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## **The Recoverability of the Cost of Borrowing in Construction Contracts**

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# The Recoverability of the Cost of Borrowing in Construction Contracts

STEVEN J. WEBER, HEIDI B. HERING, AND MICHELE MINTZ

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## I. Introduction

A recurring problem arises in construction contracts when an owner requires changed or extra work or delays a project without concurrently adjusting the contract price to compensate the contractor for the increased cost of performance. By failing to make the adjustment, the owner effectively requires the contractor to finance the changed, extra, or additional project work. In these situations it is both foreseeable and likely that the contractor will borrow money to finance the additional work. This unanticipated borrowing often requires the contractor to incur increased financing expenses, including interest paid to the lender. This cost of borrowing, or interest paid on the borrowed funds, is a direct cost of performing the changed or additional work and, consequently, should be recoverable.

Federal courts once permitted contractors to recover the cost of borrowing

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in limited instances as part of an equitable adjustment.<sup>1</sup> Regulatory developments during the past forty years, however, have created uncertainty among government contractors as to whether interest on borrowings may be recovered under any circumstances.<sup>2</sup>

This Article provides an historical perspective on the development of the law related to contractors' recovery of the cost of borrowing. It analyzes the current state of the law and examines the direct conflict between federal regulatory provisions and the principle of equitable adjustment. Finally, this Article critiques judicial decisions that have denied government contractors' claims to recover the cost of borrowing and compares them with decisions that have granted recovery for the cost of borrowing as an element of construction damages in state and local governments as well as private party disputes.

## II. Interest "On a Claim" vs. Interest as a Cost of Performance

Interest for government delay in the payment of amounts due a contractor is referred to as interest "on a claim."<sup>3</sup> Generally, absent an express statutory or contract provision, this type of interest is unrecoverable from the United States.<sup>4</sup> Federal statutes, such as 28 U.S.C. § 2516(a), reflect this principle, providing that "[i]nterest on a claim against the United States shall be allowed in a judgment of the United States Court of Federal Claims only under a contract or Act of Congress expressly providing for payments thereof."<sup>5</sup> Although the language of the statute refers only to Court of Claims<sup>6</sup> decisions, the statute

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1. See, e.g., *Gevyn Constr. Corp. v. United States*, 827 F.2d 752, 754-55 (Fed. Cir. 1987); *S.S. Silberblatt, Inc. v. United States*, 228 Ct. Cl. 729, 731 (1981); *Dravo Corp. v. United States*, 594 F.2d 842, 849 (Ct. Cl. 1979); *Singer Co. v. United States*, 568 F.2d 695, 718 (Ct. Cl. 1977); *Framlau Corp. v. United States*, 568 F.2d 687, 694 (Ct. Cl. 1977); *Bell v. United States*, 404 F.2d 975, 984 (Ct. Cl. 1968); *Hoffman Constr. Co. v. United States*, 7 Cl. Ct. 518, 528 (1985); *Entwistle Co. v. United States*, 6 Cl. Ct. 281, 287-88 (1984).

2. See FAR 31.102, 31.205-17; ASPR 15-106 (1976 ed.) (July 1, 1976), 15-205.17 (1960 ed.) (July 1, 1960); FPR 1-15.106, 1-15.205-17.

3. See W. Robert Buxton et al., *Payment Delay Claims*, in *PROVING AND PRICING CONSTRUCTION CLAIMS* 336 (Robert F. Cushman and David A. Carpenter eds., 1990); 1 *FED. CONT. MGT. (MB)* ¶ 7.10(3), at 7-142 (1996).

4. See 28 U.S.C. § 2516(a) (1994); see also *United States v. Thayer-West Point Hotel Co.*, 329 U.S. 585, 588 (1947); *Mar-Pak Corp. v. United States*, 203 Ct. Cl. 718, 720 (1973); *Komatsu Mfg. Co. v. United States*, 131 F. Supp. 949, 950 (Ct. Cl. 1955); *Ramsey v. United States*, 101 F. Supp. 353, 356 (Ct. Cl. 1951).

5. 28 U.S.C. § 2516(a).

6. The Court of Claims has undergone several name changes over its history. The United States Claims Court succeeded the U.S. Court of Claims as a result of the Federal Courts Improvement Act of 1982, Pub. L. No. 97-164, 96 Stat. 27 (codified at 28 U.S.C. § 171 (1988)). Congress enacted the Federal Courts Administration Act of 1992, Pub. L. No. 102-572, 106 Stat. 4506, on October 29, 1992, and changed the name of the U.S. Claims Court to the U. S. Court of Federal Claims. The U.S. Court of Federal Claims succeeded the U.S. Claims Court in all respects.

also applies to suits in federal district court and appeals before boards of contract appeals.<sup>7</sup>

After the enactment of the Contract Disputes Act of 1978 (CDA),<sup>8</sup> however, federal entities could not claim immunity from paying interest on monetary claims for governmental delay in payment.<sup>9</sup> The CDA provides contractors with relief in the form of “prejudgment” interest on claims from the date the claims are submitted to the Contracting Officer until the date the contractor actually receives payment from the Government.<sup>10</sup> Prejudgment interest is designed to compensate a contractor wrongfully denied its funds for a period of time.

Courts often confuse prejudgment interest with an entity’s cost of borrowing because of the label “interest.”<sup>11</sup> Unlike prejudgment interest, however, the cost of borrowing is a direct cost incurred by a contractor asked to perform extra work.<sup>12</sup> The cost of borrowing funds, therefore, represents a separate cost that should be recoverable independent of and in addition to prejudgment interest. Whereas prejudgment interest statutes exist because the Government, as sovereign, must waive its immunity from paying interest on claims, a statute addressing the cost of borrowing is unnecessary because the cost of borrowing is a direct cost incurred by a contractor in performing extra work.

Despite the confusion, federal courts have distinguished between awarding damages for prejudgment interest and awarding damages for the cost of borrowing to complete extra work. In *Havens Steel Co. v. Randolph Engineering Co.*<sup>13</sup> the court awarded a contractor its contract damages, including the interest the contractor paid on monies borrowed to finance additional work.<sup>14</sup> The court’s opinion emphasized “that this [was] not an effort to calculate or impose prejudgment interest.”<sup>15</sup> Similarly, the United States Court of Appeals for the Eighth Circuit distinguished between the award of prejudgment interest and the cost of borrowed funds in *Nebraska Public Power District v. Austin Power, Inc.*<sup>16</sup> The *Nebraska* court itemized the plain-

7. See *United States v. 106.64 Acres of Land*, 264 F. Supp. 199, 202 (D. Neb. 1967); *Fruehauf Corp.*, PSBCA No. 197, 76-1 BCA ¶ 11,771, at 56,189.

8. 41 U.S.C. §§ 601-613 (1994).

