points in your opponent's brief could work to your disadvantage.

Final Thoughts

This article does not suggest that all ASBCA judges run their cases the same way. Within certain parameters, ASBCA judges are given wide latitude and discretion to structure the hearing to suit the circumstances of each case. In the end, effective presentation of your appeal depends on thoughtful organization and presentation of your documentary and testimonial evidence, and thorough preparation of your witnesses.

* - Peter D. Ting has been a member of the Armed Services Board of Contract Appeals since 1983. The views expressed herein are his, and not those of the ASBCA or the Department of Defense.

Endnotes

¹ - Use of the word "appeal" can sometimes be confusing. Under the Contract Disputes Act, 41 U.S.C. §§601-613, an "appeal" to the ASBCA is taken from a contracting officer's decision or his or her failure to issue a decision. 41 U.S.C. §§605(a), 605(c)(5). The ASBCA reviews the contracting officer's decision de novo either on the written record without a hearing (Rule 11) or by conducting hearings akin to civil trials without a jury. *Assurance Co. v. United States*, 813 F.2d 1202, 1206 (Fed. Cir. 1987) (ASBCA had authority to reduce or nullify contracting officer awards); *Wilner v. United States*, 24 F.3d 1397, 1402 (Fed. Cir. 1994)(once an action is brought following a contracting officer's decision, the parties start in court or before the board with a clean slate"); *England v. Sherman R. Smoot, Corp.*, 388 F.3d 844, 856 (Fed. Cir. 2004)(the McMullen presumption arising out of a CO's "interim decision" is at odds with the CDA).

² - Federal district courts typically issue local rules for summary judgment motions. In supplementation of ASBCA Rule 5(b), the Board has issued "Guidance for Summary Judgment Motions" (February 7, 2007). If you do not have this guidance, contact the board for a copy.

³ - "Relevant evidence" is defined as that which has "any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence." Fed. R. Evid. 401.

⁴ - For a more thorough discussion of the use and preparation of Rule 4 files, see Peter D. Ting and Reba Ann Page, *Practice Pointers: A Short Primer on the Effective Preparation and use of Rule 4 Files*, 43-4 *The Procurement Lawyer*, Summer 2008.

⁵ - *Nager Electric Co. v. United States*, 442 F.2d 936 (Ct. Cl. 1971)(exhibit can be properly excluded when its preparation fails to "present any adequate evidence as to the validity or correctness of the exhibit.").

⁶ - 41 U.S.C. §610.

⁷ - Fed. R. Evid. 615.

⁸ - Depending on the complexity of the case, the parties are generally given between 30 to 60 days to submit post-hearing briefs, and less time to submit reply briefs. Post-hearing briefs can be simultaneous or sequential depending upon the judges' or the parties' preference. An investment of time and effort in preparing witness books before the hearing can pay off during the briefing phase.

⁹ - Documents in a witness book should already be included in the Rule 4 file or its supplements, or exchanged pursuant to a pretrial order.

¹⁰ - Fed. R. Evid. 701-05.

¹¹ - *Daubert v. Merrill Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 598 (1993).

¹² - *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 140 (1999).

¹³ - *Daubert*, 509 U.S. at 591.

¹⁴ - *General Elec. Co. v. Joiner*, 522 U.S. 136, 143 (1997).

¹⁵ - *See generally*, Note, Expert Legal Testimony, 97 *Harv. L. Rev.* 797 (1984); *Rumsfeld v. United*

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Practice Pointers (cont'd):

Technologies Corp., 315 F.3d 1361, 1369 (Fed. Cir.), *cert. denied*, United Technologies Corp. v. Rumsfeld, 540 U.S. 1012 (2003).

¹⁶ - *Daubert*, 509 U.S. at 596 (“Vigorous cross-examination, presentation of contrary evidence, and careful construction on the burden of proof are the traditional and appropriate means of attacking shaky but admissible evidence.”).

¹⁷ - Fed. R. Evid. 702.

¹⁸ - See, e.g., *Martin v. Weaver*, 666 F.2d 1013, 1020 (6th Cir. 1981), *cert. denied*, 456 U.S. 962 (1982).

