

# Prince, Ramish and Johnson in The Government Contractor: The Most Important Cost And Pricing Cases Of 2025—Part 1

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PRACTICES Government Contracts Transactions, Government Contracts

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This article, presented in two parts, discusses noteworthy decisions from the past year regarding cost and pricing issues from the Armed Services Board of Contract Appeals, U.S. Court of Federal Claims and U.S. Court of Appeals for the Federal Circuit. The first installment reviews cases addressing the enforceability of advance agreements (*Pratt & Whitney*), termination settlement procedures (*Intelligent Investments*) and nuclear indemnification (*Cotter Corp.*).

**Sec’y of Def. v. Pratt & Whitney, 160 F.4th 1224 (Fed. Cir. 2025); 68 GC ¶ 7**—The U.S. Court of Appeals for the Federal Circuit issued a decision in a longstanding dispute regarding the treatment of so-called “Drag” costs in Pratt & Whitney’s overhead cost pools under Cost Accounting Standard (CAS) 418. The court ruled that a 2006 agreement between the parties about how to account for Drag costs prospectively was unenforceable against the Government because it failed to comply with Federal Acquisition Regulation 31.109 requirements for advance agreements. The Federal Circuit’s decision risks rendering a variety of agreements unenforceable if the logic of the decision is extended, including advance agreements and settlement agreements involving future costs.

Certain Pratt contracts with its commercial engine parts suppliers are structured as “collaboration agreements.” Under those agreements, instead of paying fixed prices for parts, Pratt pays parts suppliers a percentage share of engine program revenues. The collaborator agreements further provided that a “drag” fee would be subtracted from the revenue payments. Drag “represents a portion of Pratt’s cost of supervising the commercial engine program that is reimbursed by the Collaborators,” which is “calculated through a fixed percentage of a Collaborator’s revenue share of commercial program profits rather than a function of the actual cost of overhead incurred by Pratt.”

Pratt initially did not include a cost for parts provided by collaborators in its overhead pool, treating the parts as having no direct material cost, and at the same time removed the drag fee from its indirect cost pool. The Government asserted a claim arguing that the company’s practice of not assigning a cost to the engine parts acquired from collaborators violated CAS 418. The ASBCA agreed with the contractor and upheld the practice. *United Techs. Corp., Pratt & Whitney*, ASBCA 47416, 50453, & 50888, 01-2 BCA ¶ 31,592. The Federal Circuit reversed the Board and ruled that declining to assign a cost to the parts was inconsistent with CAS 418 and resulted in “a substantial

distortion in overhead allocation” between the company’s commercial and Government engine programs. *Rumsfeld v. United Techs. Corp.*, 315 F.3d 1361, 1372 (2003); [45 GC ¶ 45](#). The court remanded to the board to determine the appropriate method for calculating the cost of the engine parts.

Following that decision, in 2006 the parties executed both a settlement agreement and the “drag agreement.” Under the drag agreement, the parties agreed that Pratt would “include a cost for collaboration parts in its allocation base or bases” and would discontinue its “prior practice of crediting DRAG to its overhead cost pools.” The agreement covered the period from Jan. 1, 2005, through the date of the execution, and would apply “prospectively” provided that the DRAG provisions of the collaborator agreements did not materially change.

In 2013, a new contracting officer contested the parties’ agreement regarding accounting for parts provided under the collaborator agreements on two bases. First, the CO challenged Pratt’s use of an estimate of material costs of the commercial engine parts instead of actual costs. The estimate, referred to as “Manufacturing Target Cost” (MTC), “represented how much Pratt expected it would cost to manufacture the parts itself.” Instead, the CO asserted that gross revenue share (the portion of the list price that Pratt owed a collaborator when an engine was sold) was an appropriate measure of material costs. Second, the CO asserted that the drag agreement was invalid and that Pratt was required to remove drag costs from the overhead cost pool. The CO asserted a total claim of more than \$210 million.

Pratt appealed again to the ASBCA. The board concluded that Pratt’s use of MTC as an estimate of material costs was not consistent with CAS 418 but determined that net revenue share—the amount actually paid to collaborators after certain deductions and discounts—was more appropriate than gross revenue share. The board further held that the drag agreement was valid and enforceable, and that Pratt was not required to remove drag from its overhead pool. The decision was limited to entitlement, so the board remanded to the parties to attempt to negotiate quantum, whereupon the parties filed cross-appeals to the Federal Circuit.

