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# GOVERNMENT CONTRACTORS, BEWARE: CIVIL AND CRIMINAL PENALTIES ABOUND FOR DEFECTIVE PRICING

*Steven D. Overly\**

## I. INTRODUCTION

In 1962, Congress enacted the Truth In Negotiations Act (Act),<sup>1</sup> and in 1978, the Contract Disputes Act,<sup>2</sup> which together provide an excellent vehicle for resolving both government and contractor defective pricing claims. When these acts were enacted, Congress never envisioned the Justice Department's criminalization of the contracting process. Over the last four years, however, allegations regarding a \$7600 coffee-maker, a \$916 nylon stool cap and a \$31,000 machined metal ring have caused members of Congress to join Pentagon auditors and Justice Department attorneys in an effort to indict and prosecute government contractors in the defense industry.<sup>3</sup>

As a result of such public scrutiny, Defense Department Inspector General Joseph H. Sherick reported to Congress in 1985 that forty-five of the top one hundred defense contractors were under criminal investigation.<sup>4</sup> The Defense Procurement Fraud Unit, created by the Justice Department in August 1982, claims its efforts have resulted in thirty-one convictions.<sup>5</sup> According to the Inspector General's semiannual report of audit and investigative activities, during the six-month period ending September 30, 1986, 222 contractors were debarred and 246 contractors were suspended. In addition, there were 401 indictments and 525 convic-

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1. Pub. L. No. 87-653, 76 Stat. 528 (1962) (codified as amended in scattered sections of 10 U.S.C.).

2. Pub. L. No. 95-653, 92 Stat. 2383 (1978) (codified as amended in scattered sections of 5, 28, 31 & 41 U.S.C.).

3. *Whistle-Blower Takes Aim at Price Gouging*, St. Louis Post-Dispatch, Dec. 15, 1985, at B-1.

4. *Pentagon Camouflages Data: Statistics Suggest Better Performance than Facts Warrant*, St. Louis Post-Dispatch, Dec. 18, 1985, at A-1.

5. *How Deep? Commitment is Questioned*, St. Louis Post-Dispatch, Dec. 19, 1985, at A-1; *Arms Costs: A Wasteland? System Fails Despite Layers of Control*, St. Louis Post-Dispatch, Dec. 15, 1985, at A-1.

tions reported. Fines, forfeitures, recoveries and civil settlements amounted to \$71.7 million for the period.<sup>6</sup>

On March 29, 1984, Robert W. Ogren, Chief of the Fraud Section (Criminal Division), identified the Justice Department's principal concerns in the defense procurement fraud area: mischarging of labor costs, product substitution, defective pricing, bid rigging and corruption of procurement officers.<sup>7</sup> This Article will focus on the area of defective pricing, one of the most likely areas for both civil and criminal investigations into allegations of procurement fraud.

## II. THE TRUTH IN NEGOTIATIONS ACT

The Truth In Negotiations Act,<sup>8</sup> and the regulations promulgated thereunder,<sup>9</sup> require contractors to submit cost or pricing data, to certify that such data is accurate, complete and current,<sup>10</sup> and to agree to include a price reduction clause in each contract which requires such a certificate.<sup>11</sup> Specifically, the law requires contractors to submit certified cost or pricing data in the following circumstances:

- (A) before the award of any prime contract under this chapter . . . entered into after using procedures other than sealed-bid procedures, if the price is expected to exceed \$100,000;
- (B) before the pricing of any contract change or modification if the price adjustment is expected to exceed \$100,000, or such lesser amount as may be prescribed by the head of the agency;
- (C) before the award of a subcontract at any tier, when the prime contractor and each higher tier subcontractor have been required to furnish such a certificate, if the price of such subcontract is expected to exceed \$100,000; or
- (D) before the pricing of any contract change or modification to a subcontract covered by clause (C), if the price adjustment is expected to exceed \$100,000, or such lesser amount as may be prescribed by the head of the agency.<sup>12</sup>

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6. 46 Fed. Cont. Rep. (BNA) 1007 (Dec. 15, 1986).

7. Address by Robert W. Ogren, Chief of the Fraud Section, Criminal Division, U.S. Department of Justice, at the Georgetown University Law Center (Mar. 29, 1984).

8. 10 U.S.C. § 2306(f) (Supp. 1985).

9. Federal Acquisition Regulations (FAR), 48 C.F.R. § 15.804-2(a)(1) (1985).

10. *Id.* § 15.804-2. Submission and certification of cost or pricing data is not required, however, if the price is based on adequate price competition, based on established catalog or market prices of commercial items sold in substantial quantities to the general public, or set by law or regulation. *Id.* § 15.804.3(a).

11. 10 U.S.C. § 2306(f)(1) (Supp. 1985); *see also* FAR § 15.804-2.

12. *See* FAR § 15.804-8(a) & (b).

The following discussion on the Truth In Negotiations Act will outline the government's procedures for obtaining "cost or pricing data" and the possible civil consequences for a contractor's failure to properly submit such data.

### A. Standard Form 1411

#### 1. Generally

Initially, the government requires contractors to acknowledge on Form 1411 that their proposal "reflects [their] best estimates and/or actual costs as of this date."<sup>13</sup> The instructions to Form 1411 require the submission of cost or pricing data and any information reasonably required to explain the offeror's estimating process.<sup>14</sup> This includes both "[t]he judgmental factors applied and the mathematical or other methods used in the estimate, including those used in projecting from known data" and "[t]he nature and amount of any contingencies included in the proposed price."<sup>15</sup>

In addition to factual cost or pricing data, Form 1411 requires disclosure of any cost estimates included in a contractor's proposal that are based on judgments.<sup>16</sup> Such disclosure is designed to ensure that the government is provided sufficient detail to evaluate a proposal.<sup>17</sup> While the Form 1411 instructions define the term "submittal" only with regard to cost or pricing data, they arguably allow "submittal" of the contractor's estimating processes either by actual submission to the contracting officer or by specific identification in the proposal.

Form 1411 requires costs to be broken down for each contract line item, with supporting information suitable for detailed analysis. While the government has a penchant for requiring that this pricing information be consistent with the contractor's cost accounting system, the Armed Services Board of Contract Appeals (ASBCA) has tended to be more liberal. In *Texas Instruments, Inc.*,<sup>18</sup> the ASBCA agreed with the

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13. U.S. GOVERNMENT PRINTING OFFICE, STANDARD FORM 1411, CONTRACT PRICING PROPOSAL COVER SHEET (1984). By signing Standard Form 1411, the contractor attests that the form is completed in accordance with its instructions.

Form 1411 was promulgated as part of the Federal Acquisition Regulations (FAR). When the FAR replaced the Defense Acquisition Regulations, Form 1411 replaced DD Form 633.

14. Instruction No. 2, Table 15-2: Instructions for Submission of A Contract Pricing Proposal, FAR § 15.804-6 (1986).

15. *Id.*

16. *See* Levinson Steel Co., 73-2 B.C.A. (CCH) ¶ 10,116, at 47,547 (1973).

17. Muncie Gear Works, Inc., 75-2 B.C.A. (CCH) ¶ 11,380, at 54,169 (1975).

18. 79-1 B.C.A. (CCH) ¶ 13,800, *aff'd on motion for reconsideration*, 79-2 B.C.A. (CCH) ¶ 14,184 (1979).

contractor's decision to use data, in support of its proposal, that was accumulated in a manner contrary to the contractor's customary cost accounting practices. The government argued that Cost Accounting Standard (CAS) 401 required estimating cost practices used in pricing to be consistent with cost accounting practices used in accumulating and reporting costs. However, the ASBCA upheld the contractor's use of such data, since it had clearly indicated the process and method by which it derived the numbers on the supplemental schedule to its proposal.<sup>19</sup>

## 2. Liability for Misuse

At least two cases have dealt with government allegations that a contractor misused Department of Defense (DD) Form 633, the predecessor of Form 1411, to defraud the government. The government prevailed in both instances. In *United States v. Foster Wheeler Corp.*,<sup>20</sup> a civil fraud case, the court found the contractor's submission of DD Form 633 false and misleading because: (1) the estimated costs certified on the form were not based on the company's books and records; (2) the contractor's breakdown on the form of lump sum cost figures was artificial and designed to hide an increase in the estimated cost figures; and (3) the contractor made oral representations that an 11% loss had been sustained on an earlier contract involving identical goods when, in fact, its books and records revealed a 6.7% profit on the earlier contract.<sup>21</sup> The court not only held that the contractor acted intentionally, but also found that it negligently made misrepresentations of material fact on which the government relied.<sup>22</sup> Thus, the contractor was found to have violated the False Claims Act<sup>23</sup> and to have perpetrated common-law fraud based upon statements contained in its DD Form 633.<sup>24</sup>

In *United States v. White*,<sup>25</sup> a criminal fraud case, the court affirmed the contractor's convictions under 18 U.S.C. sections 287, 371 and 1001.<sup>26</sup> There, the contractor misrepresented that it performed certain work under the contract (actually performed by another company), altered time cards to support fictional labor data contained in its proposal and claimed that the numbers used pertaining to labor data were esti-

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19. *Id.* at 67,606, 67,619-20.

20. 316 F. Supp. 963 (S.D.N.Y. 1970), *modified on other grounds*, 447 F.2d 100 (2d Cir. 1971).

21. *Id.* at 966.

22. *Id.* at 974.

23. 31 U.S.C. § 3729 (1983).

24. *Foster*, 316 F. Supp. at 974.

25. 765 F.2d 1469 (11th Cir. 1985).

