

**Section of Public Contract Law  
American Bar Association**

**Comments on Interest for Consideration of the Section 1423 Panel,  
The Acquisition Advisory Panel**

The Section of Public Contract Law submits for the consideration of the Section 1423 Panel (the Acquisition Advisory Panel) the following comments addressing fundamental inequities with respect to government payment of interest in connection with claims and disputes on government contracts.

**I. OVERRIDING PRINCIPLES, TOGETHER WITH INCONSISTENCIES WITH THESE PRINCIPLES AND FUNDAMENTAL INEQUITIES WITH RESPECT TO GOVERNMENT PAYMENT OF INTEREST IN CONNECTION WITH CLAIMS AND DISPUTES**

**ISSUE 1**

A. Principle. Contractors should have a reasonable and basic right to recover interest from the government for government actions and omissions, e.g., changes, breaches, etc., as the government has to recover and does recover interest from contractors.

B. Fundamental Inequity. While the government has rights to recover interest against virtually any debtor, there are various kinds of government contracts where the contractor has no interest recovery rights.

C. Discussion. The government has broad rights to recover interest against contractors. In fact, the government not only has a right, but also has duty to charge interest on its claims under 31 U.S.C. § 3717(a)(1):

The head of an executive, judicial, or legislative agency shall charge a minimum annual rate of interest on an outstanding debt on a United States Government claim owed by a person that is equal to the average investment rate for the Treasury tax and loan accounts for the 12- month period ending on September 30 of each year, rounded to the nearest whole percentage point.

If there is another, more specific statute governing interest recovery for the government, that more specific provision will control. Such other statutes include the Truth in Negotiation Act ("TINA"), 10 U.S.C. § 2306a(1)(A) and the Cost Accounting Standards Board Act, 41 U.S.C. § 422(h)(1)(B), (h)(4). Responsible contracting officials are obligated generally to charge interest on any contract debt unpaid after 30 days from the issuance of a demand. See FAR 32.614-1(a); 52.232-17 (Interest clause). The government generally seeks and obtains interest as part of its claim recoveries.<sup>1</sup>

Examples of contracts for which the contractor has no general right to interest on amounts due from the government<sup>2</sup> are: (1) Winstar cases, an example of which is the Suess decision cited below. The Winstar cases involved government breach of obligations to purchasers of failed savings and loans. The government was found in breach but, as a matter of law, interest was excluded as part of damages. (2) Spent nuclear fuel leases. The government was in breach of its obligation to provide spent nuclear fuel storage, but interest was not recoverable as a matter of law. (3) Government sales contracts; here the contractor is the purchaser. An example is the Hughes Communications Galaxy case. Hughes Communications Galaxy, Inc. v. United States, 47 Fed. Cl. 236 (2000). The government provided launch services to Hughes. After the Challenger disaster, the government declined to continue. Hughes had to reprocur launch services. The government was found in breach. Hughes received a monetary award but no interest. (4) Contracts involving purchase of real property. (5) Alleged breaches of insurance contracts under the National Flood Insurance Program. (6) Cooperative research and development agreements.

The need for legislative reform in this interest coverage area was forcefully stated in an opinion by then Chief Judge Loren Smith of the United States Court of Federal Claims as follows:

The court understands, of course, that the award of approximately \$35 million for the value of a franchise seized 12 years ago provides Franklin with far less in economic terms than it is owed. While the court is limited by the prohibition

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<sup>1</sup> Including interest starting well before "demand" as a practice.

<sup>2</sup> Fairly highly visible cases are used for examples.

on pre-judgment interest in this case, the court believes that the award is grossly inadequate in view of the damages actually suffered by Franklin. This, of course, is a recurring problem in the *Winstar*-related cases, because the parties who are harmed, even when able to prove damages in these difficult and novel cases, will not be made fully whole. Indeed, it is ironic that Franklin is prevented under the law from being made whole because it cannot obtain interest on its damages caused by the government's breach, but the government itself claims massive interest assessments against Franklin on the tax it contends the Franklin receivership owes.