9. See 41 U.S.C. § 611 (1994).

10. See *id.*

11. See, e.g., *Servidone Constr. Corp. v. United States*, 931 F.2d 860, 863 (Fed. Cir. 1991); *Granite Constr. Co.*, ENG BCA No. 5849, 93-1 BCA ¶ 25,450 (discussing the Government’s sovereign immunity from liability for prejudgment interest).

12. See *Buxton et al.*, *supra* note 3, at 338; 1 FED. CONT. MGT. (MB) ¶ 7.10(1), at 7-141 (1996); Richard C. Walters, *The Matter of Interest in Federal Government Contracting*, 14 PUB. CON. L.J. 96, 97-100 (1983).

13. 613 F. Supp. 514 (W.D. Mo. 1985), *aff’d*, 813 F.2d 186 (8th Cir. 1987).

14. See *id.* at 542.

15. *Id.*

16. 773 F.2d 960, 973 (8th Cir. 1985).

tiff's claims and listed the cost of borrowed funds separately from the prejudgment interest.<sup>17</sup>

State courts have also addressed the difference between awards for pre-judgment interest and awards for the cost of borrowing to finance additional work. In *Martel Construction, Inc. v. Montana*<sup>18</sup> a construction company brought an action against the state of Montana seeking damages for increased costs, including interest payments on borrowed funds used to finance additional work.<sup>19</sup> The court held that although "payments made by Martel [the contractor] to its bank were in the form of interest, they are part of its actual damages, subject to the appropriate proof, and not 'interest' chargeable against the State as prohibited by [Montana's anti-prejudgment interest statute]."<sup>20</sup>

### III. Interest on Borrowings Under Federal Law

#### A. Federal Case Law Development

In the federal procurement arena, *Bell v. United States*<sup>21</sup> is the most widely cited opinion recognizing the validity of claims for the cost of borrowings as a direct cost of additional work.<sup>22</sup> In *Bell* a contractor incurred interest on borrowing as a result of production delays caused by government-ordered contract changes.<sup>23</sup> The Government argued that 28 U.S.C. § 2516(a)<sup>24</sup> precluded the allowance of interest as part of the equitable adjustment.<sup>25</sup> The court noted, however, that the Department of Defense (DoD) changed its policy in 1954 to allow the cost of borrowing as part of equitable adjustments under fixed-price contracts and that since 1954 a large number of Armed Service Board of Contract Appeals (ASBCA) decisions allowed such interest.<sup>26</sup> The court held this "long-standing practice allowable and not in conflict with 28 U.S.C. § 2516(a)," explaining that:

[t]he statute and its policy apply to demands for damages in "breach" claims against the United States where the plaintiff seeks compensation for delay in payment. The demand here is not based upon a "breach" but upon a change compensable under the "Changes" article. . . . Extra interest

17. See *id.* at 970 n.10.

18. 817 P.2d 677 (Mont. 1991).

19. See *id.* at 677-78.

20. *Id.* at 681.

21. 404 F.2d 975 (Ct. Cl. 1968).

22. See *id.* at 984-85.

23. See *id.* at 978-80, 984.

24. See *id.* at 984. As discussed above, 28 U.S.C. § 2516(a) (1964) prohibited any interest on a successful claim against the United States unless provided for under contract or by statute.

25. See *Bell*, 404 F.2d at 984.

26. See *id.* (citing *Kaman Aircraft Corp.*, ASBCA No. 10141, 66-1 BCA ¶ 5581, at 26,081).

on the borrowed money became due . . . and under generally accepted principles was undoubtedly an increased cost of contract performance attributable to the change.<sup>27</sup>

The court concluded that “[i]ncreased costs on borrowed money could be ‘in the very same category as more tangible costs of construction.’ Conversely, the amounts sought by these plaintiffs are not compensation for the Government’s delay in making payment.”<sup>28</sup>

Subsequent decisions by the Court of Claims followed the rationale developed in *Bell* but imposed greater restrictions on the contractor’s burden of proof.<sup>29</sup> In *Framlau Corp. v. United States*<sup>30</sup> the court held that contractors must demonstrate a nexus between the interest on a specific borrowing and the changed work.<sup>31</sup> The contractor in *Framlau* failed to prove what portion, if any, of its borrowings could be traced to performance changes ordered by the Government. Consequently, the court denied recovery of interest.<sup>32</sup>

In *Singer Co. v. United States*<sup>33</sup> the Court of Claims recognized two types of factual situations in which a party could recover its cost of borrowing.<sup>34</sup> The first scenario, referenced above, involves “a specific loan undertaken in order to finance the changed work.”<sup>35</sup> The second instance typically involves a more complex business environment in which a company has regular dealings with lending institutions for general business borrowings.

In *Singer* the contractor, Librascope, was a division in a complex corporate structure.<sup>36</sup> Librascope borrowed all the funds necessary to perform the contract from its parent corporation, General Precision, Inc. (GPI). GPI was funded by its parent corporation, General Precision Equipment Corporation (GPEC).<sup>37</sup> The evidence indicated that GPEC supported its own cash demands, as well as those of GPI and Librascope, by borrowing from banks and other lending institutions.<sup>38</sup> The *Singer* court focused solely upon the

27. *Id.* (emphasis added).

28. *Id.* (quoting *Phillips Constr. Co. v. United States*, 374 F.2d 538, 540 (Ct. Cl. 1967)).

29. See, e.g., *S.S. Silberblatt, Inc. v. United States*, 228 Ct. Cl. 729, 731 (1981); *Dravo Corp. v. United States*, 594 F.2d 842, 849 (Ct. Cl. 1979); *Singer Co. v. United States*, 568 F.2d 695, 718 (Ct. Cl. 1977); *Framlau Corp. v. United States*, 568 F.2d 687, 694 (Ct. Cl. 1977); *Entwistle Co. v. United States*, 6 Cl. Ct. 281, 287-88 (1984).

30. 568 F.2d 687 (Ct. Cl. 1977).

31. See *id.* at 694.

32. See *id.* at 694 n.17 (explaining that “it is doubtful that plaintiff could show any borrowing was necessitated by such a small increase in contracts costs as was here approved for changes”).

33. 568 F.2d 695 (Ct. Cl. 1977).

34. See *id.* at 718.

35. See *id.* (citing *Bell v. United States*, 404 F.2d 975 (Ct. Cl. 1968)); *Aeronca Mfg. Corp.*, ASBCA No. 9173, 69-2 BCA ¶ 7811.