26. *Id.* at 1482.

mates derived from actual cost experience.<sup>27</sup> In representing the latter, the contractor omitted the formula that it had used to arrive at the resulting "estimate" so as to hide the underlying factual data supporting it.<sup>28</sup> It did this despite earlier statements during negotiations that the numbers in the proposal were derived from "real facts."<sup>29</sup>

In reaching a decision, the *White* court noted three things which distinguished this case from those in which defendants had escaped criminal liability. First, the contractor had not made affirmative representations that could reasonably be interpreted as true. Rather, it omitted facts supporting its labor figures even though it had underlying data with which to do so. This was contrary to the specific instructions accompanying Department of Defense Form 633 that called for price breakdowns and disclosure of the formulas and factors used to derive the submitted numbers.<sup>30</sup>

Second, the *White* court contrasted the contractor's behavior with that of the defendant in *Maxwell v. United States*.<sup>31</sup> In *Maxwell*, the Court of Appeals for the Sixth Circuit found that the contractor had exhibited "forthright" behavior because it repeatedly and honestly informed the government that it had no numbers to support its estimate, which was in fact "pulled from thin air."<sup>32</sup> In contrast, the *White* court characterized the contractor's behavior as "deceitful." The court perceived that by initially telling the government that it used actual hours and then later contending that the numbers were mere estimates with no factual support, by altering time cards, and by falsely attributing more work to the subcontractor than was actually performed, the contractor's behavior was nothing less than "a willful attempt to fleece the system."<sup>33</sup>

Finally, the *White* court noted that even if the estimates were based on nothing more than mathematical formulas, the contractor had a duty to show that they reasonably reflected incurred costs. Failure to do so evidenced a "reckless disregard of the truth, with a conscious purpose to avoid learning the truth," sufficient to show that a "false statement was made knowingly or willfully."<sup>34</sup>

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27. *Id.* at 1473-78.

28. *Id.* at 1481-82.

29. *Id.*

30. *Id.* at 1479.

31. 277 F.2d 481 (6th Cir. 1960).

32. *Id.* at 509.

33. *White*, 765 F.2d at 1480-81.

34. *Id.* at 1481-82.

## B. Cost Or Pricing Data

### 1. Definition

The Federal Acquisition Regulations (FAR) define "cost or pricing data" as:

[A]ll facts as of the time of price agreement that prudent buyers and sellers would reasonably expect to affect price negotiations significantly. Cost or pricing data are factual, not judgmental, and are therefore verifiable. While they do not indicate the accuracy of the prospective contractor's judgment about estimated future costs or projections, they do include the data forming the basis for that judgment. Cost or pricing data are more than historical accounting data; they are all the facts that can be reasonably expected to contribute to the soundness of estimates of future costs and to the validity of determinations of costs already incurred. They also include such factors as (a) vendor quotations; (b) nonrecurring costs; (c) information on changes in production methods and in production or purchasing volume; (d) data supporting projections of business prospects and objectives and related operations costs; (e) unit-cost trends such as those associated with labor efficiency; (f) make-or-buy decisions; (g) estimated resources to attain business goals; and (h) information on management decisions that could have a significant bearing on costs.<sup>35</sup>

Few cases rely on the precise language defining cost or pricing data found in the regulations. Instead, they remove and use only those portions that are helpful. Although the regulations define cost or pricing data as "all facts existing up to the time of agreement on price which prudent buyers and sellers would reasonably expect to have a significant effect on price negotiations,"<sup>36</sup> case law dwells on the prudent *buyer* rather than on the prudent seller. The prudent buyer standard has been interpreted to include all data that *might* affect the price or that *might* serve to establish future costs or the validity of costs already incurred.<sup>37</sup> Thus, if an estimate (e.g., of future business or of future labor rates) is used in a price proposal, the underlying facts upon which the estimate is based must be disclosed to the buyer.<sup>38</sup> Those underlying facts represent

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35. FAR § 15.801.

36. *Id.*

37. *Singer Co. v. United States*, 576 F.2d 905, 918 (Ct. Cl. 1978) (per curiam); *Cutler-Hammer, Inc. v. United States*, 416 F.2d 1306, 1314-15 (Ct. Cl. 1969); *Norris Indus., Inc.*, ASBCA No. 15,442, 74-1 B.C.A. (CCH) ¶ 10,482, at 49,571 (1974).

38. *Baldwin Elecs., Inc.*, ASBCA No. 20,717, 76-2 B.C.A. (CCH) ¶ 12,199, at 58,739

cost or pricing data. Even estimates derived from cost data must be disclosed when they can be verified against that data and are information that a prudent buyer would expect to significantly affect price negotiations.<sup>39</sup> It has been held that an estimate is only a judgment if there is no contrary factual data on which the contractor could revise his estimate.<sup>40</sup> Otherwise, it is a fact and must be disclosed as cost or pricing data.<sup>41</sup>

The ASBCA has employed a "reasonableness" standard to determine whether items constitute cost or pricing data under the above definition.<sup>42</sup> Using that standard, the seller must be permitted to draw a line somewhere in determining whether information constitutes cost or pricing data and whether it should be disclosed. Accordingly, the ASBCA has held that a contractor has failed to disclose only if it did so "for no good reason, or for reasons with which a prudent buyer would reasonably disagree."<sup>43</sup>

For example, in *TRA Architecture Engineering/R, James Dersham, AIA Architects (JV)*,<sup>44</sup> the ASBCA approved the contractor's decision to deliberately ignore data for the three most recent years in favor of older data.<sup>45</sup> The contractor claimed that the more recent data was "not meaningful" because it included figures reflective of activities in which the company did not normally engage.<sup>46</sup> The ASBCA lauded the contractor's decision and stated that the more recent statistics would have distorted the price, thus it was appropriate to use the "meaningful" data.<sup>47</sup>

## 2. Judgment versus fact

Although the definition of "cost or pricing" data emphasizes that it is comprised of verifiable facts rather than judgments, it leaves the government room to construe as verifiable fact information which in some instances may not fall clearly within the meaning of that term. There is

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(1976); *Hardie-Tynes Mfg. Co.*, ASBCA No. 20,717, 76-2 B.C.A. (CCH) ¶ 12,121, at 58,227 (1976).

39. *Lambert Eng'g Co.*, ASBCA No. 13,338, 69-1 B.C.A. (CCH) ¶ 7663, at 35,576 (1969).

40. *See Rogerson Aircraft Controls*, ASBCA No. 27,954, 85-1 B.C.A. (CCH) ¶ 17,725, at 88,491 (1984).

41. *Id.*

42. *See Hardie-Tynes*, ASBCA No. 20,717, 76-2 B.C.A. (CCH) at 58,227; *Plessey Indus., Inc.*, ASBCA No. 16,720, 74-1 B.C.A. (CCH) ¶ 10,603, at 50,278 (1974); *Luzon Stevedoring Corp.*, ASBCA No. 14851, 71-1 B.C.A. (CCH) ¶ 8745, at 40,604 (1971).

43. *Plessey*, ASBCA No. 16,720, 74-1 B.C.A. (CCH) ¶ 10,603, at 50,278 (1974).

44. ASBCA Nos. 28,525, 28,980, 84-1 B.C.A. (CCH) ¶ 17,152 (1984).

45. *Id.* at 85,462.

46. *Id.* at 85,466-67.

47. *Id.* at 85,467.



considerable support for the proposition that all data that might in any way affect the price negotiations must be disclosed.<sup>48</sup> The contractor is then free, after disclosure, to argue that the data is irrelevant to price determination. It seems apparent, however, that the contractor cannot unilaterally decide what is not pertinent and therefore refuse to disclose it.<sup>49</sup> Otherwise, if the contractor could pick and choose which data it wishes to disclose, the Act's purpose would be defeated.

In *Aerojet-General Corp.*,<sup>50</sup> the ASBCA determined that a contractor whose engineering studies and analyses revealed its subcontractor's bid to be grossly overstated had a duty to disclose those studies and analyses to the government as cost or pricing data. The ASBCA held that the "studies" were facts even though there were elements of judgment involved, basing its decision on the premise that both the underlying data and the "studies" themselves were verifiable.<sup>51</sup>

### C. Accurate, Complete and Current

The Act requires that each contractor or subcontractor "shall be required to submit cost or pricing data . . . and shall be required to certify that, to the best of such contractor's or subcontractor's knowledge and belief, the cost or pricing data submitted was accurate, complete and current."<sup>52</sup> Use of inaccurate, incomplete or noncurrent data when there is more accurate,<sup>53</sup> complete<sup>54</sup> and current<sup>55</sup> data "practically available" is

48. A contractor must keep in mind that, while the Truth In Negotiations Act only requires disclosure of cost or pricing data, Form 1411 also requires disclosure of the judgmental factors applied in arriving at cost estimates. See *supra* text accompanying notes 13-17. Moreover, if a contractor fails to disclose certain information that is later found to constitute cost or pricing information, he may find himself subject to the civil and criminal penalties outlined herein.

49. *Singer Co.*, 576 F.2d at 918; *Bell & Howell Co.*, ASBCA No. 11,999, 68-1 B.C.A. (CCH) ¶6993, at 32,347 (1968) (holding that data available but not used in a price bid must be disclosed, but that the contractor is free to explain the reason for nonuse).

50. ASBCA No. 12,264, 69-1 B.C.A. (CCH) ¶ 7664, at 35,577 (1969), *modified in part*, 70-1 B.C.A. (CCH) ¶ 8140, at 37,811 (1970).

51. *Id.* at 35,582-84.

52. 10 U.S.C. § 2306(f)(1) (1986); see also FAR §§ 15.804-2, -3.