Unfortunately, the courts, at least at this juncture, are not the fora that can make the damaged parties whole. This represents one of those gaps in our Nation's system of the rule of law. Our great Constitution's Framers were men of extraordinary vision. They understood that while a framework for the protection of rights under the law had been established in 1789, its complete fulfillment was an ongoing project for the ages. Through statute and executive action our Nation has moved toward that goal. This is a case where the movement should continue through the legislative process.

Robert Suess et al. v. United States, 52 Fed. Cl. 221, 232 (2002) (emphasis added).

D. Recommendation. Extend the interest provisions of the Contract Disputes Act ("CDA"), 41 U.S.C. § 601, et seq., to all government contracts. Such a change could be easily accomplished without applying other provisions of the CDA to those non-CDA contracts and without affecting the jurisdiction of any forum to consider and adjudicate disputes.

## **ISSUE 2**

A. Principle. Effective contracting and competition in the long run requires fair resolution of disputes which, in turn, requires fair compensation to contractors when the government is responsible for harm to contractors.

B. Fundamental Inequity. While the CDA allows its form of interest for covered contracts with the United States, various Boards of Contract Appeals and Courts routinely have held that current law denies recovery to contractors of damages for incurred interest

when represented as interest on a "stand alone" or interest only basis; i.e., interest that is not incurred as a result of financing another element or elements constituting an amount found due, and is claimed without an accompanying claim for the principal amount from which the incurred interest cost derives. Such claimed prejudgment interest costs have been denied, even though the costs have been acknowledged to have been incurred as a result of a government breach. In denying these interest claims, the Boards and Courts rely on the doctrine of sovereign immunity, the statute at 28 U.S.C. § 2516(a), or both, as well as, at times, the cost principle prohibiting interest in contract pricing (FAR 31.205-20).<sup>3</sup> The result is that contractors often are not compensated for costs caused by government action or omissions when those costs are interest costs – a fundamental unfairness. It is noteworthy that the application of sovereign immunity to interest claims, which remains the majority view, has been subjected to recent serious criticism. Gordon R. England, Secretary of the Navy v. Contel Advanced Systems, Inc., 384 F.3d 1372, 1382-83 (Fed. Cir. 2004) (Newman, J., dissenting). Moreover, there is considerable inconsistency in the judicial determinations, and therefore a lack of predictability. The recommendations set forth herein would provide both consistency and predictability.

C. Discussion. When a contractor suffers economic harm as the result of a breach of contract or other government act or omission, the contractor should recover interest. The theory of damages is to make an injured party whole. This principle is almost universally recognized with the exception of interest claims under government contracts. A contractor should not be forced to suffer economic damage in the form of additional interest caused by the government without recognition of interest entitlement. Interest is no less real a cost than materials or labor, and unrecovered interest constitutes no less an economic injury than unrecovered labor, material cost, profit or lost profits (as in patent cases) which are routinely reimbursed.

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<sup>3</sup> The FAR disallowance of interest may be acceptable for original contract pricing and for most cost reimbursable contract settlements. For changed work, terminations, suspensions, delays and breaches caused by government actions and omissions, the FAR disallowance of interest is grossly unfair, causes much mischief and calls for remedial legislation.

The following represent examples of the general necessity of recognizing interest, including prejudgment interest, to provide injured parties fair compensation:

(1) The Supreme Court has repeatedly recognized in a variety of contexts that interest is awarded because of considerations of fairness, as a step toward making a party reasonably whole for another party's act or omission. See, e.g., Milwaukee v. Cement Div., Nat'l Gypsum Co., 515 U.S. 189, 194-97 (1995) (citing numerous authorities).

Indeed, as long ago as 1896, the United States Supreme Court eloquently stated:

It is a dictate of natural justice, and the law of every civilized country, that a man is bound in equity, not only to perform his engagements, but also to repair all the damages that accrue naturally from their breach. . . . Every one who contracts to pay money on a certain day knows that, if he fails to fulfill his contract, he must pay the established rate of interest as damages for his non-performance.

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It is no hardship for one who has had the use of money owing to another to be required to pay interest thereon from the time when the payment should have been made.

Spalding v. Mason, 161 U.S. 375, 396 (1896) (citations omitted).

