

# Government Contracts Blog

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## Federal Circuit Affirms, Requires Showing of Benefit to the Government for Allocability of Development Costs

In *Teknowledge Corp. v. U.S.*, Fed. Cir., No. 2009-5053, 11/03/09, the U.S. Court of Appeals for the Federal Circuit affirmed a decision by the Court of Federal Claims (COFC) that software development costs were not allocable to the Government because the Government did not receive a benefit from the costs. Earlier this year we [wrote](#) about the potential implications of the COFC's decision.

On appeal, Teknowledge argued that the COFC erred in requiring it to demonstrate a benefit to the Government from the development of its TekPortal software. It argued that allocability may be determined by the costs' potential future benefit to the Government. Since its costs were "indirect" rather than "direct" costs, Teknowledge argued that the COFC improperly looked for a nexus between the costs and a specific government contract.

The Federal Circuit disagreed with Teknowledge and focused on its decision in *Boeing N. Am., Inc. v. Roche*, 298 F.3d 1274 (Fed. Cir. 2002), which emphasized that "benefit," as used in FAR Part 31.201-4, required a contractor to show a nexus between the contractor's cost and the contractor's government work. Here, the development costs resulted from work done in anticipation of acquiring government contracts. Since Teknowledge could not point to any specific government contract for the development or use of its TekPortal software, the required nexus did not exist. The court found any benefit of the costs to the Government to be remote and insubstantial.

In our previous posting on the COFC decision, we discussed the implications of the case on independent research and development (IR&D) costs. In these cases, both the COFC and Federal Circuit found a lack of benefit to the Government, in large part, because of the absence of a government contract. However, IR&D costs by their nature are not tied to a specific contract. Under FAR Part 31.205-18, IR&D "does not include the costs of effort sponsored by a grant or required in the performance of a contract." Similar to the COFC decision, the Federal Circuit makes no mention of IR&D. Indeed, there is no evidence to suggest that Teknowledge even considered using the FAR's IR&D provisions to characterize the development costs. Nevertheless, until further clarification from the courts, these two cases have the potential to negatively hang over IR&D projects.

The Federal Circuit's full opinion is available [here](#).

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