¹⁹ - 6 Wigmore, Evidence §1873 (Chadbourn rev. 1976).

²⁰ - *United States v. Moody*, 903 F.2d 321, 330, 331 (5th Cir. 1990).

²¹ - 6 Wigmore, Evidence §1874 (Chadbourn rev. 1976).

²² - Except with respect to Rule 12.2 cases (expedited procedure where “[d]ecisions will be rendered for the Board by a single Administrative Judge”) and Rule 12.3 cases (accelerated procedure where “[d]ecisions will be rendered for the Board by a single Administrative Judge with the concurrence of a Vice-Chairman, or by a majority among these two and the Chairman in case of disagreement”), appeals at the ASBCA are decided in favor of or against a party by a majority of judges on a panel. Each ASBCA panel consists of five judges. Thus, if three out of the five judges are in agreement with the outcome of an appeal, the case need not go to the full five-judge panel. If one of the three judges disagrees with the result reached by the assigned judge, the case goes to the full five-judge panel and it is decided in favor of or against a party based on a majority of the five-judge panel.



An IFRS Primer for Government Contractors (And Other Uninterested People)

by
Peter A. McDonald*

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In the next few years, the International Financial Reporting Standards (IFRS) will replace generally accepted accounting principles (GAAP) as the authoritative body of accounting rules. It is unlikely that government contractors will be equally impacted by the changes, but all government contractors will be affected to some extent. To prepare for these changes, each contractor will need to assess the impact of IFRS on its business.

I. IFRS

IFRS has been developed and is overseen by the International Financial Accounting Board (IFAB), located in London, U.K. IFRS is used by almost every country that matters in the business world except the United States.

In the United States, GAAP has long provided the accounting standards by which financial statements of U.S. companies were prepared. To assist in proper financial reporting, accountants in the United States have all been trained in GAAP. GAAP was created by the Financial Accounting Standards Board (FASB), headquartered in Norwich, Connecticut.

Unfortunately, by adhering to GAAP, the United States has increasingly isolated itself from the international business community. By using common financial reporting systems, U.S. companies that use IFRS will have greater access to international capital markets. This is because it will be easier for investors to compare the financial statements of companies in different countries. Simply put, the migration to IFRS is a consequence of the fact that business is now global. While not a benefit intended by IFRS, financial professionals (including CPAs) will see their practice horizons broaden.

Over the last several years, FASB has become increasingly concerned about the role of U.S. companies in the global economy, and the concomitant need for U.S. companies to adopt international accounting standards. Toward that end, in 2002 FASB and the IASB entered into a memorandum of understanding, which has come to be called the Norwalk Agreement. In this memorandum, FASB and the IASB each pledged to develop accounting standards that could be used for both domestic and international financial reporting.

The Securities & Exchange Commission (SEC) supports the Norwalk Agreement because it supports having a single set of accounting standards.¹ Toward this end, in 2007 the SEC permitted the financial statements of foreign private issuers to be in accordance with IFRS without requiring those statements to be reconciled to GAAP.² It would appear then that the adoption of IFRS by U.S. companies may not be too far off. On this point, the IASB and FASB have agreed to develop one set of accounting standards no later than 2013.³ Indeed, an April 2008 survey by the American Institute of Certified Public Accountants (AICPA) found that more than half of the CPAs at accounting firms and companies were preparing for IFRS.

The process of replacing GAAP with IFRS will not be a dramatic event occurring on a certain day. To the contrary, IFRS will become the accounting standards through a gradual process spanning several years. In fact, the partial adoption of IFRS has already occurred (e.g., for banks). This process, by which IFRS replaces
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An IFRS Primer for Government Contractors (cont'd):

GAAP, is generally referred to as “convergence,” in the sense that U.S. accounting standards are converging with international standards. The process of convergence will likely see a period of voluntary adoption before IFRS becomes mandatory.