36. See *Singer Co. v. United States*, F.2d 695, 718-19 (Ct. Cl. 1977).

37. See *id.* at 718.

38. See *id.*

interest on GPEC's borrowings because those borrowings were the ultimate source of Librascope's funds.<sup>39</sup>

The court held that the contractor failed to offer specific and detailed evidence demonstrating that the Government's action increased GPEC's borrowing needs.<sup>40</sup> According to the court:

the record does not disclose the nature of the various transactions that comprised the total of that company's annual indebtedness (its course of borrowing), it does not disclose the company's cash position or the changes in that position during the 3-year period in question nor does it disclose the manner in which Librascope's capital demands were satisfied by General Precision Equipment Corporation—whether by cash (surplus), by new borrowings or simply by extending past borrowings through added interest payments.<sup>41</sup>

The court, therefore, declined to award the contractor its costs of borrowing.

A similar evidentiary problem arose in *Dravo Corp. v. United States*.<sup>42</sup> In that case the plaintiff, Dravo, was a corporation with worldwide operations and more than twenty-five separate business divisions.<sup>43</sup> One of Dravo's subordinate organizations, Western Construction Division (Western), managed a number of construction projects, including the project in dispute.<sup>44</sup> Dravo collected the proceeds from the various divisional projects and placed them into a "fungible pot" from which they were redistributed as necessary.<sup>45</sup> The cumulative monetary situations of the various divisions at any given time determined the extent of Dravo's outside borrowing.<sup>46</sup> Thus, whether Western borrowed funds to finance additional work depended upon the cash situation of the other divisions.<sup>47</sup>

Dravo argued that even if it was unable to identify the category of borrowed capital used to pay for the particular changed work, recovery should be granted where the mere fact of financing was undisputed.<sup>48</sup> The Court of Claims, however, declined to follow the ASBCA's "evolutionary pattern" of lowering the contractor's burden of proof and continued to require that a contractor establish a clear necessity for increased borrowings occasioned by the change.<sup>49</sup> In holding that the plaintiff had failed to prove this clear necessity, the court stated that "[a] mere showing of a history of business

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39. See *id.*

40. See *id.* at 720.

41. *Id.* at 719-20.

42. 594 F.2d 842, 848-49 (Ct. Cl. 1979).

43. See *id.* at 843.

44. See *id.* at 845.

45. See *id.* at 848.

46. See *id.*

47. See *id.*

48. See *id.* at 849.

49. See *id.* For examples of this "evolutionary pattern" see *Ingalls Shipbuilding Div.*, ASBCA No. 17717, 76-1 BCA ¶ 11,851; *Aerojet-General Corp.*, ASBCA No. 17171, 74-2 BCA ¶ 10,863; *Keco Indus., Inc.*, ASBCA No. 15131, 72-1 BCA ¶ 9262.

borrowings and a course of dealings with various banks during the time frame at issue is insufficient to prove a claim for interest.<sup>50</sup> Thus, although the court recognized that interest paid on borrowings was an actual performance cost that could be recoverable as part of an equitable adjustment,<sup>51</sup> the burden of proof was difficult for contractors, particularly complex corporations, to meet.<sup>52</sup>

In *S.S. Silberblatt, Inc. v. United States*<sup>53</sup> the Court of Claims clarified its earlier decisions in *Bell, Singer, and Dravo* by holding that a contractor could recover the additional interest paid or incurred on existing loans as a direct result of the Government's delay.<sup>54</sup> Various boards of contract appeals had interpreted *Bell, Singer, and Dravo* as limiting a contractor's ability to recover interest to borrowings incurred or increased as a result of the need for new loans to finance a contract change or government-caused delay.<sup>55</sup> In *Silberblatt*, however, the Court of Claims determined that interest expenses incurred on existing indebtedness were also compensable under the "suspension of work" clause unless the contractor would have paid or incurred the interest even without the delay.<sup>56</sup> Essentially, the Court of Claims expanded upon the instances in which interest payments could be recovered.<sup>57</sup>

### B. Imputed Interest on Equity Capital

Although the court in *Bell* addressed the recovery of interest on actual borrowings, or debt capital, the court did not address the issue of whether imputed interest should be recognized when contractors use their own equity capital to finance additional performance costs. Two arguments support the recoverability of an imputed cost for use of equity capital. First, by using their own equity capital to finance changes in a government contract, contractors forego opportunities to earn actual interest by investing the equity capital.<sup>58</sup> Second, the "decision to use equity capital to finance current capital acquisitions or operations may necessitate actual borrowing to finance subsequent acquisitions and operations."<sup>59</sup>

50. *Dravo*, 594 F.2d at 849 (citing *Singer Co. v. United States*, 568 F.2d 695, 718-19 (Ct. Cl. 1977)).

51. *See id.*

52. *See, e.g., Gevyn Constr. Corp. v. United States* 827 F.2d 752, 754-55 (Fed. Cir. 1987); *Dravo*, 594 F.2d at 848 (citing *Singer*, 568 F.2d at 718-19; *Gulf Contracting, Inc. v. United States*, 23 Cl. Ct. 525, 531 (1991)).

53. 228 Ct. Cl. 729 (1981).

54. *See id.* at 731.

55. *See id.*

56. *See id.*

57. *See id.*

58. *See Dravo Corp. v. United States*, 594 F.2d 842, 849 (Ct. Cl. 1979); *see also* JOHN CIBINIC, JR. AND RALPH C. NASH, JR., *COST-REIMBURSEMENT CONTRACTING* 647 (2d ed. 1993).

59. CIBINIC & NASH, *supra* note 59, at 647.



A line of board of contract appeals decisions in the 1970s permitted recovery of imputed interest either as an actual cost item or as additional profit in the computation of equitable adjustments for changed work.<sup>60</sup> The Court of Claims, however, declined to follow the decisions that allowed the recovery of interest on equity capital. In *Framlau Corp. v. United States*<sup>61</sup> the court refused to distinguish between interest on debt capital and interest on equity capital.<sup>62</sup> Initially, the contractor's claim in *Framlau* was based upon interest on borrowings.<sup>63</sup> After failing to prove that any of its borrowings were directly attributable to compensable changes, the contractor made an alternative argument that interest should be recoverable without regard to whether debt or equity capital was used to finance the changes.<sup>64</sup> The court, however, rejected this approach, stating that:

[i]t may be argued that differing treatment of debt and equity capital follows an artificial distinction and that it rewards thin capitalization, but we are constrained by the statute discussed earlier [28 U.S.C. § 2516(a)] and further believe that the distinction is supported by reason in that the cost to the contractor of borrowing capital is clearly determinable, while the value to him of the use of equity capital is not so readily ascertainable.<sup>65</sup>

In *Dravo*, the Court of Claims dealt extensively with the issue of interest on equity capital.<sup>66</sup> There, the contractor contended that in the event it was not entitled to recover its interest costs on a debt capital (borrowing) theory, it should be compensated for the loss incurred as a result of the use of its equity capital to finance the changed work.<sup>67</sup> The court acknowledged the unfairness of the situation, explaining that a contractor using its own money for changed work without immediate reimbursement will obviously incur a cost.<sup>68</sup> The court also recognized that denying such recovery may draw an artificial distinction between smaller companies that are entirely debt capitalized and larger, more complex corporations that may use both equity and capital.<sup>69</sup> Nevertheless, the court felt constrained by both its earlier decision in *Framlau* and its interpretation of 28 U.S.C. § 2516(a) and

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60. See *Lockheed Shipbuilding and Constr. Co.*, ASBCA No. 18460, 77-1 BCA ¶ 12,458; *Bailfield Indus., Inc.*, ASBCA Nos. 13418, 13555, 17241, 77-1 BCA ¶ 12,308; *Fischbach & Moore Int'l Corp.*, ASBCA No. 18146, 77-1 BCA ¶ 12,300, *aff'd*, 617 F.2d 223 (Ct. Cl. 1980); *New York Shipbuilding Co.*, ASBCA No. 16164, 76-2 BCA ¶ 11,979; *Ingalls Shipbuilding Div.*, ASBCA No. 17717, 76-1 BCA ¶ 11,851; *Aerojet-Gen. Corp.*, ASBCA No. 17171, 74-2 BCA ¶ 10,863.