53. Something is generally considered to be "accurate" when it is "free from error and defect," or when it is "substantially accurate and not distorted . . ." *Hoye v. Schaefer*, 148 N.E.2d 532, 534 (Ohio Ct. C.P. 1957), *aff'd*, 109 Ohio App. 489, 157 N.E.2d 140 (1959). See also *Lewis v. Vallis*, 356 Mass. 662, 666, 255 N.E.2d 337, 340 (1970).

54. While there are many definitions of the word "complete," those definitions all agree in essence with that found in *Black's Law Dictionary*: "Full; entire; including every item or element of the thing spoken of, without omissions or deficiencies; . . . [p]erfect; consummate; not lacking in any element or particular." *BLACK'S LAW DICTIONARY* 258 (5th ed. 1979).

55. "Current" is defined as "belonging to the time actually passing; new, present, most recent." *Kozak v. Retirement Bd. of the Firemen's Annuity & Benefit Fund*, 99 Ill. App. 3d

improper.<sup>56</sup> However, if the most current information is not available and there are other "reasonable and responsible data . . . and a good reason for preferring them, . . . the contractor may choose to use such . . . data."<sup>57</sup>

#### D. *Submittal of Cost or Pricing Data*

In order to comply with the Act, the contractor must certify that all of the cost or pricing data contained in its proposal or submitted in support of its proposal is accurate, complete and current.<sup>58</sup> As a result, the contractor has a continuing obligation to update the cost or pricing data contained in his proposal until a final agreement on contract price is reached.<sup>59</sup> Such certification, however, applies only to the factual data submitted to the government and does not constitute a representation as to the accuracy of the contractor's judgment on the estimate of future costs or projections.<sup>60</sup>

For data to be properly submitted to the government, it must either

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1015, 1018, 425 N.E.2d 1371, 1373 (1981) (quoting RANDOM HOUSE DICTIONARY OF THE ENGLISH LANGUAGE (unabridged ed. 1966)), *aff'd*, 447 N.E.2d 394 (Ill. 1983). However, "[t]he word 'current', when used as an adjective, has many meanings, and definition depends largely on [the] word which it modifies, or [the] subject matter with which it is associated." BLACK'S LAW DICTIONARY, *supra* note 54, at 345. When, as in our context, the word "current" deals with subject matter that must also be "complete," it can mean only such material or data that is both complete and current. Otherwise, the two words are contradictory.

56. *Singer Co. v. United States*, 576 F.2d 905, 920 (Ct. Cl. 1978) (per curiam); *Conrac Corp. v. United States*, 558 F.2d 994, 998 (Ct. Cl. 1977); *M-R-S Mfg. Co. v. United States*, 492 F.2d 835, 843 (Ct. Cl. 1974).

57. *Luzon Stevedoring Corp.*, ASBCA No. 14,851, 71-1 B.C.A. (CCH) ¶ 8745, at 40,604 (1971).

58. 10 U.S.C. § 2306(f) (Supp. 1985); *S.T. Research Corp.*, ASBCA No. 29,070, 84-3 B.C.A. (CCH) ¶ 17,568, at 87,547 (1984). The actual certification language is as follows:

This is to certify that, to the best of my knowledge and belief, the cost or pricing data (as defined in section 15.801 of the Federal Acquisition Regulation (FAR) and required under FAR subsection 15.804-2) submitted, either actually or by specific identification in writing, to the contracting officer or to the contracting officer's representative in support of [identify the proposal, quotation, request for price adjustment, or other submission involved, giving the appropriate identifying number] are accurate, complete, and current as of [insert the day, month, and year when price negotiations were concluded and the contract price was agreed to]. This certification includes the cost or pricing data supporting any advance agreements and forward pricing rate agreements between the offeror and the Government that are part of the proposal.

FAR § 15.804-4(a).

59. *See Lambert Eng'g Co.*, ASBCA No. 13,338, 69-1 B.C.A. (CCH) ¶ 7663, at 35,575 (1969).

60. FAR § 15.804-4(b). *See M-R-S Mfg. Co. v. United States*, 492 F.2d 835, 838 n.3, 840 (Ct. Cl. 1974); *Rogerson Aircraft Controls*, ASBCA No. 27,954, 85-1 B.C.A. (CCH) ¶ 17,725 (1984); *Luzon Stevedoring Corp.*, ASBCA No. 15,606, 71-1 B.C.A. (CCH) ¶ 8,745 (1971); *Lambert*, ASBCA No. 13,338, 69-1 B.C.A. (CCH) ¶ 7,663 (1969).

be delivered physically to the government *or* be made available to the government coupled with the disclosure of its significance to the particular contract.<sup>61</sup> If the government was specifically advised during negotiations that the required information was available and pertinent to the subject negotiations, the government cannot later contend that such information was not disclosed.<sup>62</sup> In this regard, later disclosures can arguably be construed as informal supplementation of the contractor's proposal. The rationale being that, in a dispute over nondisclosure, the government has the ultimate burden of proving that it was not advised of relevant information and that it lacked knowledge of the allegedly undisclosed information.<sup>63</sup> Similarly, as long as disclosure is *or was made, in some form*, to the "prenegotiation auditor, the [Defense Contract Administrative Service Region] DCASR price analyst, or *other* appropriate government personnel," the government will be unable to prove nondisclosure if changes occur that affect cost between the time the proposal is submitted and the final agreement on price.<sup>64</sup>

### E. Contract Price Adjustment

#### 1. Generally

Price increases resulting from inaccurate, incomplete or noncurrent cost or pricing data entitle the government to a "price adjustment, including profit or fee, of any significant amount by which the price was increased because of the defective data."<sup>65</sup> The government is entitled to a price adjustment for defects in cost or pricing data submitted by either a prime contractor or subcontractor.

In *M-R-S Manufacturing Co. v. United States*,<sup>66</sup> the contractor argued that since it had submitted no data in support of its price proposal,

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61. *M-R-S Mfg. Co.*, 492 F.2d at 842-43; *Sylvania Elec. Prods., Inc.*, ASBCA No. 13,622, 70-2 B.C.A. (CCH) ¶ 8387, at 38,999, *aff'd*, 479 F.2d 1342 (Ct. Cl. 1973) (1970); *Defense Elec., Inc.*, ASBCA No. 11,127, 66-1 B.C.A. (CCH) ¶ 5604, at 26,202 (1966); *American Bosch Arma Corp.*, ASBCA No. 10,305, 65-2 B.C.A. (CCH) ¶ 5280 (1965). *Cf. Singer Co. v. United States*, 576 F.2d 905, 914-16 (Ct. Cl. 1978) (requiring the contractor to physically deliver the data and to make known its significance).

62. *Conrac Corp.*, ASBCA No. 19,507, 78-1 B.C.A. (CCH) ¶ 12,985, at 63,295 (1977).

63. *Id.*

64. *Whittaker Corp.*, ASBCA No. 17,267, 74-2 B.C.A. (CCH) ¶ 10,938, at 52,078 (1974) (emphasis added).

65. FAR § 15.804-7(b); *see also* 10 U.S.C. § 2306(f)(2) (1986). However, in *Aerojet-General Corp.*, ASBCA No. 12,873, 69-1 B.C.A. (CCH) ¶ 7585 (1969), and *Bell & Howell Co.*, ASBCA No. 11,999, 68-1 B.C.A. (CCH) ¶ 6993 (1968), the Armed Services Board of Contract Appeals (ASBCA) arrived at a compromise price adjustment.

66. ASBCA No. 14,825, 71-1 B.C.A. (CCH) ¶ 8821 (1971), *aff'd*, 492 F.2d 835 (Ct. Cl. 1974).

the government was not entitled to a price reduction. The contractor had executed a certificate, however, and the contract contained a price reduction clause. The Court of Claims rejected the contractor's argument, stating that:

The second flaw in the plaintiff's argument concerns its assertion that data must be submitted in support of a proposal before the Defective Pricing Clause allows a price reduction. The plaintiff interprets the Defective Pricing Clause and the Certificate of Current Cost or Pricing Data so as to sanction his argument. Such an interpretation might have merit if only contractual provisions, and not a statutory directive, were involved. However, since the clause and the certificate exist pursuant to the directions of the Truth in Negotiations Act, 10 U.S.C. § 2306(f), the scope of these items turns on the scope of the Act.

As this court has said on several occasions, the Truth in Negotiations Act imposes a duty on Government contractors to completely disclose cost and pricing information. . . . Therefore, even if, as the plaintiff asserts, no data were submitted "in support" of the proposal . . . , the plaintiff still did not meet the requirements imposed by the Act.<sup>67</sup>

If the government establishes that it is entitled to a contract price adjustment as a result of defective pricing, the contractor is entitled to offset against any such overstatement the amount of any understatements it later finds it made on the same contract.<sup>68</sup> Specifically, the FAR provides that:

In arriving at a price adjustment under the [contract] clause, the contracting officer shall consider—

(1) The time by which the cost or pricing data became reasonably available to the contractor;

(2) The extent to which the Government relied upon the defective data; and

(3) Any understated cost or pricing data submitted in support of price negotiations, up to the amount of the Government's claim for overstated pricing data arising out of the same pricing action (for example, the initial pricing of the same con-

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67. M.R.S. Mfg. Co. v. United States, 492 F.2d 835, 840-41 (Ct. Cl. 1974).