II. IFRS Impact on Accountants

At present, all accountants are concerned about IFRS because they are the new rules that will govern the preparation and reporting of financial statements. To put it mildly, IFRS represents an event of seismic significance for accountants. As a rough example, suppose you were an attorney practicing in a particular state. You would have been trained in the laws of that state, and indeed, your bar exam would have tested your detailed knowledge of those laws. Assume in this example that your state decides one day to replace its laws with the laws of another state. There would be many similarities in the legal codes, of course. For example, criminal law would probably not change very much (murder would still be murder). However, there would be differences as well. In a roughly similar way, that is how it is for accountants getting trained in IFRS. Individuals in related fields (actuaries, valuation experts, auditors, and so on) will also need to be trained in IFRS. For all concerned, now is the time.

Perhaps the most fundamental difference between GAAP and IFRS is that GAAP uses historical costs to value assets while IFRS uses fair value, or mark-to-market. (The accounting problem of determining the fair value of assets in an inactive market lies beyond the scope of this article.) Here is an illustrative list of other substantive problem areas:

- GAAP allows First In First Out (FIFO) and Last In First Out (LIFO) as inventory costing methods. However, LIFO is not a recognized inventory cost method under IFRS;
- Under certain circumstances, GAAP permits violations of debt instrument provisions to be cured after the end of a fiscal year, but IFRS does not;
- Unlike IFRS, GAAP contains much more detailed guidance on revenue recognition (there are over 200 separate provisions), some of which address the practices in particular industries;
- GAAP permits the entry of extraordinary items on the Income Statement, which IFRS does not allow;
- Financial statements under IFRS include a Statement of Changes in Equity;
- GAAP uses a two-step method for asset impairment write-downs, while IFRS has only a single step; and
- The GAAP probability threshold for contingencies is “reasonable likelihood,” while the IFRS standard is the much lower “more probable than not.”

The last item will likely involve government contract attorneys involved in the likelihood of litigation outcomes. Finally, the most noticeable difference between GAAP and IFRS is in their bulk. Accountants have already noticed with some amusement that GAAP is considerably more voluminous.

III. IFRS Impact on Government Contractors

To repeat, GAAP applies to all U.S. companies, not just government contractors, and IFRS will replace GAAP. Therefore, IFRS will affect the financial reporting of all government contractors (some more than others). Obviously, the migration to IFRS should be a matter of concern to a company’s management as well as its board of directors. In short, all individuals involved in the financial reporting process will need to become knowledgeable about IFRS, and most importantly on the key IFRS/GAAP differences. At the very least, government contractors will need to address the challenges presented by adopting IFRS. One challenge will be to ensure that the accounting issues are appropriately identified, and obviously contractors without
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An IFRS Primer for Government Contractors (cont'd):

internal resources will be at a disadvantage. Another challenge may be to develop a cohesive transition plan that identifies the risks is resolving those issues. Separate and apart from financial statement preparation and financial reporting requirements under IFRS, the IFRS accounting treatment of the following matters should be of general concern to government contractors.

- Compensation for personal services (FAR 31.205-6);
- Contingencies (FAR 31.205-7);
- Gains and losses (FAR 31.205-16)(i.e., impairment of assets); and
- Rental costs (FAR 31.205-36)(i.e., leases).

From this overview, it would appear that IFRS will likely impact some government contractors more than others. For example, service contractors with leased facilities may encounter more convergence issues than construction contractors. In like manner, defense contractors with assets impaired by terminations for convenience will be more affected by the transition to IFRS than health industry contractors working on research and development projects. As with the business world in general, the migration to IFRS will have a disparate impact on government contractors.

IV. Conclusion

IFRS will affect all companies, and adoption of IFRS is not a matter of if but when. There are numerous requirements that apply the first time a company uses IFRS, including a disclosure that explains how the transition affected its financial performance. Government contractors already must comply with accounting regulations such as the Federal Acquisition Regulation and the Cost Accounting Standards, and are subject to the additional scrutiny of government auditors. Meeting these requirements generally calls for a staff of more highly trained accounting professionals. Where this is the case, government contractors should be better able to embrace a new regulatory regime such as IFRS.

More detailed information is available at <http://www.ifrs.org>.