(2) In the last 50 years, most states in the United States have enacted statutes allowing prejudgment interest on verdicts or awards in court. The Attachment summarizes and sets forth examples of prejudgment statutes in the states of California, Maryland, New York, Virginia and the District of Columbia.

(3) The Restatement of Contracts states:

(1) If the breach consists of a failure to pay a definite sum in money or to render a performance with fixed or ascertainable monetary value, interest is recoverable from the time for performance on the amount due less all deductions to which the party in breach is entitled.

(2) In any other case, such interest may be allowed as justice requires on the amount that would have been just compensation had it been paid when performance was due.

RESTATEMENT (SECOND) OF CONTRACTS § 354 (1981).

(4) Award of prejudgment interest is the usual rule in patent cases where the government is the infringer. Interest is also awarded against the U.S. government in "takings" cases. Interest against the government in these cases often is held to begin at the time of the infringement or the taking. There is no economic justification for requiring interest from the government as damages in patent infringement, in other words, making the injured party whole, while denying interest caused by a government breach of a procurement contract.<sup>4</sup>

It is time to change the law on when and how contractors recover interest against the government to better reflect 21st century economic realities in the United States, rather than those of medieval England, and to achieve fairer resolution of disputes.

D. Recommendation. Amend the CDA to allow stand alone or "interest only" type claims. Such change easily could be accomplished without altering requirements to demonstrate a basis of entitlement, fact of damage and causation or changing relevant burden of proof requirements.

### ISSUE 3

A. Principle. Effective competition requires fair resolution of disputes, which, in turn, requires fair compensation to contractors when the government is responsible for harm to contractors.

B. Fundamental Inequity. The interest rates used to determine interest recovery obtained by contractors pursuant to the CDA are grossly inadequate to compensate those contractors for the financing costs incurred as a result of government actions and omissions.

C. Discussion. The CDA provides for simple interest at the "Treasury Rate" (the old "Renegotiation Board" rate). Over time, the CDA rate approximates the yields on 10-

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<sup>4</sup> With regard to infringement by the government, Judge James W. Booth noted 24 years ago that the Supreme Court had held that interest on assessed patent damages was necessary to achieve the required legal remedy of "entire compensation," and that "entire" was also, in the words of the Supreme Court, "intended to accomplish complete justice between the plaintiff and the United States." J. Booth, Interest and Federal Contracts: A Perspective 20 (Arthur Andersen & Co. 1982). Under 35 U.S.C. § 284, interest is awardable when a private party has infringed a U.S. patent, and prejudgment interest is routinely awarded in patent cases between private parties.

year United States Treasury notes, being only slightly higher. The CDA rate is substantially less than the interest rates at which companies in the private sector obtain financing, as well as less than the rates used to reimburse the government by contractors for violations of the TINA and the Cost Accounting Standards ("CAS") regulations.

Consider the following current interest rates:

10-year US Treasury Note	5.065%
CDA	5.125%
Internal Revenue Service 6621(a)(2) [used by government for individual tax underpayments and TINA and CAS violations by contractors]	7.0 %
Internal Revenue Service 6621(c)(1) [used by government for large corporate tax underpayments]	9.0 %
Prime	8.0 %
Cost of large company equity capital, Total S&P 500 (estimated)	12.0 % <sup>5</sup>

The cost of capital for smaller companies and small businesses is higher still than the prime and cost of equity capital rates shown above – much higher (for instance, it is common for bank loans to small businesses to be quoted at two to three percentage points above prime, exclusive of fees. For example, see "Bank Term Loans," Entrepreneur. Com, Inc., December 1, 2005, [www.entrepreneur.com/article/0,4621,300791,00.html](http://www.entrepreneur.com/article/0,4621,300791,00.html)). Moreover, the full cost of equity capital for small businesses is considerably more.