61. 568 F.2d 687 (Ct. Cl. 1977).

62. See *id.* at 694-95.

63. See *id.* at 694.

64. See *id.*

65. *Id.* at 694-95.

66. See *Dravo Corp. v. United States*, 594 F.2d 842, 849 (Ct. Cl. 1979).

67. See *id.*

68. See *id.*

69. See *id.*

concluded that it was not “free to substitute its view of what the law ought to be; that function [was] reserved for the Congress.”<sup>70</sup>

After *Dravo*, the agency boards of contract appeals retreated from their stance that imputed interest on equity capital was properly recoverable.<sup>71</sup> The ASBCA, however, issued one aberrant decision in 1982. In *Blue Cross and Blue Shield Association (of Pennsylvania)*<sup>72</sup> the board allowed a contractor to recover the cost of equity capital used to purchase or build equipment and facilities because it was an actual incurred cost of contract performance.<sup>73</sup> The ASBCA has subsequently restricted the *Pennsylvania Blue Shield* holding to its facts because a unique clause in the contract at issue<sup>74</sup> failed to incorporate standard cost principles.<sup>75</sup> The holding in *Dravo*, precluding the recovery of imputed interest where a contractor uses its own equity capital to finance project changes, reflects the current state of the law in both the courts and the boards.

### C. Federal Regulations and the Pricing of Adjustments Clause

As discussed in *Bell*, in 1954 the DoD changed its long-standing policy by allowing “interest on borrowings, as part of equitable adjustments under fixed-price contracts.”<sup>76</sup> In 1970, however, the DoD issued Defense Procurement Circular No. 79, which eliminated the policy of paying interest as part of a contract price adjustment.<sup>77</sup> The circular, effective July 1, 1970, mandated that a new “Pricing of Adjustments” clause be included in all of the DoD’s standard fixed-price contracts.<sup>78</sup> According to the “Pricing of Adjustments” provision:

[w]hen costs are a factor in any determination of a contract price adjustment pursuant to the Changes clause or any other provision of this contract, such costs shall be in accordance with Section XV of the Armed Services Procurement Regulation as in effect on the date of this contract.<sup>79</sup>

70. *Id.* at 850.

71. See, e.g., *Environmental Tectonics Corp.*, ASBCA No. 42540, 92-2 BCA ¶ 24,902; *Fletcher & Sons, Inc.*, VABCA No. 3248, 92-1 BCA ¶ 24,726; *Washington Patrol Serv.*, ASBCA No. 26470, 82-2 BCA ¶ 15,846; *Owen L. Schwam Constr. Co.*, ASBCA No. 22407, 79-2 BCA ¶ 13,919.

72. ASBCA No. 21113, 82-2 BCA ¶ 15,966.

73. See *id.*

74. The provision allowed for recovery of “actual, necessary, accrued expenses, determined by the corporations . . . incurred in connection with the administration of [the] contract.” *Id.* at 79,139 (emphasis added).

75. See *Blue Cross and Blue Shield*, ASBCA No. 32240, 87-1 BCA ¶ 19,510, at 98,619 (discussing the interpretation of the special contract provision and resultant limitation of the decision).

76. See *supra* note 25 and accompanying text.

77. See DEPARTMENT OF DEFENSE, *Defense Procurement Circular No. 79* (May 15, 1970).

78. See *id.*

79. ASPR 7-103.26 (1976 ed., Rev 8) (Sept. 30, 1970).

The provision required that the cost principles set forth in the Armed Services Procurement Regulation (ASPR) section 15, part 2 govern all price adjustments including "equitable adjustments" under such provisions as the Standard "Changes" and "Differing Site Conditions" clauses as well as other "adjustments" (such as those negotiated under the "Suspension of Work" clause in construction contracts).<sup>80</sup> Those cost principles, previously only applicable to cost-reimbursement contracts, expressly provided that interest on borrowings, however represented, was not an allowable cost.

The Federal Procurement Regulation (FPR) was similarly revised on March 7, 1972, to include a "Pricing of Adjustments" clause mandating application of the cost principles to negotiated adjustments under fixed-price contracts.<sup>81</sup> As a result, all price adjustments became subject to the cost principles' specific disallowance of interest on borrowings.<sup>82</sup> The FPR revision became effective on September 21, 1972.<sup>83</sup>

Therefore, under federal regulations a contractor could not recover interest on borrowings under any fixed-price government contract awarded between September 21, 1972, and April 1, 1984, when the Federal Acquisition Regulation (FAR) went into effect. Consequently, the rule established in *Bell* and developed in subsequent Court of Claims decisions was inapplicable to contracts executed between 1972 and 1984.<sup>84</sup>

In at least two decisions, however, the U.S. Claims Court entertained the possibility of allowing the cost of borrowing as part of an equitable adjustment if the contractor met the requisite burden of proof.<sup>85</sup> In *Hyman Construction Co. v. United States*<sup>86</sup> the plaintiff entered into a construction contract with the Veteran's Administration (VA) on September 30, 1980, under which the VA issued several change orders requiring the plaintiff to perform additional work.<sup>87</sup> The court determined that "[i]f plaintiff borrowed money to finance the change order work, and thus incurred an additional interest expense, then such an added interest cost may well be a compensable increase in the cost of performance which would entitle plaintiff to an equitable adjustment."<sup>88</sup> Ultimately, the court held that the plaintiff was not entitled to recover the interest on borrowings because plaintiff failed to meet its burden of proof and because change orders issued by the defendant for amounts proposed by the plaintiff constituted an accord and satisfaction between the parties.<sup>89</sup> Significantly, the court never discussed whether the

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80. See DEPARTMENT OF DEFENSE, *supra* note 78; ASPR 7-602.38.