* - Peter A. McDonald, an attorney-C.P.A., is a director in the Government Contracts Practice at Navigant Consulting Inc., Vienna, Va., and a member of the *Federal Contracts Report* Advisory Board.



**UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION**

Rothe Development Corporation,)	
)	
)	
Plaintiff)	
)	
vs.)	Civil Action No. SA-98-CV-1011-XR
)	
U.S. Department of Defense and the U.S. Department of Air Force,)	
)	
)	
Defendants)	

ORDER

FILED
FEB. 26, 2009
CLERK, U.S. DISTRICT COURT
WESTERN DISTRICT OF TEXAS

On this date, the Court considered the Government's Motion for entry of injunctive order (docket no. 364).

Background

This case concerns the constitutionality of Section 1207 of the National Defense Authorization Act of 1987 (the "1207 Program" or the "Act"), Pub. L. No. 99-661, 100 Stat. 3859, 3973 (1986) (as amended), codified at 10 U.S.C. §2323, which permits the United States Department of Defense ("DoD") to preferentially select bids submitted by small businesses owned by socially and economically disadvantaged individuals ("SDBs"). Plaintiff Rothe Development Corporation brought this suit arguing that section 2323 is facially unconstitutional because it takes race into consideration in violation of the equal protection component of the due process clause of the Fifth Amendment. This Court found that the 2006 Congressional reauthorization of the 1207 Program satisfied the requirements of strict scrutiny. This Court further found that Congress had a compelling interest when it reauthorized the 1207 Program in 2006, and that compelling interest was supported by a strong basis in the evidence. Furthermore, this Court found that the 2006 Reauthorization of the 1207 Program was narrowly tailored. *See Rothe Development Corp. v. U.S. Dept. of Defense*, 499 F. Supp.2d 775 (W.O. Tex. 2(07)).

On November 4, 2008, the Federal Circuit issued its opinion affirming in part and reversing in part this Court's order and judgment. *See Rothe Development Corp. v. Department of Defense*, 545 F.3d 1023 (Fed. Cir. 2(08)). In relevant part, the Federal Circuit held that "Congress did not have a 'strong basis in evidence' before it in 2006, upon which to conclude that DOD was a passive participant in racial discrimination in relevant (continued on next page)

Rothe Development (cont'd):

markets across the country and that therefore race-conscious remedial measures were necessary..... *Id.* at 1027. Accordingly, the Federal Circuit reversed this court's judgment in part and held that Section 1207 (i.e., 10 U.S.C. §2323) is unconstitutional on its face. *Id.* Finally, the Federal Circuit directed this court "to enter a judgment (1) denying Rothe any relief regarding the facial constitutionality of Section 1207 as enacted in 1999 or 2002, (2) declaring that Section 1207 as enacted in 2006 (i.e., the current 10 U.S.C. §2323) is facially unconstitutional, and (3) enjoining application of the current 10 U.S.C. §2323." *Id.* at 1050.

Current version of 10 U.S.C. §2323

10 U.S.C. §2323(a)(1) provides that except as exempted for national security considerations, a goal of 5 percent of certain contracts shall be the objective of the Department of Defense, the Coast Guard, and the National Aeronautics and Space Administration in each fiscal year for contracts and subcontracts entered into with small business concerns, owned and controlled by socially and economically disadvantaged individuals and qualified HUBZone small business concerns; historically Black colleges and universities; minority institutions; Hispanic-serving institutions; and Native Hawaiian-serving institutions and Alaska Native-serving institutions. *See* 10 U.S.C. §2323(a)(1).

Section 2323(c) states: "To attain the goal specified in subsection (a)(1), the head of an agency shall provide technical assistance¹ to the entities referred to in that subsection and, in the case of historically Black colleges and universities, Hispanic-serving institutions, Native Hawaiian-serving institutions and Alaska Native-serving institutions, and minority institutions, shall also provide infrastructure assistance.²"

Further, section 2323(e) provides that agency heads may advance payments to contractors described in subsection (a). Further, to "facilitate achievement of the 5 percent goal described in subsection (a), the head of an agency may ... enter into contracts using less than full and open competitive procedures....."