The CDA rate is almost always lower than the Internal Revenue Service 6621(a)(2) rate used by the government to collect interest on tax underpayments and for TINA and CAS violations (over the past sixteen plus years, the Internal Revenue Service 6621(a)(2) rate has

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<sup>5</sup> This represents the current risk-free rate of approximately 5% (based on long-term U.S. Treasury note yields), plus estimated equity risk premium of approximately 7% (based on total market returns over long-horizon periods). An alternative method for gauging the S&P 500 equity risk premium – estimated real earnings growth, plus dividend yield, plus projected inflation – produces a comparable estimate.

exceeded the CDA interest rate by an average of 1.6 percentage points per quarter). Even though the Internal Revenue Service rate is significantly below interest rates for financing in the private sector, the Internal Revenue Service rate represents a much fairer rate than the CDA rate for purposes of paying contractors interest.

Although the Section does not recommend compound interest, a discussion of commercial practices is instructive to underscore the need for an increase in the CDA interest rate. In the commercial market place, whenever a cost determination involving interest is required, compound interest is the rule; compounding is considered absolutely necessary for proper determination of financing cost. But interest payable pursuant to the CDA is at simple interest, substantially further understating contractor recovery of financing costs. This understatement still would occur even if the CDA interest rate were made equivalent to the Internal Revenue Service 6621(a)(2) rate.

When companies, as well as individuals, fail to pay their suppliers for purchased goods and services; their real estate taxes; their water, gas, electric and telephone bills, their income taxes; or repay their bank debt; etc., these companies and individuals are routinely assessed interest charges from the time the failure to make timely payment occurred. The interest rates charged by the supplying vendor, electric company, telephone company, bank, credit card company, municipality or taxing authority, are usually at or near commercial market rates and the resulting interest is compounded. Notably, the Internal Revenue Service assesses compound interest at rates higher than government financing rates from the time the taxpayer fails to make the required tax payment. The interest owed to the Internal Revenue Service by taxpayers is compounded daily.

"Compound interest is used in most business situations. Simple interest is generally applicable only to short term situations of one year or less." Kieso, Donald E. et al., Financial Accounting, Tools For Business Decision Making, C-3 (3d ed. 2004). Savings accounts often pay compound interest daily.

Compound interest is frequently awarded in patent cases, both where only private parties are involved and where the government is the infringer. The United States Court of Federal Claims has made it clear that where the government is the infringer:

[I]nterest rates shall be compounded annually since no prudent, commercially reasonable investor would invest at simple interest. Compounding interest annually, therefore, is more likely to place the patentee in the same financial position it otherwise would have held had royalties been timely paid, [citations omitted], and has expressly been approved by the Federal Circuit. [citations omitted].

Brunswick Corp. v. United States, 36 Fed. Cl. 204, 219 (1996). See also Standard Mfg. Co., Inc. v. United States, 42 Fed. Cl. 748, 777 (1999).

The statute providing for interest on judgments in Federal Courts, 28 U.S.C. § 1961, "Interest," provides for annual compounding of interest. The Prompt Payment Act, enacted in 1982, provides for interest owed by the government to be compounded every 30 days. 31 U.S.C. §§ 3901 et seq.

To compare the result of allowing simple interest with real interest financing cost, consider the following interest amounts on an "amount found due" of \$1,000,000 after seven years – not an uncommon time to adjudicate a CDA claim – at the indicated current interest rates:

	<u>Simple Interest</u>	<u>Compound Interest (Quarterly)</u>	<u>Percentage Difference</u>
Current CDA rate, 5.125%	\$358,750	\$428,300	19.4 %
Internal Revenue Service rate:			
6621(a)(2) [TINA & CAS], 7%	\$490,000	\$625,400	27.6 %
6621(c)(1) [large corporate] , 9% <sup>6</sup>	\$630,000	\$864,500	37.2 %
Prime rate, 8%	\$560,000	\$741,000	32.3 %

<sup>6</sup> Rate for "large corporate underpayments," defined by the Internal Revenue Code as any corporate tax underpayment that exceeds \$100,000 for any tax period.

Since the contractor's true cost-of-capital financing rates are usually even higher than the rates indicated above – indeed, they are always higher than the presently defined CDA interest rate – the illustrations above actually understate the losses suffered by contractors.