81. See FPR 1-15.106; see also NASA PR 15.106.

82. See FPR 1-15.205-17; see also NASA PR 15.205-17.

83. See 37 Fed. Reg. 5295, 5296 (1972).

84. See Fletcher & Sons, Inc., VABCA No. 3248, 92-1 BCA ¶ 24,726, at 123,408.

85. See *Gulf Contracting, Inc. v. United States*, 23 Cl. Ct. 525, 530-31 (1991); *Hyman Constr. Co. v. United States*, 7 Cl. Ct. 518, 528-29 (1985).

86. 7 Cl. Ct. 518 (1985).

87. See *id.* at 520.

88. *Id.* at 528 (citing *Bell v. United States*, 404 F.2d 975, 984 (Ct. Cl. 1968)).

89. See *id.* at 528-29.

FPR's Pricing of Adjustments Clause and resultant cost principles should have governed any and all pricing adjustments.

The court in *Gulf Contracting, Inc. v. United States*,<sup>90</sup> on the other hand, acknowledged the federal regulations that existed at the time the contract was awarded on May 19, 1975 by the U.S. Army Corps of Engineers.<sup>91</sup> Specifically, the court held that ASPR 15-205.17 precluded the recovery of interest on borrowings by the contractor and subcontractor.<sup>92</sup> The court still recognized, however, that the contractor and subcontractor were entitled to recover interest on borrowings as long as they established the necessary linkage between the changed work and the borrowings under "Claims Court precedent."<sup>93</sup> Thus, although the federal regulations explicitly disallowed interest on borrowings during this time period, the Claims Court circumvented those regulations and adhered to the precedent established in cost-of-borrowing cases. Consequently, the Claims Court created further confusion among government contractors.

#### **D. The FAR and the Current State of the Law**

When the FAR was published in 1984, the Pricing of Adjustments clause was not incorporated into its provisions. As a result, the issue of recovering the cost of borrowing has become more complex and confusing.<sup>94</sup> Under the FAR's cost principles, interest on borrowings, however represented, is an unallowable cost.<sup>95</sup> Although there is no question that the cost principles are incorporated into cost-reimbursement contracts,<sup>96</sup> it is unclear whether the cost principles are applicable to fixed-price contracts under the FAR. The general language of FAR 31.102 provides the sole basis for applying the cost principles to adjustments in fixed-price contracts:<sup>97</sup>

The applicable subparts of Part 31 shall be used in the pricing of fixed-price contracts, subcontracts, and modifications to contracts and subcontracts whenever (a) cost analysis is performed, or (b) a fixed-price contract clause requires the determination or negotiation of costs. However, application of cost principles to fixed-price contracts and subcontracts shall not be construed as a requirement to negotiate agreements on individual elements of cost in arriving at agreement on the total price. The final price accepted by the parties reflects agreement only on the total price. Further, notwithstanding the mandatory use of cost principles, the objective will continue to be to

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90. 23 Cl. Ct. 525 (1991).

91. See *id.* at 526-31.

92. See *id.* at 530-31.

93. See *id.* at 531.

94. See RALPH C. NASH, *GOVERNMENT CONTRACT CHANGES* 16-38 (1989).

95. See FAR 31.205-20.

96. See FAR 52.216-7.

97. See John Cibinic, Jr., *Cost Principles and Fixed Price Contract Adjustments: Strange Bedfellows*, 4 NASH & CIBINIC REP. ¶ 66 (Nov. 1990).

negotiate prices that are fair and reasonable, cost and other factors considered.<sup>98</sup>

Three agencies have resolved this ambiguity by mandating the use of the Pricing of Adjustments<sup>99</sup> clause in fixed-price contracts similar to those adopted by the ASPR and FPR. The Department of Health and Human Services Acquisition Regulation (HHSAR) provides that the FAR cost principles apply to price adjustments under the Changes clause or any provision of this contract.<sup>100</sup>

The Department of Defense Federal Acquisition Regulation Supplement (DFARS) 252.243-7001 is somewhat broader, stating that “[w]hen costs are a factor in any price adjustment under this contract, the contract cost principles and procedures in FAR Part 31 and DFARS Part 231, in effect on the date of this contract, apply.”<sup>101</sup> This clause, as well as the virtually identical General Services Administration Acquisition Regulation (GSAR) 552.243, appear to “apply to any type of price adjustment, whether or not provided for in a contract clause . . . includ[ing] actions for breach of contract damages or other adjustments, such as correction of mistakes.”<sup>102</sup> The HHSAR provision, on the other hand, would only pertain to price adjustments covered by a contract clause.<sup>103</sup> Regardless of each provision’s possible breadth, the Pricing of Adjustments clause renders the FAR’s cost principles’ disallowance of interest applicable to DoD, HHS, or GSA fixed-price contracts.<sup>104</sup>

When a contractor signs a contract with DoD, HHS, or GSA, the contractor agrees to be bound by the cost principles through the mandatory Pricing of Adjustments clause in the contract. If a contract does not contain a Pricing of Adjustments clause, the cost principles should not be binding on the contractor. FAR 31.102 is the only FAR provision that applies the cost principles to fixed-price contracts. This language is not directed at contractors but rather at the Contracting Officer. Furthermore, the provision “is not incorporated by reference into fixed price contracts.”<sup>105</sup> If the contractor never agreed to be bound by the FAR’s cost principles, the FAR’s specific provision denying the recovery of interest on borrowings should not apply. Arguably, if a contract is not subject to the cost principles,

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98. FAR 31.102.

99. See GSAR 543.205, 552.243-70; HHSAR 352.270-4; DFARS 243.205-71, 252.243-7001. The DFARS provision is entitled “Pricing of Contract Modifications.” As the language of the clause is essentially the same as that in the Pricing of Adjustments clause, it will be referred to as the Pricing of Adjustments clause in this Article.

100. See HHSAR 352.270-4.

101. DFARS 252.243-7001.

102. Cibinic, *supra* note 98, ¶ 66.

103. See *id.*

104. See Davis Group, Inc., ASBCA No. 48431, 95-2 BCA ¶ 27,702; Tayag Bros. Enters., Inc., ASBCA No. 42097, 94-3 BCA ¶ 26,962; Tomahawk Constr. Co. ASBCA No. 45071, 94-1 BCA ¶ 26,312.

105. See Cibinic, *supra* note 98, ¶ 66.

interest on borrowings may properly be included in an equitable adjustment pursuant to *Bell* and its progeny.