Defendants' motion for entry of injunctive order

Rothe requests that this Court enjoin application of 10 U.S.C. §2323 in its entirety. Defendants argue that this Court need only enjoin portions of section 2323 that address race-based procurement programs for small and disadvantaged businesses. Defendants argue that Plaintiff's claim "has always focused only on the SDB contracting programs in 10 U.S.C. §2323" and that this Court's and the Federal Circuit's review of this case was always limited to the SDB programs. Defendants argue that section 2323's "race-neutral small business contracting programs and educational institution grant, scholarship and technical assistance programs" should not be enjoined. The Government argues that HUBZone small business concerns may be owned and operated by any citizen regardless of race or ethnicity and certain preferential treatment is only afforded them because they have located their principal offices in a historically underutilized business zone. *See* 13 C.P.R. Part 126³. Accordingly, the Government argues that since this preference is race-neutral, there is no strict scrutiny concern with regard to this part of the statute. The Government also argues that inasmuch as Rothe provides information technology services and is not an institution of higher learning, it is not harmed by any assistance given to any colleges and universities and Rothe does not have any standing to raise any constitutional concern over section 2323's educational grant, scholarship and technical assistance programs.

Rothe responds that it has always "attacked" the 1207 program in its entirety, that the Government never attempted to sever any portions of section 2323 from its "attack", and the remand order of the Federal Circuit is clear ("instructions to enter a judgment ... enjoining application of the current 10 U.S.C. §2323").

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Rothe Development (cont'd):

Analysis

The Court agrees with Rothe that it challenged section 2323's five percent "goal for small disadvantaged businesses and certain institutions of higher education." See Plaintiff's First Amended Complaint filed February 8, 1999, docket no. 38 at paragraph 32. The Court recognizes, however, that all the briefing and argument in this case concerned only Rothe's loss of a contract to SDBs.

Section 2323(a)

The Federal Circuit's opinion mandates that historically Black colleges and universities, minority institutions, and Hispanic-serving institutions, as well as SDBs, may not receive any preferences provided for under section 2323(a). The Federal Circuit's holding that "Congress did not have a 'strong basis in evidence'" to allow for preferential treatment to SDBs is just as applicable to historically Black colleges and universities, minority institutions, and Hispanic-serving institutions. As to "qualified HUBZone small business concerns", even assuming that this is a preference granted to a race-neutral entity, the Court concludes that inasmuch as the Federal Circuit has stricken the preferences granted to SDBs, historically Black colleges and universities, minority institutions, and Hispanic-serving institutions, not enjoining section 2323 to "qualified HUBZone small business concerns" would result in a court imposed fundamental rewrite of this congressional statute. As currently written, Congress expected that the five percent goal would apply to five distinct entities (SDBs, historically Black colleges and universities, minority institutions, Hispanic-serving institutions, and "qualified HUBZone small business concerns"). The Government's request here would have the Court direct the entire five percent goal to "qualified HUBZone small business concerns." It is far from certain that this result is what Congress intended. In addition, this Court is obligated to follow the Federal Circuit's Judgment and Mandate, and the Federal Circuit made no exclusions for historically Black colleges and universities, minority institutions, Hispanic-serving institutions, or "qualified HUBZone small business concerns."

Section 2323(b)

Section 2323(b) is unable to survive because this subsection addresses how to calculate the amounts the Department of Defense should apply to reach the five percent goal in section 2323(a).

Section 2323(c)

Section 2323(c) provides that to "attain the goal specified in subsection (a)(1), the head of an agency shall provide technical assistance to the entities referred to in that subsection and, in the case of historically Black colleges and universities, Hispanic-serving institutions, Native Hawaiian-serving institutions and Alaska Native-serving institutions, and minority institutions, shall also provide infrastructure assistance."