An adjustment of the CDA interest rate placing contractors closer to market place realities would also carry out another principle recognized by the Supreme Court, namely: "The United States does business on business terms." United States v. Nat'l Exchange Bank, 270 U.S. 527, 534 (1926). That principle has been reiterated several times by the Supreme Court; among recent instances is United States v. Winstar, 518 U.S. 839, 895 (1996) (plurality opinion).

D. Recommendation. The CDA interest rate should be adjusted to a rate that more equitably compensates contractors and reflects the huge disparity between government and private sector financing costs.<sup>7</sup> The Section recommends the Internal Revenue Service 6621(c)(1) rate for large corporate tax underpayments, currently 9%.

Alternatively, the Section recommends an increase in the CDA interest rate to at least the same rate used for individual tax underpayments and for TINA and CAS violations, i.e., the Internal Revenue Service 6621(a)(2) rate.

### III. CONCLUSION

The Section 1423 Panel's statutory charter included the charge to review and recommend changes to acquisition laws with a view toward ensuring effective and appropriate use of commercial practices to promote "the effective, efficient and fair award and administration of Federal contracts." See Acquisition Advisory Panel website at [www.acquisition.gov/comp/aap/index.html](http://www.acquisition.gov/comp/aap/index.html).

The recommendations set forth above would address various inequities with respect to government payment of interest as follows:

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<sup>7</sup> For TINA and CAS violations, for example, the government collects interest at a current rate of 7%, yet obtains financing at a current long term rate of about 5% (the current 10-year Treasury note yield).

1) All government contracts would be made subject to the CDA's interest provisions, eliminating the interest coverage gaps that currently exist for certain kinds of contracts.

2) The CDA would be amended to allow for stand alone or interest only claims, which would provide fair compensation to contractors when they are forced to incur financing costs on behalf of the government.

3) The rates of interest used to pay interest for CDA claims would be adjusted to rates that are closer to those incurred by companies in the private sector to obtain commercial financing, helping to address – in part – the fundamental unfairness caused by today's government payment of interest at woefully inadequate rates. Interest rates would be adjusted to more appropriately reflect the real cost of financing in the commercial market place and huge disparity between government and private sector financing cost.

The Section believes these recommendations address the interest issues fairly, and that they achieve the desirable objectives of the Section 1423 Panel by incorporating more economic truth, more commercial practices into the CDA interest provisions and modifying those provisions to cause more equitable payment of interest.

## Attachment

### Examples of Prejudgment Interest Statutes

**California. In a breach of contract action, in the case of a liquidated claim, the claimant is entitled to recover interest from the date the right to recover damages is vested. In the case of an unliquidated claim, the claimant may also recover interest from a date fixed by the court in its discretion, but no earlier than date the action was filed.**

CAL. CIV. § 3287 (Deering 2006). Authorization

(a) Every person who is entitled to recover damages certain, or capable of being made certain by calculation, and the right to recover which is vested in him upon a particular day, is entitled also to recover interest thereon from that day, except during such time as the debtor is prevented by law, or by the act of the creditor from paying the debt. This section is applicable to recovery of damages and interest from any such debtor, including the state or any county, city, city and county, municipal corporation, public district, public agency, or any political subdivision of the state.

(b) Every person who is entitled under any judgment to receive damages based upon a cause of action in contract where the claim was unliquidated, may also recover interest thereon from a date prior to the entry of judgment as the court may, in its discretion, fix, but in no event earlier than the date the action was filed.

**Maryland court rules and state Constitution allow prejudgment interest at the discretion of the fact finder with an interest rate of 6%, except that interest is recoverable as a matter of right on a contractual obligation to pay a liquidated sum at a certain time.**

Md. Rule 2-604. Interest

(a) Pre-judgment interest. Any pre-judgment interest awarded by a jury or by a court sitting without a jury shall be separately stated in the verdict or decision and included in the judgment.

(b) Post-judgment interest. A money judgment shall bear interest at the rate prescribed by law from the date of entry.

Md. Const. art. III, § 57. Legal rate of interest

The Legal Rate of Interest shall be *Six per cent. per annum*; unless otherwise provided by the General Assembly. (emphasis in original).