As a threshold matter, the Federal Circuit addressed jurisdiction. The court determined that it did not have jurisdiction over the Government’s claim regarding material cost calculation because the board’s decision did not resolve quantum and therefore was not final. As to the claim regarding the drag agreement, the decision was final because the board “affirmed Pratt’s ongoing practice of calculating the overhead pool without regard to Drag payments,” thus no further determination of quantum was necessary.

As to the merits of the drag claim, the Government argued the drag agreement was invalid and unenforceable because it violated the FAR. Specifically, FAR 31.109(b) specifies that an advance agreement “must be ... incorporated into applicable current and future contracts” and “shall contain a statement of its applicability and duration.” The board had found that “there was no evidence that the Drag agreement was incorporated into any of Pratt’s Government contracts and that the Drag agreement lacks a statement of its duration.” However, the board held that the drag agreement was nevertheless an enforceable contract governing the treatment of future costs, concluding that an advance agreement pursuant to FAR 31.109 was not the only mechanism for addressing such costs. The board noted that the drag agreement settled several disputes regarding Pratt’s accounting for commercial collaboration agreements addressed in Defense Contract Audit Agency audits.

The Federal Circuit reversed. The court concluded it was “undeniable” that the drag agreement was an advance agreement. The drag agreement stated on its face it was “entered into ... under

authority of [FAR] 31.109” (the advance agreement provision), and it was a “negotiated agreement to ‘prospectively’ agree to the treatment of costs.” Therefore, the court reasoned that the agreement was required to meet the requirements of FAR 31.109. That the drag agreement was a settlement of disputed claims did not “give[] the [CO] authority to disregard the FAR restrictions because a settlement agreement is involved.” The court held that “[b]ecause the [CO] lacked authority to bind the government, the Drag agreement cannot be enforced against it.” The court remanded to the board to decide whether the FAR credits provision at 31.201-5 required Pratt to exclude the drag costs from its overhead pool, expressing skepticism that reimbursed costs could properly be included.

The Federal Circuit’s decision in this case is unsettling, and not merely because it potentially jeopardizes many settlement agreements and advance agreements. The court characterized this as an issue of CO authority, but that is not quite right. The board found that the divisional administrative CO had authority to execute the drag agreement. The court disagreed because the advance agreement did not fully meet the FAR technical and procedural requirements. The court concluded that actions running counter to the FAR render the CO without authority. But this ignores that “[w]hen an imperative sentence directs action, the CO is responsible for the action, unless another party is expressly cited.” FAR 1.108(f). In other words, the Government’s COs were responsible for ensuring the agreement included a statement of its duration and was incorporated into applicable contracts. The COs had both the authority and the responsibility to make the Drag agreement enforceable against the Government by meeting the additional requirements. The Federal Circuit’s decision unfairly penalizes the contractor for the COs’ failure to fulfill their responsibilities under the FAR.

What is more, the court permitted the Government to disavow its agreement with the contractor after the costs at issue had already been incurred. The courts and boards long applied the doctrine of retroactive disallowance, established by the Court of Claims in *Litton Sys., Inc. v. U.S.*, 449 F.2d 392 (Ct. Cl. 1971), which held that the Government could not impose a retroactive disallowance of contractor costs without giving the contractor “authoritative notice” of the Government’s changed position with respect to a cost-accounting practice the contractor had reasonably relied upon. The courts and boards ceased applying the rule in recent years. This decision underscores the continued need for such a rule to ensure fair treatment of contractors. See Richard C. Johnson, John S. Pachter, Gregory A. Smith, Daniel H. Ramish, *The Doctrine Disfavoring Retroactive Cost Disallowance: Who Needs Estoppel Anyway?*, 52 Pub. Cont. L.J. 579 (2023).

If the Government may freely disavow any actions of the CO that fail to meet every formal requirement of the FAR, this risks further diminishing the role of the CO. See John S. Pachter, *The Incredible Shrinking Contracting Officer*, 39 Pub. Cont. L.J. 705 (2010) (examining the erosion of contracting officer authority by Congress, auditors, and courts and the resulting uncertainty for contractors). The FAR states that “[t]he Government’s policy is to try to resolve all contractual issues in controversy by mutual agreement at the [CO’s] level.” FAR 33.204. That approach holds less appeal for contractors if the CO’s errors can be used against them. Heightened enforcement of FAR formalities may also cut both ways—it could undermine provisions of interest to the Government as well. The FAR Council would do well to scrutinize FAR 31.109 and other sections imposing prescriptive formalities as part of the second phase of the Revolutionary FAR Overhaul to temper the effects of this decision.