The Court agrees that section 2323(c)'s establishment of undergraduate, graduate, and doctoral programs in scientific disciplines, making Department of Defense personnel available to advise and assist faculty at colleges and universities, establishing partnerships between defense laboratories and historically Black colleges and universities and minority institutions, awarding scholarships, equipping laboratories for the performance of defense research, and expanding Reserve Officer Training Corps activities do not impact Rothe in the least. It is difficult to ascertain Rothe's objections to these efforts. Nonetheless, Rothe does object and seeks their cancellation. Inasmuch as the Federal Circuit has stricken section 2323(a), this Court is obligated to comply and grant Rothe's request. Section 2323(c) is contingent upon section 2323(a). Inasmuch as the Federal Circuit has stricken section 2323(a), the Federal Circuit's decision causes the fall of section
(continued on next page)

Rothe Development (cont'd):

2323(c).

Section 2323(d)-(k)

The remainder of section 2323 contains definitions and other subsections addressing implementation of section 2323(a). Because the Federal Circuit has struck section 2323(a), these sections also fall.

Conclusion

Defendant's Motion for Entry of Injunctive Order (docket no. 364) is denied. Pursuant to the Federal Circuit's Judgment and Mandate, this Court will enter a judgment (1) denying Rothe any relief regarding the facial constitutionality of Section 1207 as enacted in 1999 or 2002, (2) declaring that Section 1207 as enacted in 2006 (i.e., the current 10 U.S.C. §2323) is facially unconstitutional, and (3) enjoining application of the current 10 U.S.C. §2323.

It is so ORDERED.

SIGNED this 26th day of February, 2009.

/s/

XAVIER RODRIGUEZ
UNITED STATES DISTRICT JUDGE

Endnotes

1. "Technical assistance provided under this section shall include information about the program, advice about agency procurement procedures, instruction in preparation of proposals, and other such assistance as the head of the agency considers appropriate. If the resources of the agency are inadequate to provide such assistance, the head of the agency may enter into contracts with minority private sector entities with experience and expertise in the design, development, and delivery of technical assistance services to eligible individuals, business firms and institutions, acquisition agencies, and prime contractors. Agency contracts with such entities shall be awarded annually, based upon, among other things, the number of minority small business concerns, historically Black colleges and universities, and minority institutions that each such entity brings into the program." 10 U.S.C. §2323(c)(2).
2. "Infrastructure assistance provided by the Department of Defense under this section to historically Black colleges and universities, to Hispanic-serving institutions, to Native Hawaiian-serving institutions and Alaska Native-serving institutions, and to minority institutions may include programs to do the following:
 - (A) Establish and enhance undergraduate, graduate, and doctoral programs in scientific disciplines critical to the national security functions of the Department of Defense.
 - (B) Make Department of Defense personnel available to advise and assist faculty at such colleges and universities in the performance of defense research and in scientific disciplines critical to the national security functions of the Department of Defense.
 - (C) Establish partnerships between defense laboratories and historically Black colleges and universities and minority institutions for the purpose of training students in scientific disciplines critical to the national security functions of the Department of Defense.
 - (D) Award scholarships, fellowships, and the establishment of cooperative work-education programs in scientific disciplines critical to the national security functions of the Department of Defense.

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Rothe Development (cont'd):

Endnotes (cont'd)

(E) Attract and retain faculty involved in scientific disciplines critical to the national security functions of the Department of Defense.

(F) Equip and renovate laboratories for the performance of defense research.

(G) Expand and equip Reserve Officer Training Corps activities devoted to scientific disciplines critical to the national security functions of the Department of Defense.

(H) Provide other assistance as the Secretary determines appropriate to strengthen scientific disciplines critical to the national security functions of the Department of Defense or the college infrastructure to support the performance of defense research." 10 U.S.C. §2323(c)(3)(A) - (H).

3. HUBZone means a historically underutilized business zone, which is an area located within one or more: (1) Qualified census tracts; (2) Qualified non-metropolitan counties; (3) Lands within the external boundaries of an Indian reservation; (4) Qualified base closure area; or (5) Redesignated area.