Neither the courts nor the boards have dealt with this issue directly. The most analogous situation was addressed by the Postal Service Board of Contract Appeals in *Automation Fabricators & Engineering Co.*<sup>106</sup> In addition to containing the standard “Changes” clause for fixed-price supply contracts, the contract also contained a Pricing of Adjustments clause, which stated that:

[w]hen costs are a factor in any determination of a contract price adjustment pursuant to the “Changes” clause or any other provisions of this contract, section 15 of the Postal Contracting Manual, as in effect on the date of this contract, shall serve as a guide in negotiation of such contract price adjustments.<sup>107</sup>

Under section 15, entitled “Contract Cost Principles and Procedures,” interest on borrowings was an unallowable cost. The board, however, determined that absent more definitive language in the contract and regulations, section 15 was only intended to guide the negotiation of equitable adjustments.<sup>108</sup> The board also recognized that a contractor’s right to recover extra interest expenses incurred on borrowings due to a government-directed change had been clearly established by the courts and boards.<sup>109</sup> Accordingly, the board held that the contractor was entitled to recover its interest expenses as part of the contractor’s equitable adjustment under the Changes clause.<sup>110</sup>

### E. Conflicting Provisions and Principles

The Government purportedly is committed to the concept of “equitable adjustment,” as evidenced by the language of the Changes clause in the FAR.<sup>111</sup> According to the clause, if the CO alters the contract and “causes an increase or decrease in the cost of, or the time required for, performance of any part of the work under [the] contract, whether or not changed by the order, the Contracting Officer shall make an equitable adjustment in the contract price . . . and shall modify the contract.”<sup>112</sup>

The Changes clause, as well as the general concept of equitable adjustments, directly conflict with the cost principles’ specific disallowance of interest.<sup>113</sup> The Government’s long-standing refusal to award the cost of borrowing was designed to treat all of its contractors consistently, irrespective

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106. PSBCA No. 2701, 90-3 BCA ¶ 22,943.

107. *Id.* at 115,163.

108. *See id.* at 115,165.

109. *See id.*

110. *See id.*

111. *See* FAR 52.243-1.

112. FAR 52.243-1(b).

113. *See* FAR 31.205-20.

of their different financing methods.<sup>114</sup> Although the Government seeks to avoid creating inequality among contractors by refusing to recognize interest on borrowings as a direct cost, contractors firmly believe that “a cost is a cost, and interest is a cost.”<sup>115</sup>

The disallowance of this interest cost has raised concerns among government contractors because interest expenses have increased substantially in recent years.<sup>116</sup> Further, the ideological and practical purposes of the “equitable adjustment” mechanism are not being served. In *Bruce Construction Corp. v. United States*<sup>117</sup> the Court of Claims discussed the purpose of equitable adjustments:

Equitable adjustments . . . are simply corrective measures utilized to keep a contractor whole when the Government modifies a contract. Since the purpose underlying such adjustments is to safeguard the contractor against increased costs engendered by the modification, it appears patent that the measure of damages cannot be the value received by the Government but must be more closely related to and contingent upon the altered position in which the contractor finds himself by reason of the modification.<sup>118</sup>

The *Bruce* court firmly established that the proper measure of an equitable adjustment is based upon the contractor's actual costs. Thus, routine denial of a contractor's financing expenses in connection with equitable adjustments is unjustifiable. The Court of Claims determined in *Bell* that the cost of borrowing is as tangible a cost of construction as is the cost of extra materials, equipment, and labor to perform the changed work.<sup>119</sup> Indeed, when a “contractor has been compelled to perform the work with its own money . . . there can be no equitable adjustment to the contractor until the contractor recovers the entire cost of the additional work.”<sup>120</sup> A contract adjustment that excludes interest on borrowings is, therefore, not only inequitable but also fails to satisfy the purported objective of equitable adjustments—keeping the contractor whole.

Furthermore, by contracting with the Federal Government, contractors find themselves in a particularly unique position. Under provisions such as the Changes and Disputes clauses, contractors must continue to perform their contracts as directed by the Government without stopping to litigate.<sup>121</sup> The contractors only recourse is to dispute the amount of the equitable adjustment at a later date.<sup>122</sup>

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114. See H. Robert Weiss, *Recovery of Interest Expense in Defense Industry: The Problem and a Possible Solution*, 6 NAT. CONT. MGT. J. 25, 30 (1972).

115. See *id.*

116. See *id.*

117. 324 F.2d 516 (Ct. Cl. 1963).

118. *Id.* at 518.

119. See *Phillips Constr. v. United States*, 374 F.2d 538, 540 (Ct. Cl. 1967).

120. See S. REP. NO. 95-1118 (1978), reprinted in 1978 U.S.C.C.A.N. 5235.

121. See *id.*

122. See *id.*

## IV. The Recoverability of Interest on Borrowings Under State Law

As discussed above, an equitable adjustment under the Changes clause is intended to fully compensate a contractor for any contract modifications that occur. The Federal Government has implemented provisions such as the Changes and Suspension of Work clauses in order to avoid liability for breach of contract when effecting contract modifications, which inevitably arise.

State and local government contracts, as well as private contracts, often contain remedy-granting provisions similar to the Changes and Suspension of Work clauses found in federal government contracts. When the contracts do not incorporate such clauses, courts typically award contractors damages under generally accepted breach of contract principles for performing additional work and incurring expenses not originally provided for in the contracts.<sup>123</sup> Although the federal and state theories for allowing recovery are different, the same underlying principles apply. Both the “equitable adjustment” mechanism and breach of contract damages are intended to place contracting parties in the same position in which they would have been but for the change order or the breach, respectively.

### A. Contracting with State and Local Government Entities

Contractors have sought to recover their cost of borrowing from either state or local government entities in a limited number of cases.<sup>124</sup> In each instance courts have recognized interest paid on construction loans as a recoverable item of damages once certain criteria are met. Although different courts apply varied standards, in general, the contractor must prove: (1) a breach of the contract through changed work or delays to the project; (2) the contractor’s need to borrow additional funds; and (3) the amount of the borrowings and actual interest incurred with a reasonable degree of certainty.<sup>125</sup>

Additionally, some courts have relied more stringently upon the requirement of foreseeability.<sup>126</sup> In order to demonstrate foreseeability, a contractor must establish that the parties either contemplated the borrowing at the time of contracting or reasonably foresaw the probable result of the breach. Often, courts will deny recovery of legitimate damages on the grounds of lack of foreseeability.<sup>127</sup>

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123. See, e.g., *Nebraska Pub. Power Dist. v. Austin Power, Inc.*, 773 F.2d 960 (8th Cir. 1985); *Mendoyoma, Inc. v. County of Mendocino*, 87 Cal. Rptr. 740 (Cal. Ct. App. 1970); *Bates & Rogers Constr. Corp. v. North Shore Sanitary Dist.*, 414 N.E.2d 1274 (Ill. App. Ct. 1980).

124. See, e.g., *Nebraska Pub. Power*, 773 F.2d at 972-73; *Mendoyoma*, 87 Cal. Rptr. at 743-45; *Bates & Rogers*, 414 N.E.2d at 1278; *Martel Constr., Inc. v. Montana*, 817 P.2d 677, 679-81 (Mont. 1991); *State Highway Comm’n v. Brasel & Sims Constr. Co.*, 688 P.2d 871, 881 (Wyo. 1984).