In the meantime, contractors should review their advance agreements and settlement agreements addressing future costs to confirm that they state their duration, have been incorporated into applicable contracts, and meet the other FAR requirements, and take corrective action where necessary.

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***Intelligent Invs., Inc. v. U.S., 178 Fed. Cl. 143 (2025)***—The very broad power of the Government to terminate a contract at will is coupled with an obligation to compensate the contractor for unrecovered contract cost. FAR part 49 prescribes two methods the Government may apply for determining reimbursable cost in a termination settlement: the inventory method and the total cost method. FAR 49.206-2. Under the inventory method, costs are separately allocated to completed items and work in process, whereas in the total cost method costs are aggregated, net of contract payments. Although in theory both methods should produce the same result (E.g., *The Douglas Corp.*, ASBCA 5550, 60-1 BCA ¶ 2531), Government auditors and COs frequently opt, as they did here, for the inventory method in the apparent belief that it favors the Government position while contractors, conversely, favor the total cost method.

Intelligent Investments entered into a contract with the Corps of Engineers to assist in clean-up and debris removal following a tornado in Joplin, Missouri. Just two months later, while the contract had been only partially performed, the Corps terminated it for convenience. Intelligent Investments submitted its termination claim on the total cost basis but DCAA refused to audit it claiming it should have been submitted on the inventory basis. The contractor refused and after a considerable stalemate, sought review in the COFC.

Moving for summary judgment, the Government asserted that the “settlement proposal was not compatible with the FAR,” and more specifically, “that the Contract required use of the inventory basis of accounting.” Since nothing in the contract prescribed the use of either method, the Government thus maintained that the general regulatory provisions of the FAR—here part 49—were binding on the contractor and determined the choice of accounting issue. In this regard, FAR 49.206-2 provides that “[w]hen use of the inventory basis is not practicable or will unduly delay settlement, the total-cost basis ... may be used if approved in advance by the [termination CO].”

Harking back to a 63-year-old ASBCA precedent (*Caskel Forge, Inc.*, ASBCA 7638, 1962 BCA ¶ 3318), the COFC rejected the Government’s argument on the grounds that FAR part 49 was not incorporated in the contract:

As an initial matter, the central thread holding the Government’s argument together is that the Contract, pursuant to FAR 49.206-2, required the Contractor to get the [CO’s] approval to use the total cost basis, which the Contractor purportedly failed to do.... But regardless of whether the Contractor obtained approval or not, FAR 49.206-2 is not part of the Contract ... and thus does not bind the parties.

It is surprising that Government counsel here made such an erroneous argument on such a basic issue. FAR 1.101 states that the regulation “is established for the codification and publication of uniform policies and procedures for acquisition by all executive agencies,” and FAR 1.104 provides that the FAR applies to all acquisitions as defined in Part 2 of the FAR, except where expressly excluded, but nowhere does the FAR itself purport to apply to contractors. Only where a **contract clause** incorporates some part of the FAR does that part of the FAR become binding on a contractor, perhaps the best example being the Part 31 cost principles incorporated in contracts that include the Allowable Cost and Payment clause, FAR 52.216-7.

Having disposed of the Government’s principal argument, the Court followed well-established law in ruling that summary judgement was inappropriate in the convenience termination context where the guiding principles are equity, fairness and reasonableness.

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*Cotter Corp., N.S.L. v. U.S.*, 127 F.4th 1353 (Fed. Cir. 2025)—An example of the post-war Congress working successfully with the administration was the fashioning of a legal and contractual structure that facilitated the development of civilian nuclear power and nuclear material usage. The wartime nuclear program included private firms operating under cost-type contracts the reimbursement provisions of which could extend to coverage for third-party liability arising out of potential nuclear incidents, but this ended in the post-war period.

Congress, working with the Atomic Energy Commission (AEC) first enacted the Price-Anderson Act (PAA) P.L. 85-256, 71 Stat. 576 (Sept. 2, 1957), providing contractual indemnity to firms engaged in nuclear energy activities. The Act provided indemnification to the contractors against risks of nuclear incidents but extended as well to persons for “public liability arising out of or in connection with the contractual activity.” “Person indemnified” included not only the contractor but also “any other person who may be liable for public liability.”