HUBZone small business concern (HUBZone SBC) means an SBC that is (1) At least 51% owned and controlled by 1 or more persons, each of whom is a United States citizen; (2) An ANC owned and controlled by Natives (as determined pursuant to section 29(e)(1) of the ANCSA, 43 U.S.C. §1626(e)(1)); (3) A direct or indirect subsidiary corporation, joint venture, or partnership of an ANC qualifying pursuant to section 29(e)(1) of the ANCSA, 43 U.S.C. 1626(e)(1)), if that subsidiary, joint venture, or partnership is owned and controlled by Natives (as determined pursuant to section 29(e)(2) of the ANCSA, 43 U.S.C. §1626(e)(2)); (4) Wholly owned by one or more Indian Tribal Governments, or by a corporation that is wholly owned by one or more Indian Tribal Governments; (5) An SBC that is owned in part by one or more Indian Tribal Governments or in part by a corporation that is wholly owned by one or more Indian Tribal Governments, if all other owners are either United States citizens or SBCs; (6) An SBC that is wholly owned by a CDC or owned in part by one or more CDCs, if all other owners are either United States citizens or SBCs; or (7) An SBC that is a small agricultural cooperative organized or incorporated in the United States, wholly owned by one or more small agricultural cooperatives organized or incorporated in the United States or owned in part by one or more small agricultural cooperatives organized or incorporated in the United States, provided that all other owners are small business concerns or United States citizens.

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Rothe Development (cont'd):

**UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION**

Rothe Development Corporation,)	
)	
)	
Plaintiff)	
)	
vs.)	Civil Action No. 98-CA-1011-XR
)	
U.S. Department of Defense and the U.S. Department of Air Force,)	
)	
)	
Defendants)	

FINAL JUDGMENT

FILED
FEB. 26, 2009
CLERK, U.S. DISTRICT COURT
WESTERN DISTRICT OF TEXAS

In accordance with the mandate of the United States Court of Appeals for the Federal Circuit issued December 29, 2008, the Court hereby orders (1) that Judgment be entered for Defendants on Plaintiff's claims for declaratory and injunctive relief challenging the facial constitutionality of the 1999 and 2002 reauthorizations of 10 U.S.C. §2323, and that Plaintiff take nothing on those claims; (2) that Judgment be entered for Plaintiff on its claim for declaratory relief challenging the facial constitutionality of the present 10 U.S.C. §2323, and that the present 10 U.S.C. §2323 is held facially unconstitutional; (3) that all application of the present 10 U.S.C. §2323 is enjoined.

With regard to any award of attorney's fees, any motion for an award of attorney's fees shall be filed and served no later than fourteen (14) days after entry of judgment pursuant to Rule 54 of the Federal Rules of Civil Procedure. Counsel for the parties shall meet and confer for the purpose of resolving all disputed issues relating to attorney's fees prior to making application. The application shall certify that such a conference has occurred. If no agreement is reached, the applicant shall certify the specific reason(s) why the matter could not be resolved by agreement. The motion for attorney's fees shall include a supporting document organized chronologically by activity or project, listing attorney name, date, and hours expended on the particular activity or project, as well as an affidavit certifying (1) that the hours expended were actually expended on the topics stated, and (2) that the hours expended and rate claimed were reasonable. Such application shall also be accompanied by a brief memo setting forth the method by which the amount of fees was computed, with sufficient citation of authority to permit this court the opportunity to determine whether such computation is correct. The request shall include reference to the statutory authorization or other authority for the request.
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Rothe Development (cont'd):

Detailed time sheets for each attorney for whom fees are claimed may be required to be submitted upon further order of the Court.

Any objections to any motion for attorney's fees shall be filed on or before eleven (11) days after the date the motion for award of attorney's fees is filed. If there is no timely objection, the Court may grant the motion as unopposed.

The motion shall be resolved without further hearing, unless an evidentiary hearing is requested, reasons therefor presented, and good cause shown, whereupon hearing on the motion may be granted.

Any motion for award of attorney's fees filed beyond the fourteen (14) day period may be deemed untimely and a waiver of entitlement to fees.

Signed this 26th day of February, 2009.

/s/

XAVIER RODRIGUEZ
UNITED STATES DISTRICT JUDGE