68. FAR § 15.804-7(b)(3); *see also* Cutler-Hammer, Inc. v. United States, 416 F.2d 1306, 1312 (Ct. Cl. 1969); Muncie Gear Works, Inc., ASBCA No. 18,184, 75-2 B.C.A. (CCH) ¶ 11,380, at 54,181-82 (1975).

tract or the pricing of the same change order). Such offsets need not be in the same cost groupings (e.g., material, direct labor, or indirect costs).<sup>69</sup>

Offsets are permissible up to the amount asserted as defective pricing, even though the contract has been administratively closed.<sup>70</sup>

The Defense Procurement Improvement Act,<sup>71</sup> contained in the Department of Defense (DOD) Authorization Act of 1986,<sup>72</sup> provides that the contractor will be liable for interest on any contract overpayment resulting from his submission of inaccurate, incomplete, or noncurrent cost or pricing data.<sup>73</sup> In addition, if the contractor *knowingly* submits such data, the government can impose a separate civil penalty in the amount of the contract overpayment.<sup>74</sup> These new statutory provisions have been recodified in the new Truth In Negotiations Act provisions added by the DOD Authorization Act of 1986.<sup>75</sup>

## 2. Burden of proof

In defective pricing cases, the government has the burden of showing "that *more* accurate, complete and current cost and pricing data [was] reasonably available to [the contractor] on the date of certification."<sup>76</sup> To demonstrate that "more accurate, complete and current cost and pricing data" existed, the government must establish a nexus "between the raw data and how it could reasonably be expected to contribute to sound estimates of future costs and how prudent buyers and sellers would reasonably expect its disclosure to have a significant effect on price negotiations."<sup>77</sup>

Next, the government must establish a nexus between the alleged defective pricing data and a resulting significant overstatement of contract price. If the government would not have relied on information that was withheld or did not rely on misinformation that was provided, it is not entitled to a contract price adjustment since there was no overstate-

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69. FAR § 15.804-7(b).

70. See 1A McBRIDE, WACHTEL & TOUHEY, GOVERNMENT CONTRACTS § 7.70[8] (rev. 1985).

71. Pub. L. No. 99-145, tit. 9, 99 Stat. 583, 682 (1986).

72. Pub. L. No. 99-145, 99 Stat. 583 (1986).

73. Pub. L. No. 99-145, tit. 9, § 934.

74. *Id.* § 952.

75. *Id.*; 10 U.S.C. § 2306a(e).

76. See Central Navigation & Trading Co., S.A., ASBCA No. 23,946, 82-2 B.C.A. (CCH) ¶ 16,074, at 79,746 (1982) (emphasis added) (citing LTV Electrosystems, Inc., ASBCA No. 16,802, 73-1 B.C.A. (CCH) ¶ 9957, at 46,708) (1973).

77. Boeing Co., ASBCA No. 20,875, 85-3 B.C.A. (CCH) ¶ 18,351, at 92,032 (1985).

ment of contract price.<sup>78</sup> Although there is a presumption that defective data will cause an increase in the negotiated price, the presumption is rebutted when the government demonstrates that it knew the proposal was based on other than the most accurate, complete or current data.<sup>79</sup> Furthermore, when the contractor has provided erroneous data but discloses such error, the government assumes the risk of overpayment if it relies on that data.<sup>80</sup>

Regarding the government's burden of proof, the ASBCA has held that the government is not automatically entitled to a price reduction once an overstatement has been established.<sup>81</sup> Specifically, in *American Machine & Foundry Co.*,<sup>82</sup> the ASBCA stated that:

It is crystal clear that the statute does not expressly provide for an automatic price reduction measured by the amount of any overstatement of the cost of a component part of the end item, plus the percentages that the Government chooses to use for G&A [General & Administrative expenses] and profit. . . . Rather, the remedy clearly envisaged by the statute where an overstatement in the cost of a component part has been established is an adjustment in the contract price of the end item "to exclude any significant sums by which it may be determined . . . that such price was increased because the contractor or any subcontractor . . . furnished cost or pricing data which . . . was inaccurate, incomplete or noncurrent." In other words, the statute, rather than requiring an automatic price reduction in the end item equal to the amount of the dollar and cents overstatement of a component part, plus G&A and profit, as advocated by the Government, requires that first, as a *sine qua non*, there exist a causal connection between any inaccurate, incomplete or noncurrent data with respect to a component part, on the one hand, and any increase of the contract price of the end item, on the other hand. Further, even if the existence of such a causal relationship is established, the statute requires that, before a price reduction may be effected, the "significant sums

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78. See *Muncie*, ASBCA No. 18,184, 75-2 B.C.A. (CCH) at 54,173-74; *American Mach. & Foundry Co.*, ASBCA No. 15,037, 74-1 B.C.A. (CCH) ¶ 10,409, at 49,174-75 (1973); *Levinson Steel Co.*, ASBCA No. 16,520, 73-2 B.C.A. (CCH) ¶ 10,116, at 47,548 (1973).

79. *Rogerson Aircraft Controls*, ASBCA No. 27,954, 85-1 B.C.A. (CCH) ¶ 17,725, at 88,491 (1984).

80. *McDonnell Douglas Corp.*, ASBCA No. 12,786, 69-2 B.C.A. (CCH) ¶ 7897, at 36,734 (1969).

81. *American Mach.*, ASBCA No. 15,037, 74-1 B.C.A. (CCH) ¶ 10,409, at 49,174-75.

82. ASBCA No. 15,037, 74-1 B.C.A. (CCH) ¶ 10,409 (1973).

by which . . . such price [for the end item] was increased because the contractor or any subcontractor . . . furnished cost or pricing data [with respect to a component part] which . . . was inaccurate, incomplete, or noncurrent" must be determined, because such "significant sums," and no other, may be excluded from the contract price for the end item because of the defective pricing data furnished with respect to the component part.<sup>83</sup>

After the government has satisfied its burden of proof, a rebuttable presumption arises that the natural and probable consequence of such nondisclosure is an overstated negotiated contract price.<sup>84</sup> The contractor now has the "burden of persuasion" that such nondisclosure did not result in an overstated price.<sup>85</sup>

### 3. Waiver and estoppel

The government and its agents cannot waive the statutory obligations and duties imposed by the Act.<sup>86</sup> Estoppel, on the other hand, may apply against the government.<sup>87</sup> The requirements for estoppel, however, are stringent and can seldom be met. First, the government must have knowledge of that which was not disclosed. Second, the government must intend or the contractor must believe that the government intends that its conduct be acted upon. Third, the contractor must be ignorant of the true facts. Finally, the contractor must have relied on the government's conduct to its detriment.<sup>88</sup> Estoppel by acquiescence may also be applied against the government if it knew that the contractor's

83. *Id.*

84. See *Aerogjet-General*, ASBCA No. 12,264, 70-1 B.C.A. (CCH) ¶ 8140; *American Bosch Arma Corp.*, ASBCA No. 10,305, 65-2 B.C.A. (CCH) ¶ 5280 (1965); see also FAR § 15.804-7.

85. See *Sylvania Elec. Prods., Inc.*, ASBCA No. 13,622, 70-2 B.C.A. (CCH) ¶ 8387 (1970), *aff'd*, 479 F.2d 1342 (Ct. Cl. 1973); see also *Lear Siegler, Inc.*, ASBCA No. 20,040, 78-1 B.C.A. (CCH) ¶ 13,110 (1978); *Muncie*, ASBCA No. 18,184, 75-2 B.C.A. (CCH) ¶ 11,380; *Norris Indus., Inc.*, ASBCA No. 15,442, 74-1 B.C.A. (CCH) ¶ 10,482 (1974); *American Mach.*, ASBCA No. 15,037, 74-1 B.C.A. (CCH) ¶ 10,409; *Levinson Steel*, ASBCA No. 16,520, 73-2 B.C.A. (CCH) ¶ 10,116; *Luzon Stevedoring Corp.*, ASBCA No. 14,851, 71-1 B.C.A. (CCH) ¶ 8745 (1971); *McDonnell Douglas*, ASBCA No. 12,786, 69-2 B.C.A. (CCH) ¶ 7897; *Lambert Eng'g Co.*, ASBCA No. 13,338, 69-1 B.C.A. (CCH) ¶ 7663 (1969); *FMC Corp.*, ASBCA Nos. 10,095 & 11,113, 66-1 B.C.A. (CCH) ¶ 5483 (1966).

86. See *Singer Co. v. United States*, 576 F.2d 905, 917 (Ct. Cl. 1978); *M-R-S Mfg. Co.*, 492 F.2d at 841; *ReCon Paving, Inc.*, ASBCA No. 27,836, 83-2 B.C.A. (CCH) ¶ 16,658, at 82,834 (1983); *Beech Aircraft Corp.*, ASBCA No. 25,338, 83-1 B.C.A. (CCH) ¶ 16,532, at 82,182-83 (1983); *Boeing Co.*, ASBCA No. 20,875, 82-1 B.C.A. (CCH), ¶ 15,508, at 76,917 (1981).

87. See *Emeco Indus. v. United States*, 485 F.2d 652 (Ct. Cl. 1973) (government estopped from denying existence of a contract); *Manloading & Management Assocs. v. United States*, 461 F.2d 1299, 1303 (Ct. Cl. 1972) (oral advice at bidders' conference estopped government).