The Maryland Court of Special Appeals has held:

Maryland law regarding the availability of prejudgment interest is well settled. The general rule is that determination of interest should be left to the discretion of the fact finder, and certain exceptions exist that are as well established as the general rule. A contractual obligation to pay a liquidated sum at a certain time and where the money has already been used are pertinent exceptions where interest is recoverable as a matter of right.

Maxima Corp. v. 6933 Arlington Dev. Ltd. Partnership, 100 Md. App. 441, 459-60 (Md. Ct. Spec. App. 1994) (citations omitted).

**New York law states that prejudgment interest shall be recovered on sums awarded for breach of contract, and makes no distinction between liquidated and unliquidated claims. Interest is computed from either the date the cause of action existed or the date damages were incurred thereafter. Where damages were incurred at various times, interest is computed on each item from the date it was incurred or from a single reasonable intermediate date.**

N.Y. C.P.L.R. § 5001 (Consol. 2006). Interest to verdict, report or decision

(a) Actions in which recoverable. Interest shall be recovered upon a sum awarded because of a breach of performance of a contract, or because of an act or omission depriving or otherwise interfering with title to, or possession or enjoyment of, property, except that in an action of an equitable nature, interest and the rate and date from which it shall be computed shall be in the court's discretion.

(b) Date from which computed. Interest shall be computed from the earliest ascertainable date the cause of action existed, except that interest upon damages incurred thereafter shall be computed from the date incurred. Where such damages were incurred at various times, interest shall be computed upon each item from the date it was incurred or upon all of the damages from a single reasonable intermediate date.

(c) Specifying date; computing interest. The date from which interest is to be computed shall be specified in the verdict, report or decision. If a jury is discharged without specifying the date, the court upon motion shall fix the date, except that where the date is certain and not in dispute, the date may be fixed by the clerk of the court upon affidavit. The amount of

interest shall be computed by the clerk of the court, to the date the verdict was rendered or the report or decision was made, and included in the total sum awarded.

**Virginia law provides for both prejudgment and postjudgment interest, and makes no distinction between liquidated and unliquidated claims. The date at which prejudgment interest commences to run, if not provided for in a contract between the parties, is at the discretion of the judge or jury.**

Va. Code Ann. § 8.01-382 (Matthew Bender 2006). Verdict, judgment or decree to fix period at which interest begins; judgment or decree for interest

In any action at law or suit in equity, the verdict of the jury, or if no jury the judgment or decree of the court, may provide for interest on any principal sum awarded, or any part thereof, and fix the period at which the interest shall commence. The judgment or decree entered shall provide for such interest until such principal sum be paid. If a judgment or decree be rendered which does not provide for interest, the judgment or decree awarded or jury verdict shall bear interest at the judgment rate of interest as provided for in § 6.1-330.54 from its date of entry or from the date that the jury verdict was rendered. Notwithstanding the provisions of this section, any judgment entered for a sum due under a negotiable instrument, as defined by § 8.3A-104, shall provide for interest on the principal sum in accordance with § 8.3A-112 at the rate specified in the instrument. If no such rate is specified, interest on the principal sum shall be at the judgment rate provided in § 6.1-330.54.

**Under District of Columbia law, prejudgment interest shall be included on a liquidated debt payable by contract, commencing from the date on which the principal was due and payable. In a suit for damages for breach of contract, post-judgment interest is allowed, but this does not preclude the court or jury from including interest as an element of damages if necessary to fully compensate the plaintiff.**

D.C. Code § 15-108. Interest on judgment for liquidated debt

In an action in the United States District Court for the District of Columbia or the Superior Court of the District of Columbia to recover a liquidated debt on which interest is payable by contract or by law or usage the judgment for the plaintiff shall include interest on the principal debt from the time when it was due and payable, at the rate fixed by the contract, if any, until paid.

D.C. Code § 15-109. Interest on judgment for damages in contract or tort

In an action to recover damages for breach of contract the judgment shall allow interest on the amount for which it is rendered from the date of the judgment only. This section does

not preclude the jury, or the court, if the trial be by the court, from including interest as an element in the damages awarded, if necessary to fully compensate the plaintiff. In an action to recover damages for a wrong the judgment for the plaintiff shall bear interest.