125. See *Nebraska Pub. Power*, 773 F.2d at 972-73.

126. See *Mendoyoma*, 87 Cal. Rptr. at 744.

127. See *id.*



In *Nebraska Public Power District v. Austin Power, Inc.*<sup>128</sup> Austin Power, Inc. contracted with the Nebraska Public Power District, a public corporation and political subdivision of the State of Nebraska, to construct an electrical power plant.<sup>129</sup> The court held that Austin had sufficiently established that its loans and interest expenses resulted from Nebraska Power's contract breaches, which delayed the project and caused cost overruns.<sup>130</sup> Austin also proved that it borrowed \$25 million from its parent corporation, which in turn borrowed the required funds from a bank to cover Austin's shortage and, as a result, incurred \$4.7 million in interest costs.<sup>131</sup>

The court then looked to Nebraska law to determine whether the cost of borrowed funds is recoverable.<sup>132</sup> No Nebraska case had previously addressed the issue, and, consequently, the court gave "great weight to the district court's holding that the state courts would be receptive toward allowing full compensation for actual damages arising from contract breaches."<sup>133</sup> The court affirmed the district court's decision to present the jury with the issue of whether the contractor was entitled to recover its cost of borrowing.<sup>134</sup> As a result, the court further held that the jury's decision to award the cost as an element of damages was entirely consistent with the evidence presented.<sup>135</sup>

In *Martel Construction, Inc. v. State of Montana*<sup>136</sup> a construction company brought an action against the State of Montana seeking damages for breach of contract, including interest expenses paid on borrowed funds to finance extra work.<sup>137</sup> Due to errors in the state's contract drawings, the state required the company to perform additional work not contemplated under the contract.<sup>138</sup> The court held that other than the prohibition against prejudgment and postjudgment interest, the state was liable for damages in contract cases to the same extent as private litigants under similar circumstances.<sup>139</sup> Relying upon previous holdings, the court permitted Martel to recover funds borrowed to finance additional work to the extent that the damages were "ascertainable in both nature and origin and [could] be causally and foreseeably related to the State's breach of contract."<sup>140</sup>

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128. 773 F.2d 960 (8th Cir. 1985).

129. *See id.* at 962.

130. *See id.* at 973.

131. *See id.*

132. *See id.*

133. *See id.* (citing *New Amsterdam Cas. Co. v. Mitchell*, 325 F.2d 474 (5th Cir. 1963) (applying Georgia law); *Cal-Val Constr. Co. v. Mazur*, 636 S.W.2d 391, 392 (Mo. App. 1982); *Roanoke Hosp. Ass'n v. Doyle & Russell, Inc.*, 214 S.E.2d 155 (Va. 1975)).

134. *See id.* at 972-73, 976.

135. *See id.* at 964, 972-73, 976.

136. 817 P.2d 677 (Mont. 1991).

137. *See id.* at 677-79.

138. *See id.* at 678.

139. *See id.* at 679.

140. *See id.* at 680-81 (citing *Popp v. Gountanis*, 718 P.2d 340 (Mont. 1986); *Lee v. Andres*, 667 P.2d 919 (Mont. 1983); *Bolz v. Meyers*, 651 P.2d 606 (Mont. 1982)).

California law similarly indicates that interest on funds borrowed to finance extra work may be recovered if certain criteria are met. For instance, in *Mendoyoma, Inc. v. County of Mendocino*<sup>141</sup> a plaintiff corporation entered into a contract with the county to construct and operate facilities on public land.<sup>142</sup> The trial court concluded that, as a result of the county's breaches, the plaintiff properly treated a concession agreement as being terminated.<sup>143</sup> In its proposal the plaintiff's method of performance financing consisted of issuing shares of common stock in the company.<sup>144</sup> The plaintiff was forced, however, to finance the project through loans because the lack of project development prohibited issuance of the stock.<sup>145</sup> As a result, the plaintiff submitted a claim for approximately \$14,000, which represented the interest paid on the loans to finance its performance.<sup>146</sup> The trial court rejected the claim on the grounds that the loans were not reasonably necessary for performance of the contract work.

The appellate court disagreed with the trial court's reasoning, suggesting that costs of borrowing are a legitimate cost to the contractor.<sup>147</sup> The court ultimately denied recovery, however, concluding that the parties did not contemplate the loan method of financing at the time of contracting.<sup>148</sup> This decision implies that the cost of funding would have been recovered had the contractor financed the extra costs through a more traditional (and thus foreseeable) financial arrangement.

Because most contracts do not affirmatively represent the particular manner of funding, the foreseeability element has not been viewed by the courts as an impossible hurdle for a contractor to overcome. The Wyoming Supreme Court, for instance, considers interest paid on borrowed funds necessitated by defective specifications to be within the contemplation of the parties.<sup>149</sup> In *State Highway Commission of Wyoming v. Brasel & Sims Construction Co.*<sup>150</sup> the court stated that "[i]nterest paid on funds borrowed to maintain liquidity has been considered a normal and foreseeable incident arising from a breach of contract and, therefore, compensable as damages."<sup>151</sup> Although the contractor borrowed funds to finance its entire operation, the funds

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141. 87 Cal. Rptr. 740 (Cal. Ct. App. 1970).

142. See *id.* at 742.

143. See *id.* The concession agreement between the plaintiff and the county made the plaintiff a licensee of the county and gave the plaintiff the right to construct buildings and improvements for the service of the public and to operate them for profit for a certain period of time. See *id.*

144. See *id.* at 744.

145. See *id.* at 743.

146. See *id.*

147. See *id.*

148. See *id.* at 743-44.

149. See *State Highway Comm'n v. Brasel & Sims Constr. Co.*, 688 P.2d 871, 881 (Wyo. 1984).

150. 688 P.2d 871 (Wyo. 1984).

151. *Id.* at 881 (citing *Certain-Teed Prods. Corp. v. Goslee Roofing & Sheet Metal, Inc.*, 339 A.2d 302 (Md. App. Ct. 1975)).

from all of its projects were commingled. The court would have awarded the contractor the interest paid on borrowed funds had the amounts claimed been less speculative.<sup>152</sup>

A court may not award damages based only upon conjecture. When a contractor has demonstrated that the state or local government entity has breached its contract by burdening the performance of the work, however, courts have recognized that the interest paid on borrowed funds to finance that additional work constitutes a legitimate cost of the work itself. Consequently, such courts have held that the only way to fully compensate the contractor for the breach of contract is to include the cost of borrowing as an element of actual damages.

### **B. Contracts Between Private Parties**

The private sector has long considered interest on borrowings to be an actual loss to the contractor.<sup>153</sup> In contracts between private parties, numerous courts have held that a party that breaches its construction contract by requiring additional work or extending the project completion date is obligated to pay the interest on borrowings that result from that breach.<sup>154</sup> Not only do these decisions elaborate upon the criteria discussed above, but they also recognize the underlying rationale for awarding such damages, in contrast to cases in which the Federal Government is a party.