88. *Singer Co.*, 576 F.2d at 917.

interpretation of the contract terms was at variance with its own but expressed no disagreement.<sup>89</sup>

### III. GOVERNMENT ACCESS TO COST OR PRICING DATA

The Truth In Negotiations Act authorizes both pre-award and post-award audits, providing that:

For the purpose of evaluating the accuracy, completeness, and currency of cost or pricing data required to be submitted by this subsection, any authorized representative of the head of the agency who is an employee of the United States Government shall have the right, until the expiration of three years after final payment under the contract or subcontract, to examine all books, records, documents, and other data of the contractor or subcontractor related to the proposal for the contract, the discussions conducted on the proposal, pricing, or performance of the contract or subcontract.<sup>90</sup>

Further, 10 U.S.C. section 2313(b) and 41 U.S.C. section 254(c), which authorize post-award audits, provide similar authority for the Comptroller General to audit sealed-bid and negotiated procurements. Cases interpreting these statutes have given the government very broad access to examine any records the contractor has pertaining to the contract.<sup>91</sup>

The regulations and forms promulgated by the Department of Defense relating to defense contracts have broadened the government's access to contractors' books and records. For example, Form 1411, pertaining to the pre-award contract pricing proposal stage, grants to the contracting officer or his authorized representative "the right to examine those books, records, documents, and other supporting data that will permit adequate evaluation of the proposed price."<sup>92</sup> Department of Defense Form 633-5,<sup>93</sup> which is used for change orders to contract pricing

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89. *American Elec., Inc., ASBCA No. 16,635, 76-2 B.C.A. (CCH) ¶ 12,151, at 58,478-79 (1976).*

90. 10 U.S.C. § 2306(f)(5) (1982 & Supp. III 1985).

91. *See McDonnell Douglas Corp. v. United States, 754 F.2d 365 (Fed. Cir. 1985); SmithKline Corp. v. Staats, 668 F.2d 201 (3d Cir. 1981), cert. denied, 461 U.S. 913 (1983); Merck & Co. v. Staats, 665 F.2d 1236 (D.C. Cir. 1981) (per curiam), aff'd, 460 U.S. 824 (1983); Eli Lilly & Co. v. Staats, 574 F.2d 904 (7th Cir.), cert. denied, 439 U.S. 959 (1978); Hewlett-Packard Co. v. United States, 385 F.2d 1013 (9th Cir. 1967), cert. denied, 390 U.S. 988 (1968).*

92. Instruction No. 5, Table 15-2: Instructions for Submission of A Contract Pricing Proposal, FAR § 15.804-6 (1986).

93. U.S. GOVERNMENT PRINTING OFFICE, DD FORM 633-5, CONTRACT PRICING PROPOSAL (CHANGE ORDERS) (1968).



proposals, and Form 1412,<sup>94</sup> which governs claims for exemption from submission of certified cost or pricing data, authorize similar access for the purpose of verifying cost or pricing data and for verifying the legitimacy of the claim for exemption. Thus, both statutes and regulations obligate the contractor to allow the government access to all records and documentation pertaining to the contract.<sup>95</sup>

According to the regulations, field pricing reports are to be used to give the contracting officer "a detailed analysis of the proposal, for use in contract negotiations."<sup>96</sup> In this regard, the Defense Contract Audit Agency (DCAA) is responsible for conducting reviews of the contractor's estimating systems or methods. Among the items to be considered when auditing a contractor's estimating system are the procedures followed in developing estimates, the source of data used in developing estimates, the means of assuring that the data is accurate, complete and current, and the documentation developed and maintained by the contractor to support these estimates.<sup>97</sup> To facilitate this process, the FAR provides that the auditor shall have general access to the contractor's books and financial records.<sup>98</sup>

If the auditor's efforts to properly price a proposal are thwarted by the contractor, the auditor is required to "promptly report to the contracting officer any denial of access to records or to cost or pricing data considered essential to the preparation of a satisfactory audit report."<sup>99</sup> Moreover, if the auditor believes that the contractor's estimating methods or accounting system are "inadequate to support the proposal or to permit satisfactory administration of the contract contemplated," he must state these beliefs in his audit report.<sup>100</sup> The regulations also provide that if the contractor refuses to provide the necessary cost or pricing data, the contracting officer is to withhold the award or price adjustment and refer the contract action to higher authority.<sup>101</sup>

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94. U.S. GOVERNMENT PRINTING OFFICE, STANDARD FORM 1412, CLAIM FOR EXEMPTION FROM SUBMISSION OF CERTIFIED COST OR PRICING DATA (1984).

95. It must be kept in mind that access and submission are separate and distinct problems. An adequate submission is generally not accomplished by merely giving the government access to all of the contractor's data. See *Kisco Co.*, ASBCA No. 18,432, 76-2 B.C.A. (CCH) ¶12,147 (1976); *McDonnell Douglas Corp.*, ASBCA No. 12,786, 69-2 B.C.A. (CCH) ¶ 7897 (1969); *Aerojet-General Corp.*, ASBCA No. 12,873, 69-1 B.C.A. (CCH) ¶ 7585 (1969); *Lockheed Aircraft Corp.*, ASBCA No. 10,453, 67-1 B.C.A. (CCH) ¶ 6356 (1967), *aff'd*, 432 F.2d 801 (Ct. Cl. 1970).

96. FAR § 15.805-5(a)(2).

97. See *id.* § 15.812(c).

98. *Id.* § 15.805-5(d).

99. *Id.*

100. *Id.* § 15.805-5(e)(7).

101. *Id.* § 15.804-6(e).

## IV. DEFECTIVE PRICING AND CRIMINAL LIABILITY

Criminal prosecution for procurement fraud has largely been accomplished over the years through the expanding judicial interpretation of traditional criminal statutes. The primary statutes governing false statements,<sup>102</sup> false claims,<sup>103</sup> conspiracy,<sup>104</sup> mail and wire fraud,<sup>105</sup> and aiding and abetting,<sup>106</sup> remain essentially unchanged in statutory language, yet they provide flexible vehicles for prosecution of procurement fraud.

A. *False Statements*

The most common vehicle used by the government in prosecuting procurement fraud is 18 U.S.C. section 1001 (False Statements). Its elements are generally the easiest to prove of any of the possible criminal statutes. Specifically, 18 U.S.C. section 1001 provides as follows:

Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined not more than \$10,000 or imprisoned not more than five years, or both.<sup>107</sup>

It is well established that this section encompasses three distinct criminal offenses: (1) falsifying, concealing, or covering up a material fact by any trick, scheme or device; (2) making false, fictitious or fraudulent statements or representations; and (3) making or using any false document or writing.<sup>108</sup>

The offense of false representation requires the government to prove that: (1) the defendant made a statement; (2) the defendant knew the statement was false, fictitious or fraudulent; (3) the statement was made knowingly and willfully; (4) the statement was within the jurisdiction of

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102. 18 U.S.C. § 1001 (1982).

103. *Id.* §§ 286-87.

104. *Id.* § 371.

105. *Id.* §§ 1341, 1343.

106. *Id.* § 2.

107. 18 U.S.C. § 1001 (1982).

108. See *United States v. Tobon-Builes*, 706 F.2d 1092, 1096 (11th Cir. 1983); *United States v. Irwin*, 654 F.2d 671 (10th Cir. 1981), *cert. denied*, 455 U.S. 1016 (1982); *United States v. Diogo*, 320 F.2d 898, 902 (2d Cir. 1963).

a federal agency; and (5) the statement was material.<sup>109</sup> Although section 1001 does not specifically proscribe omissions, the act of leaving a blank or failing to provide information would be within the statute if such action amounted to a false representation.<sup>110</sup>

The first issue to be considered is whether the statement (e.g., certification of cost or pricing data) was in fact false since, if it were true, no liability would arise under section 1001. Indeed, a court could determine as a matter of law that a representation was not false and thus dispose of a case on a motion for judgment of acquittal. A statement that on its face is not false cannot support an indictment.<sup>111</sup>

Second, the statement must have been "within the jurisdiction of any department or agency."<sup>112</sup> The term "jurisdiction" has been broadly construed to mean the power to exercise authority in a particular situation, so that the statute applies to the authorized functions of an agency or department but not to matters peripheral to the business of that body.<sup>113</sup> Further, the term "department" applies to the executive, legislative and judicial branches of government.<sup>114</sup> This element of the offense, however, does not require that the statement actually be submitted to the government.<sup>115</sup> In fact, a statement that is *never* submitted to the government but is made in the contractor's records, which *may* be subject to government inspection, is sufficient.<sup>116</sup>

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109. *Irwin*, 654 F.2d at 675-76; *see also* *United States v. Seay*, 718 F.2d 1279, 1284 (4th Cir. 1983), *cert. denied*, 467 U.S. 1226 (1984); *United States v. Aarons*, 718 F.2d 188, 190 (6th Cir. 1983); *United States v. Jackson*, 714 F.2d 809, 812 (8th Cir. 1983); *United States v. Montemayor*, 712 F.2d 104, 106 (5th Cir. 1983); *United States v. Petullo*, 709 F.2d 1178, 1180 (7th Cir. 1983); *United States v. Race*, 632 F.2d 1114, 1116 (4th Cir. 1980); *United States v. Glazer*, 532 F.2d 224, 228 (2d Cir.), *cert. denied*, 429 U.S. 844 (1976). Unlike common-law "fraud," under 18 U.S.C. § 1001 the government need not prove that it relied on the defendants' statements in order to gain a conviction. However, reliance may be a significant consideration to the Justice Department in determining whether to seek an indictment and subsequent criminal prosecution. Moreover, the effect of governmental nonreliance may be persuasive to a jury in a criminal trial proceeding.

110. *Irwin*, 654 F.2d at 676; *United States v. McCarthy*, 422 F.2d 160, 162 (2d Cir.), *cert. dismissed*, 398 U.S. 946 (1970).

111. *United States v. Vesaas*, 586 F.2d 101, 104 (8th Cir. 1978).

112. 18 U.S.C. § 1001.