Beginning in 1942 and extending to 1967, the Government entered into contracts with Mallinckrodt Chemical Works for processing uranium in Government-owned plants in the St. Louis area. In the late 1960s, Cotter Corp. purchased some radioactive material and residues originally produced by Mallinckrodt. In 2012, Cotter was the subject of a suit in Missouri seeking damages from allegations of releases of radioactive material traceable to Cotter. COFC No. 1:22-cv-00414-DAT.

Cotter brought suit in the COFC in 2022 seeking indemnification on two independent bases: First, directly under the provisions of the PAA as amended; and second, as a third-party beneficiary under the indemnification provision of a Mallinckrodt’s contract. The COFC dismissed both counts in March 2023.

As to the statutory count, the COFC held that the language of the statute “arising out of or in connection with” the contractual activity required “a relationship” to the contractual activity. Cotter had failed to allege such a relationship here, it reasoned, where Cotter was not in privity with Mallinckrodt; any benefit to the Government ended with the expiration of Mallinckrodt’s contract; Cotter’s activity did not originate from Mallinckrodt’s contract; and Cotter’s handling of material that once was under the Mallinckrodt contract was “an insufficient causal sequence to trigger” indemnification.

Dismissing the contractual count as well, the COFC held that Cotter did not fall within the class clearly intended to be benefited by the indemnification provision of the PAA as transposed into the Mallinckrodt contract. The court further held that, in any event, Cotter could not assert contract breach where it had never asked the Government for indemnity.

The CAFC reversed on both counts, reflecting a broad view of the indemnification provisions Congress enacted to protect industry against catastrophic nuclear incidents. First, the court held that under the PAA “the indemnification duty, for a domestic nuclear incident (such as the one at issue here), extends beyond the contractor to *any other person who may be liable for public liability*” (emphasis in original). The phrase “public liability” in turn was defined as “arising out of or in connection with the contractual activity.” Rejecting the COFC’s narrow reading of this phrase, the CAFC pointed out that none of the indemnification language limited coverage to the period during which the contract was still active or that the indemnity claimant’s activity “was contributing to the contracting parties’ performance.” Instead, the provisions of the PAA “are focused simply on the hazard from the material—a hazard that is not limited in time to the period of performance of a particular contract and may be long lasting, for at least some of the covered nuclear materials.” The

court noted that the phrase “in connection with” the contractual activity was inclusive and significantly broader than the term “arising out of.” Here, “[t]he AEC-Mallinckrodt contractual activity of creating the nuclear material at issue was a but-for cause of the public liability, because that material, which was inherently dangerous, was the source of the nuclear incident giving rise to Cotter’s public liability.” The COFC’s more limited reading, the court stated, would “undermine the declared statutory purposes ‘to protect the public’ and to remove an important deterrent to private investment in nuclear energy.”

Turning to the contractual count, the CAFC ruled that Cotter’s pleading clearly exceeded the low standard for surviving a motion to dismiss by alleging that it was one of a class of persons intended to be benefited by the contract indemnification clause. Here the court drew on its discussion of the PAA, the terms of which were essentially incorporated in Mallinckrodt’s contract:

Our conclusion about Cotter’s coverage by statutory language that is materially identical to the contract language means that Cotter was a person expressly stated by the contract to be a direct beneficiary, as among the indemnitee class, of the contract’s indemnity obligation.

Finally, the CAFC brushed aside the defense that Cotter had failed to request Government indemnification, stating that:

The contract does not include a pre-suit demand requirement, or a similar exhaustion requirement to request and obtain a CO’s decision as a precondition to suing on ... the indemnity duty owed to Cotter. ... Nor, further, does it identify a basis for dismissing a suit for breach because of a lack of such pre-suit demand when it is clear ... that any demand would have been futile.

The *Cotter* decision thus represents the latest in a long line of cases rejecting attempts by the Government to renege on valid and binding obligations of indemnification that the Government entered into in furtherance of significant public policies. E.g., *Ford Motor Co. v. U.S.*, 378 F. 3d 1314 (Fed. Cir. 2004).

Stay tuned for Part 2, which will review additional cases and discuss recent statutory and regulatory developments affecting cost and pricing, including the National Defense Authorization Act for Fiscal Year 2026.

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