

Prohibition on Cost-Plus-Percentage-of-Cost Subcontracts Highlighted by \$70 Million False Claims Act Settlement

Litigation Alert

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On June 21, 2024, the U.S. Department of Justice (DOJ) [announced](#) it had reached a \$70 million settlement with Sikorsky Support Services, Inc. (SSSI) and Derco Aerospace Inc. (Derco), both wholly owned subsidiaries of Lockheed Martin Corporation, to resolve False Claims Act (FCA) allegations that they overcharged the Navy for spare parts and materials used under SSSI's naval aircraft training contract.

Back in 2011, a whistleblower brought a *qui tam* FCA lawsuit against SSSI and Derco arising out of SSSI's cost-reimbursement contract with the Navy for naval aviator training. The government intervened in the suit, alleging that the companies knowingly entered into a cost-plus-percentage-of-cost subcontract whereby SSSI would purchase from Derco spare parts and materials needed to repair and maintain the primary aircraft used to train naval aviators. At the time, both SSSI and Derco were members of a corporate family owned by United Technologies Company. In the subcontract at issue, SSSI allegedly agreed to purchase parts at the cost that Derco paid other suppliers for the parts plus a fixed 32 percent markup. SSSI then sought reimbursement from the Navy for the amounts it paid Derco.

Cost-plus-percentage-of-cost contracts have long been prohibited in government contracts. Federal Acquisition Regulation (FAR) 16.102(c) states that a "cost-plus-a-percentage-of-cost system of contracting shall not be used" for subcontracts under cost-reimbursement prime contracts. The government alleged that SSSI and Derco violated this prohibition and, by seeking reimbursement for the amounts SSSI paid Derco, knowingly submitted false and fraudulent claims to the government in violation of the FCA. In a [previous 2021 decision](#), the trial judge granted the government's motion for summary judgment, ruling that the subcontract between SSSI and Derco did constitute a prohibited cost-plus-a-percentage-of-cost arrangement because the parties agreed that Derco would develop its fixed prices to charge SSSI by applying a markup (of 32 percent) consisting of its estimated indirect costs and a reasonable profit.

In the [settlement agreement](#), SSSI and Derco agreed to pay \$70 million, of which approximately \$36 million was characterized as "restitution." In addition, because this was a *qui tam* case, the plaintiff whistleblower, a former financial analyst at Derco, will receive almost \$14 million of the settlement amount.

Key Takeaway

A \$70 million settlement is substantial, and no doubt SSSI and Derco also paid significant legal fees in the defense of this action. However, this is less than what may have been expected based on allegations in the complaint that SSSI and Derco received kickbacks as part of the alleged scheme, which were previously dismissed by the judge in 2018.

Ultimately, the settlement is a reminder to contractors that no matter the contract vehicle, cost-plus-a-percentage-of-cost subcontracts are always prohibited in the government contracting space, and prime contractors (and subcontractors) **need to carefully assess whether a particular subcontract can potentially be characterized as running afoul of this prohibition.**

If you have any questions about the SSSI settlement or the cost-plus-a-percentage-of-cost prohibition, please contact one of the Miller & Chevalier attorneys listed below:

Scott N. Flesch, sflesch@milchev.com, 202-626-1584

Jason N. Workmaster, jworkmaster@milchev.com, 202-626-5893

Alex L. Sarria, asarria@milchev.com, 202-626-5822

Ashley Powers, apowers@milchev.com, 202-626-5564

Connor W. Farrell, cfarrell@milchev.com, 202-626-5925

Alexandra S. Prime*

**Former Miller & Chevalier attorney*

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