113. *See* *United States v. Rodgers*, 466 U.S. 475, 479 (1984); *United States v. Balk*, 706 F.2d 1056, 1059 (9th Cir. 1983).

114. *United States v. Bramblett*, 348 U.S. 503, 509 (1955).

115. *United States v. Baker*, 626 F.2d 512, 514 (5th Cir. 1980). *See also* *United States v. Union Oil, Inc.*, 646 F.2d 946, 955 (5th Cir. 1981), *cert. denied*, 455 U.S. 908 (1982) (submission of a statement to a private purchaser in connection with such purchaser's preparation of records that ultimately influence a federal agency is sufficient); *United States v. Beasley*, 550 F.2d 261, 271 (5th Cir.), *cert. denied*, 434 U.S. 938 (1977) (submission of a claim through a state agency administering a federal program is sufficient).

116. *See* *United States v. Hooper*, 596 F.2d 219, 223 (7th Cir. 1979); *United States v.*

Third, in order to establish a violation of section 1001, the government must prove beyond a reasonable doubt that the false statement was made knowingly and willfully.<sup>117</sup> This does not, however, require the government to prove that such statement was made "with specific intent to deceive the Federal Government."<sup>118</sup> A statement is made "knowingly" if it is made with knowledge or awareness of the true facts and not prompted by mistake, accident or another innocent reason.<sup>119</sup> Knowledge can also be proven by a reckless disregard for the truthfulness of the statement coupled with a conscious effort to avoid learning the truth.<sup>120</sup> Finally, the government is not required to prove that a defendant had actual knowledge that the statement would affect a matter involving the government.<sup>121</sup> As for the requirement that the statement be made "willfully," the element of willfulness is generally satisfied if the act is done voluntarily and with the necessary intent.<sup>122</sup>

Finally, materiality depends on whether the statement has "a natural tendency to influence, or was capable of influencing the decision of

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Kraude, 467 F.2d 37, 38 (9th Cir.), *cert. denied*, 409 U.S. 1076 (1972). According to the court in *United States v. Diaz*, 690 F.2d 1352, 1357-58 (11th Cir. 1982), there need be no regulation requiring the retention of such records if they are otherwise material. In *Ebeling v. United States*, 248 F.2d 429 (8th Cir.), *cert. denied*, 355 U.S. 907 (1957), a contractor and a subcontractor prepared a series of fictitious invoices. The contractor then issued checks to the subcontractor for work that was in fact not performed. A corresponding charge for the work was subsequently included in the statement of costs submitted to the government by the contractor. At trial, the contractor contended that the false invoices were not within the jurisdiction of a government department or agency because they were never submitted to the government. The court, however, concluded that it is sufficient if a person willfully makes or uses a false statement in a document with the intention that the document bear some relation to a matter within the jurisdiction of a government department or agency. Thus, under this broad interpretation, government contract certifications will almost always fall within the jurisdiction of a government department or agency. *Id.* at 434.

117. 18 U.S.C. § 1001. *See supra* text accompanying note 109.

118. *United States v. Yermian*, 468 U.S. 63, 73 (1984).

119. *See United States v. Lange*, 528 F.2d 1280, 1288 (5th Cir. 1976); *United States v. Schreiber*, 449 F. Supp. 856, 864 (W.D. Pa. 1978), *aff'd*, 599 F.2d 534 (3d Cir.), *cert. denied*, 444 U.S. 843 (1979). Some courts, however, have been satisfied with a statement "fairly read" as false. *United States v. Rodgers*, 624 F.2d 1303, 1311 (5th Cir. 1980), *cert. denied*, 450 U.S. 917 (1981).

120. *See United States v. White*, 765 F.2d 1469, 1481-82 (11th Cir. 1985); *United States v. Schaffer*, 600 F.2d 1120, 1121-22 (5th Cir. 1979); *United States v. Evans*, 559 F.2d 244, 246 (5th Cir. 1977), *cert. denied*, 434 U.S. 1015 (1978); *United States v. Jacobs*, 475 F.2d 270, 280-81 (2d Cir.), *cert. denied*, 414 U.S. 821 (1973); *United States v. Egenberg*, 441 F.2d 441, 444 (2d Cir.), *cert. denied*, 404 U.S. 994 (1971); *see also United States v. Beck*, 615 F.2d 441, 454 (7th Cir. 1980) (the contractor did not sign or execute a document or know one would be filed, but the court found it foreseeable by the contractor that the principal would deceive the United States Customs Service).

121. *Yermian*, 468 U.S. at 68-70.

122. *See United States v. Dothard*, 666 F.2d 498, 503 (11th Cir. 1982); *United States v. Malinowski*, 472 F.2d 850, 852-56 (3d Cir.), *cert. denied*, 411 U.S. 970 (1973).

the tribunal in making a determination required to be made."<sup>123</sup> The government, however, need not actually have relied on or been influenced by the false statement.<sup>124</sup> In fact, the government can establish materiality even though it: (1) actually knew the truth; (2) never read the false statement; or (3) ignored the false statement.<sup>125</sup> Furthermore, the fact that no actual harm occurs as a result of the statement is not determinative, since the mere potential for harm can establish materiality.<sup>126</sup> Similarly, a statement may be material even if it does not result in an economic benefit to the defendant.<sup>127</sup>

Criminal liability can also result under that part of section 1001 which subjects to punishment one who "knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact."<sup>128</sup> Concealment requires proof of willful nondisclosure by means of a "trick, scheme, or device."<sup>129</sup> Moreover, there is case authority that the government must prove that the defendant had the duty to disclose the material facts at the time he was alleged to have concealed them.<sup>130</sup> In addition, the "trick, scheme, or device" language requires proof of an affirmative act by which the material facts are concealed.<sup>131</sup>

### B. *Ambiguous Statements*

In *United States v. Steinhilber*,<sup>132</sup> the Court of Appeals for the

123. *United States v. Voorhees*, 593 F.2d 346, 349 (8th Cir.), *cert. denied*, 441 U.S. 936 (1979); *see also* *United States v. Brown*, 742 F.2d 363, 365 (7th Cir. 1984) (submitting false time sheets to obtain CETA funds); *United States v. Lopez*, 728 F.2d 1359, 1362 (11th Cir.) (filing false residency applications with the Immigration and Naturalization Service), *cert. denied*, 469 U.S. 828 (1984); *United States v. Hausmann*, 711 F.2d 615, 616 (5th Cir. 1983) (providing false receipts to the Small Business Administration); *Blake v. United States*, 323 F.2d 245, 246 (8th Cir. 1963); *Gonzales v. United States*, 286 F.2d 118, 122 (10th Cir. 1960), *cert. denied*, 365 U.S. 878 (1961); *Weinstock v. United States*, 231 F.2d 699, 701-02 (D.C. Cir. 1956).

124. *See* *United States v. Lichenstein*, 610 F.2d 1272, 1278 (5th Cir.), *cert. denied*, 447 U.S. 907 (1980); *United States v. Markham*, 537 F.2d 187, 196 (5th Cir. 1976), *cert. denied*, 429 U.S. 1041 (1977).

125. *See* *Diaz*, 690 F.2d at 1358; *United States v. McIntosh*, 655 F.2d 80, 83 (5th Cir. 1981), *cert. denied*, 455 U.S. 948 (1982).

126. *See* *United States v. Dick*, 744 F.2d 546, 553 (7th Cir. 1984); *McIntosh*, 655 F.2d at 83; *United States v. Goldfine*, 538 F.2d 815, 820-21 (9th Cir. 1976).

127. *See* *United States v. Richmond*, 700 F.2d 1183, 1188-89 (8th Cir. 1983); *United States v. Cowden*, 677 F.2d 417, 419 (8th Cir. 1982).

128. 18 U.S.C. § 1001; *see Voorhees*, 593 F.2d at 350.

129. *Diogo*, 320 F.2d at 902; *see also* *Tobon-Builes*, 706 F.2d at 1096; *Irwin*, 654 F.2d at 678.

130. *Irwin*, 654 F.2d at 678-79; *see also* *United States v. Muntain*, 610 F.2d 964, 971-72 (D.C. Cir. 1979) (the court looked for a law requiring disclosure of the information).

131. *United States v. London*, 550 F.2d 206, 213 (5th Cir. 1977).

132. 484 F.2d 386 (8th Cir. 1973).

Eighth Circuit reversed a defendant's conviction for misrepresentations made to the Department of Housing and Urban Development because the government had failed to prove beyond a reasonable doubt that the defendant "knowingly and willfully" made statements that were false. In reaching its decision, the court noted that when the government's evidence infers innocence just as equally as it infers guilt, the verdict must be one of not guilty.<sup>133</sup> Furthermore, the court noted an ambiguity question raised by the defendant as to whether the defendant "knowingly and willfully" made the alleged false statements. In discussing this issue, the court stated that:

In determining whether a statement is made with knowledge of its falsity:

"[i]t is well established that we must look to the meaning intended by the [defendant], rather than to the interpretation of the statements which the . . . authorities *did in fact make*, or even to the interpretations which the authorities *might reasonably have made*. . . ."

Following these principles, we hold that here the meaning of the words in question was ambiguous and the Government had the burden of negating the claim that the defendant "did not know the falsity of his statement at the time it was made, or that it was the product of an accident, honest inadvertence, or duress."<sup>134</sup>

In *United States v. Anderson*,<sup>135</sup> the Court of Appeals for the Eighth Circuit, after determining that certain language in an invoice certification was ambiguous, again reversed the conviction of the defendant because the government failed to prove the falsity of the alleged statements as well as the defendant's knowing and willful submission of such statements.<sup>136</sup> The court held that

it was incumbent upon the government to introduce proof suffi-

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133. *Id.* at 389.