For instance, in *Havens Steel*, the United States District Court for the Western District of Missouri awarded interest paid on monies borrowed to finance additional work under two different theories: (1) ordinary contract damage rules, and (2) the language of a contract document evidencing the "practical equivalent" of an "equitable adjustment" provision.<sup>155</sup> The court recognized that it was not only foreseeable but also inevitable that increased costs from additional work without an equivalent increase in progress payments would force the contractor to borrow additional funds or use its own capital.<sup>156</sup> According to the court, the contractor would incur an actual loss in either case.<sup>157</sup> Furthermore, the court only required that a contractor

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152. See *id.*

153. See *Safeway Stores, Inc. v. Massachusetts Bonding & Ins. Co.*, 20 Cal. Rptr. 820 (1962).

154. See, e.g., *Havens Steel Co. v. Randolph Eng'g Co.*, 813 F.2d 186, 188-89 (8th Cir. 1987) (applying Missouri law); *New Amsterdam Cas. Co. v. Mitchell*, 325 F.2d 474, 475 (5th Cir. 1963) (applying Georgia law); *Chestnut Hill Dev. Corp. v. Otis Elevator Co.*, 739 F. Supp. 692, 701-03 (D. Mass. 1990) (applying Massachusetts law); *Hemenway Co. v. Bartex, Inc.*, 373 So. 2d 1356, 1358-60 (La. Ct. App. 1979); *Nickerson v. Rowe*, 647 A.2d 1191, 1192 (Me. 1994); *Cal-Val Constr. Co. v. Mazur*, 636 S.W.2d 391, 392 (Mo. Ct. App. 1982); *Quate v. Caudle*, 381 S.E.2d 842, 843-46 (N.C. Ct. App. 1989); *Roanoke Hosp. Ass'n v. Doyle & Russell, Inc.*, 214 S.E.2d 155, 160-61 (Va. 1975); *Singer v. Etherington*, 789 P.2d 108, 110 (Wash. Ct. App. 1990).

155. See *id.* at 541.

156. See *id.*

157. See *id.*

have some reasonable way of determining its borrowing cost in order to recover.<sup>158</sup>

In *Quate v. Caudle*<sup>159</sup> the court addressed whether homeowners were entitled to recover the cost of borrowing additional funds to complete their home after the contractor breached the construction contract.<sup>160</sup> The homeowners were forced to pay another contractor sums that exceeded the original contract price in order to complete construction.<sup>161</sup> Although this case involved owners rather than contractors seeking to recover interest paid on borrowed funds, the rationale for awarding the interest as an element of damages is the same. According to the court, “[a] damage award consisting of merely the principal amount of a loan and not including financing costs and interest charges for obtaining that loan will not ‘restore the victim to his original condition . . . as far as it may be done by compensation in money.’ ”<sup>162</sup>

The Supreme Court of Virginia similarly held that the interest costs of an extended term of borrowing resulting from unexcused delay constituted compensable, direct damages.<sup>163</sup> In *Roanoke Hospital Association v. Doyle & Russell, Inc.*<sup>164</sup> the court recognized that it was customary for construction contracts to require third-party financing.<sup>165</sup> Since the term of construction financing was ordinarily extended when completion of the project was delayed, the court concluded that the interest costs incurred “during such an extended term [were] predictable results of the delay. . . .”<sup>166</sup>

The U.S. District Court for the District of Massachusetts adopted the reasoning developed in *Roanoke*.<sup>167</sup> In *Chestnut Hill Development Corp. v. Otis Elevator Co.*<sup>168</sup> the owner of a condominium complex brought an action against its subcontractor to recover interest charges on loans incurred as a result of construction delays.<sup>169</sup> Concluding that the borrowing costs were direct damages, the court stated that:

158. *See id.* at 542.

159. 381 S.E.2d 842 (N.C. Ct. App. 1989).

160. *See id.* at 843.

161. *See id.*

162. *Id.* at 846 (quoting *Phillips v. Chesson*, 58 S.E.2d 343, 347 (N.C. 1950)); *see also Hemenway Co. v. Bartex, Inc.*, 373 So. 2d 1356, 1359 (La. Ct. App. 1979) (holding that interest on borrowings must be awarded as an item of damages in order for the plaintiff to be placed in the same position plaintiff would have been in had the construction been timely completed); *Cal-Val Constr. Co. v. Mazur*, 636 S.W.2d 391, 392 (Mo. Ct. App. 1982) (concluding that Missouri courts consider the recovery of interest paid on borrowings to be an integral part of plaintiff's damages).

163. *See Roanoke Hosp. Ass'n v. Doyle & Russell, Inc.*, 214 S.E.2d 155, 160-61 (Va. 1975).

164. 214 S.E.2d 155 (Va. 1975).

165. *See id.* at 160-61.

166. *See id.* at 161.

167. *Chestnut Hill Dev. Corp. v. Otis Elevator Co.*, 739 F. Supp. 692, 702 (D. Mass. 1990).

168. 739 F. Supp. 692 (D. Mass 1990).

169. *See id.* at 693-94, 702.

when the installation of elevators is delayed, thus delaying completion of a construction project, extended financing costs flow naturally from the delay. Financing costs, such as interest charges on construction loans, are closely related to a subcontract for the installation of elevators in a condominium project under construction.<sup>170</sup>

Courts adjudicating private construction disputes have recognized that interest costs paid on funds borrowed to finance extra work are a direct cost to contractors and should be recoverable in actions for breach of contract.

## V. Conclusion

The cost of borrowing funds to perform additional work is an actual cost incurred by contractors. Through high standards and burdens of proof, however, the current federal policy fails to compensate contractors equitably by limiting the occasions in which contractors can recover interest on borrowings. In failing to reform its policies to incorporate the standards and rationales adopted by both state governments and private entities, the Federal Government continues to send a strong message, without any basis, that it will not treat its contractors equitably.

The Federal Government's failure to recognize the reality that funds must often be borrowed to finance extra work results in contractors including contingencies in their bids to cover this possibility. The Competition in Contracting Act (CICA)<sup>171</sup> is premised upon the theory that fairness and equality in competition results in the best quality product at the lowest price. Any federal policy that results in the inclusion of contingencies defeats the premise underlying CICA. Thus, the Government's refusal to include the cost of borrowed funds in damage awards is inconsistent with other principles of Government contracting. Until these inconsistencies are eliminated, the Government will not obtain the best product for the best price, and contractors will continue to be treated unfairly.

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170. *Id.* at 703.

171. Pub. L. No. 98-369, 98 Stat. 1175-1203 (1984) (codified as amended in scattered sections of 10 U.S.C., 31 U.S.C., 40 U.S.C., and 41 U.S.C.).