134. *Id.* at 390 (citations omitted) (brackets in original) (emphasis in original); *see also* *United States v. Vesaas*, 586 F.2d 101, 104 (8th Cir. 1978) (prosecution for a false statement cannot be based on an ambiguous statement that may be literally and factually correct).

Similarly, courts interpreting the federal perjury statute, 18 U.S.C. § 1621 (1982), a statute often analogized to § 1001 (*see* *United States v. Clifford*, 426 F. Supp. 696 (E.D.N.Y. 1976)), have concluded that "it is settled that a false statement which is the result of an honest mistake is not perjury." *United States v. Rose*, 215 F.2d 617, 623 (3d Cir. 1954) (citing *Seymour v. United States*, 77 F.2d 577 (8th Cir. 1935)).

135. 579 F.2d 455 (8th Cir.), *cert. denied*, 439 U.S. 980 (1978).

136. *Id.* at 460.

cient to establish the falsity of the statements as well as the defendant's knowing and willful submission of the statements. In carrying out that burden the government must negate any reasonable interpretation that would make the defendant's statement factually correct.<sup>137</sup>

In *United States v. Diogo*,<sup>138</sup> the classic case on allegedly false ambiguous statements, the defendant represented to immigration authorities that he was married to an American citizen.<sup>139</sup> Under the law of the state of New York, the defendant's representation was true.<sup>140</sup> However, under the interpretation the immigration officials ascribed to the term "married," the defendant's representation was false.<sup>141</sup> In reaching its conclusion, the Second Circuit Court of Appeals stated that:

In construing these statements it is well established that we must look to the meaning intended by the appellants themselves, rather than to the interpretation of the statements which

137. *Id.* at 459-60. In this case, the defendant submitted invoices to the government containing the following certification:

I CERTIFY THAT (a) the State of Arkansas-CETA, Office of the Governor has not been billed for the services covered by this invoice; (b) funds have not been received from the State or expended for such services under any other contract agreement or grant; (c) the amount(s) claimed by this invoice constitute(s) allowable costs/expenditures under the terms of the contract agreement or grant; (d) all amounts for federal income, unemployment, and FICA taxes due through the end of the preceding quarter have been paid.

*Id.* at 459. The circuit court specifically found that clause (b) of the certification was ambiguous since a reasonable interpretation of the terms "received" and "expended" could be that "other federal funds have actually been paid out or actually received by the county for the work done." Here,

the federal funds had only been committed to the project but were still held by the Arkansas State Highway Department. Furthermore, in the context of the overall application the meaning of the phrase "any other contract agreement or grant" is somewhat unclear. A reasonable construction of the phrase would be that no prior CETA funds have been expended, rather than that no funds from some other unrelated federal grant have been expended.

*Id.* at 459-60; *see also* *United States v. Lozano*, 511 F.2d 1, 5 (7th Cir.) (the court noted its reluctance to find a knowing false statement when the challenged assertion may be literally true, even if false by implication or omission), *cert. denied*, 423 U.S. 850 (1975); *United States v. Clifford*, 426 F. Supp. 696, 705 (E.D.N.Y. 1976) ("[I]t is incumbent upon the Government to negate any reasonable interpretation that would make the defendant's [ambiguous] statement factually correct"). "This is not the type of case where defendant offers a contrived, hypertechnical or lame interpretation of his answer solely for purposes of trial." *Id.* Thus, the government must prove that: (1) the defendant used the words with the meaning suggested by the government, and (2) the defendant nevertheless made a statement which he knew to be false in the sense thus intended. *Id.*

138. 320 F.2d 898 (2d Cir. 1963).

139. *Id.* at 901.

140. *Id.* at 905.

141. *Id.*

the immigration authorities *did in fact make*, or even to the interpretation which the authorities *might reasonably have made*.

. . . .

We do not suggest that a court must accept as conclusive the meaning which a defendant, in a prosecution such as this, ascribes to the words he has used. If this were the rule to be applied, every person accused of perjury or false representations could assert his understanding of the words used in such a way as to preclude any possibility of conviction. . . . Where, as here, however, no evidence is presented on the question, it is incumbent upon the Government to negative any reasonable interpretation that would make the defendant's statement factually correct.<sup>142</sup>

The court went on to note that, in prosecutions for false statements, the problem of interpreting ambiguous statements is frequently merged into the issue of *mens rea*.<sup>143</sup> If a defendant did not intend by his statement to assert the proposition which the government has proved to be false, then he cannot ordinarily be said to have knowingly uttered a false statement.<sup>144</sup>

In *United States v. Adler*,<sup>145</sup> the Court of Appeals for the Eighth Circuit upheld the district court's refusal to give a jury instruction that the defendant's claims, if literally true, could not support conviction and that the government had the burden to demonstrate beyond a reasonable doubt that an ambiguous claim was false under any reasonable interpretation.<sup>146</sup> The district court instructed the jury, however, that if the defendant "performed or reasonably believed he or someone acting at his direction or on his behalf performed the services for which claims were made which are the subject of this indictment [he must be found not

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142. *Id.* at 905-07 (citations omitted).

143. *Id.* at 906 n.6.

144. *Id.* See also *United States v. Race*, 632 F.2d 1114, 1120 (4th Cir. 1980). To be ambiguous, a contract must be susceptible of at least two reasonable constructions. When the government concedes that a clause is ambiguous, it necessarily concedes that the defendant's construction of the clause, as one of a number of possible constructions, is reasonable. Such a conclusion requires a ruling that the defendants cannot be convicted under 18 U.S.C. § 1001 for a statement which may be said to be accurate within a reasonable construction of the contract. Thus, whenever a defendant's statement under a contract accords with a reasonable construction of the enabling language of the contract, the government will not have carried its burden of negating every reasonable interpretation that would make the defendant's statement factually correct. *Id.*

145. 623 F.2d 1287 (8th Cir. 1980).

146. *Id.* at 1289.



guilty].”<sup>147</sup> After reviewing this jury instruction, the appellate court held that the jury was instructed in substance concerning the defendant’s theory of the case, i.e., that the claims were literally true or at least he believed them to be true.<sup>148</sup>

Thus, in the defective pricing context, if the certification language—“accurate, complete and current”—is ambiguous, a contractor would not be liable for an allegedly false statement that was based upon a reasonable interpretation of the certification language. In order to gain a criminal conviction for violation of section 1001, the government would have to negate every reasonable interpretation of the phrase “accurate, complete and current” that would make the contractor’s construction factually correct. If the government is unable to prove that the contractor’s interpretation is either unreasonable or factually incorrect, it will also have failed to prove the necessary intent to deceive in order to gain a conviction under section 1001.

### *C. Other Applicable Criminal Statutes*

#### 1. Mail and wire fraud

While mail fraud requires the government to prove a higher standard of intent on the part of the defendant than does the crime of false statements, the prosecution frequently uses it because of the simplicity of the facts that must be proven to gain a conviction. Moreover, its elements lend themselves well to the prosecution’s attempt to gain multiple convictions for what is basically the same conduct. Section 1341 of 18 U.S.C. provides that:

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to

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147. *Id.* at 1290.

148. *Id.*

the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than \$1,000 or imprisoned not more than five years, or both.<sup>149</sup>

While convictions for mail fraud are more common than for wire fraud, the reasons behind the prosecution's use of 18 U.S.C. section 1343 mirror those discussed above for mail fraud. Section 1343 of 18 U.S.C. provides that:

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined not more than \$1,000 or imprisoned not more than five years, or both.<sup>150</sup>

A conviction for mail fraud under 18 U.S.C. section 1341 requires proof that the defendant:

- (1) participated in a scheme or artifice to defraud the United States out of property, money, or credit by means of false or fraudulent representations;
- (2) used or caused the use of the mails in connection with such scheme; and
- (3) used or caused the use of the mails willfully and with the specific intent to carry out some essential step in the execution of said scheme or artifice to defraud.<sup>151</sup>

In this regard, a "scheme to defraud" requires that the defendant seek to deprive the government of funds or services through fraudulent or deceptive means, such as material misrepresentation, concealment, the breach of a duty to disclose information, or the taking of bribes or kickbacks.<sup>152</sup> Thus, the government must prove a specific intent to defraud and show that the alleged scheme was "reasonably calculated to deceive persons of

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149. 18 U.S.C. § 1341 (1982).

150. *Id.* § 1343.

151. *See United States v. Haimowitz*, 725 F.2d 1561, 1568-69 (11th Cir.), *cert. denied*, 469 U.S. 1072 (1984); *United States v. Rodgers*, 624 F.2d 1303, 1306 (5th Cir. 1980), *cert. denied*, 450 U.S. 917 (1981).

152. *United States v. Pinter*, 630 F.2d 1270, 1280 (8th Cir. 1980); *see also United States v. Brown*, 540 F.2d 364, 374-75 (8th Cir. 1976); *United States v. McNeive*, 536 F.2d 1245, 1251 (8th Cir. 1976); *United States v. Nance*, 502 F.2d 615, 618 (8th Cir. 1974), *cert. denied*, 420 U.S. 926 (1975).

ordinary prudence and comprehension."<sup>153</sup> Moreover, once the government establishes willful participation in and knowledge of the scheme, a defendant not directly connected with a particular fraudulent act is nonetheless responsible if the act was of a kind to which the parties had agreed.<sup>154</sup> In the context of defective pricing, the government will most likely argue that the defective pricing itself constituted a scheme to defraud. Such scheme involved the contractor seeking to deprive the government of funds by inflating the contract price through the certification of inaccurate, incomplete or noncurrent data.

The mailing does not have to be an essential element of the scheme since it is sufficient if the mailing is incidental to an essential part of the scheme.<sup>155</sup> Indeed, the government need only show that the defendant "caused" the mailing "with knowledge that the use of the mails will follow in the ordinary course of business, or where such use can reasonably be foreseen, even though not actually intended."<sup>156</sup> Further, the mailing requirement is met even if the defendant does none of the mailing, if: (1) the defendant does an act with knowledge that use of the mails will follow in the ordinary course of business, or (2) such use can reasonably be foreseen even though not actually intended.<sup>157</sup>

Regarding intent, the government must establish beyond a reasonable doubt that the defendant acted with an intent to defraud.<sup>158</sup> The requisite intent may be inferred, however, from all the facts and circum-

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153. *United States v. Bohonus*, 628 F.2d 1167, 1172 (9th Cir.), *cert. denied*, 447 U.S. 928 (1980); *see also United States v. Beecroft*, 608 F.2d 753, 757 (9th Cir. 1979); *United States v. Pearlstein*, 576 F.2d 531, 535 (3d Cir. 1978).

154. *See United States v. Gamble*, 737 F.2d 853, 856-59 (10th Cir. 1984) (a doctor's submission of false insurance claims constitutes mail fraud even though Government agents devised the scheme and the doctor sought little profit from the scheme); *Rodgers*, 624 F.2d at 1308 (co-schemers were jointly responsible for the acts of others in furtherance of the scheme); *United States v. Amrep Corp.*, 560 F.2d 539, 545 (2d Cir. 1977), *cert. denied*, 434 U.S. 1015 (1978) (the defendant was held to be responsible for all of the acts within the general scope of the scheme on which the co-schemers embarked).

155. *Haimowitz*, 725 F.2d at 1571.

156. *Pereira v. United States*, 347 U.S. 1, 8-9 (1954); *see also United States v. Reed*, 721 F.2d 1059, 1061 (6th Cir. 1983); *United States v. Bright*, 588 F.2d 504, 510 (5th Cir.), *cert. denied*, 440 U.S. 972 (1979). *Cf. United States v. Maze*, 414 U.S. 395, 402-03 (1974) (there is no violation of § 1341 when the mails are merely used as the result of a fraudulent scheme); *United States v. Tarnopol*, 561 F.2d 466, 472 (3d Cir. 1977) (mailings used by the defendants as a "convenient but not essential tool" in carrying out a scheme do not satisfy the jurisdictional requirements of § 1341).

157. *Pereira*, 347 U.S. at 8-9; *Haimowitz*, 725 F.2d at 1571.

158. *United States v. Fuel*, 583 F.2d 978, 983 (8th Cir. 1978), *cert. denied*, 439 U.S. 1127 (1979). *See also United States v. Williams*, 545 F.2d 47, 50 n.2 (8th Cir. 1976); *Nance*, 502 F.2d at 618.

stances surrounding the defendant's actions.<sup>159</sup> Unlike prosecution under 18 U.S.C. section 1001, "knowledge" cannot be proven by a mere reckless disregard on the part of the defendant that the mail would be used to carry out some essential step in the execution of the scheme.

The elements of wire fraud are the same as for mail fraud, except that the medium involved in wire fraud is "wire, radio, or television communication in interstate or foreign commerce."<sup>160</sup> Unlike mail fraud which does not require the sending of something across state lines (intra-state use of the mails is equally criminal), however, wire fraud generally requires an interstate transmission of information.

Thus, under the above statutes, intentional misconduct by a contractor involving the mails or interstate telecommunications might be characterized as mail or wire fraud. As a result of the breadth and flexibility of these statutes and the relative ease with which the government can establish a violation under them, government contractors must be aware of the likelihood of prosecution for mail or wire fraud. In this regard, a former Chief of Business Frauds Prosecutions, in the U.S. Attorney's Office for the Southern District of New York, described the mail fraud statute in the following manner: "[It is] our Stradivarius, our Colt 45, our Louisville Slugger, our Cuisinart—and our true love. We may flirt with RICO, show off with 10b-5, and call the conspiracy law 'darling,' but we always come home to the virtues of 18 U.S.C. § 1341, with its simplicity, adaptability, and comfortable familiarity."<sup>161</sup>

## 2. Conspiracy

Conspiracy has been charged by prosecutors in indictments claiming that a contractor conspired with its employees (e.g., negotiators) or with other contractors or subcontractors to defraud the government. Section 371 of 18 U.S.C. provides that:

If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than \$10,000 or

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159. *Fuel*, 583 F.2d at 983; *see also* *United States v. Hicks*, 619 F.2d 752, 755 (8th Cir. 1980); *United States v. Sullivan*, 618 F.2d 1290, 1295 (8th Cir. 1980); *United States v. Arnold*, 543 F.2d 1224, 1225 (8th Cir. 1976), *cert. denied*, 429 U.S. 1051 (1977); *Nance*, 502 F.2d at 618.

160. 18 U.S.C. § 1343; *see also* *United States v. Brien*, 617 F.2d 299, 307 (1st Cir.), *cert. denied*, 446 U.S. 919 (1980).

161. B. ELMER, J. SWENNAN & R. BEIZER, *GOVERNMENT CONTRACT FRAUD* 3-22 (1985).

imprisoned not more than five years, or both.<sup>162</sup>

The conspiracy statute encompasses two types of crimes—conspiracy to violate some substantive provision of the federal criminal code (such as 18 U.S.C. section 1001), as well as conspiracy to defraud the United States. With respect to conspiracy to defraud the United States, it is well established that the statutory language is not confined to fraud as defined in the common law,<sup>163</sup> but it reaches any conspiracy for the purpose of impairing, obstructing or defeating the lawful function of any department of government.<sup>164</sup>

A “conspiracy” exists where two or more persons: (1) make an agreement; (2) to commit an offense or to defraud the United States; (3) with knowledge of the existence of the conspiracy and with the intentional and actual participation in the conspiracy; and (4) one or more of the conspirators performs an overt act in furtherance of the illegal goal.<sup>165</sup> The necessary “agreement” need not be formal or express and a tacit understanding may be sufficient to constitute a conspiratorial agreement.<sup>166</sup> Moreover, since conspiracy is by its very nature often not sus-

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162. 18 U.S.C. § 371.

163. *Dennis v. United States*, 384 U.S. 855, 861 (1966). With respect to common-law “fraud,” there are nine elements that must be proven: (1) a representation; (2) its falsity; (3) its materiality; (4) the speaker’s “knowledge of its falsity or ignorance of its truth”; (5) his “intent that it should be acted on by the person and in the manner reasonably contemplated”; (6) the hearer’s “ignorance of its falsity”; (7) his “reliance on its truth”; (8) his “right to rely thereon”; and (9) his “consequent and proximate injury.” *Schimmer v. H.W. Freeman Constr. Co.*, 607 S.W.2d 767, 769 (Mo. Ct. App. 1980); see also *O’Shaughnessy v. Ward Aircraft Sales & Serv., Inc.*, 552 S.W.2d 730, 733 (Mo. Ct. App. 1977). It is interesting to note that, while the federal criminal statutes discussed herein evolved out of common law fraud, the government’s burden of proving criminal conduct under the enumerated fraud statutes is less than proving common law fraud. For example, under 18 U.S.C. § 1001, the government need not prove that it relied on the defendant’s statements in order to gain a conviction. Moreover, common law fraud involves a voluntary representation/statement where the defendant elects to speak but intentionally fails to speak fully so as to mislead the listener. Under the cost or pricing data regulations, however, the defendant is compelled to make certain statements to the government. Thus, the defendant should not be liable for unintentionally misleading a listener where he involuntarily disclosed only that which the listener required him to disclose.

164. See *Dennis*, 384 U.S. at 861; *United States v. Puerto*, 730 F.2d 627, 630 (11th Cir.), cert. denied, 469 U.S. 847 (1984); see also *Hammerschmidt v. United States*, 265 U.S. 182, 188 (1924); *United States v. Keitel*, 211 U.S. 370, 393-95 (1908).

165. See *United States v. Falcone*, 311 U.S. 205, 210-11 (1940); *United States v. Soto*, 716 F.2d 989, 991-92 (2d Cir. 1983); *United States v. Richmond*, 700 F.2d 1183, 1189 (8th Cir. 1983); *Pintar*, 630 F.2d at 1275; *United States v. Skillman*, 442 F.2d 542, 547 (8th Cir.), cert. denied, 404 U.S. 833 (1971).

166. *Richmond*, 700 F.2d at 1190. See also *United States v. McCarty*, 611 F.2d 220, 222 (8th Cir. 1979), cert. denied, 445 U.S. 930 (1980); *Nilva v. United States*, 212 F.2d 115, 121 (8th Cir.), cert. denied, 348 U.S. 825 (1954). Some courts have found proof of a common resolve based upon a review of the defendant’s actions. *Hamling v. United States*, 418 U.S. 87, 124 (1974); *Pintar*, 630 F.2d at 1275.

ceptible of proof by direct evidence, the existence of an agreement may be inferred from circumstantial evidence or proof of prior similar activities, including the conduct of the alleged conspirators and the circumstances indicating their concerted action toward a common unlawful goal.<sup>167</sup>

In *Haas v. Henkel*,<sup>168</sup> the Supreme Court held that the conspiracy statute is "broad enough in its terms to include any conspiracy for the purpose of impairing, obstructing or defeating the lawful function of any department of Government."<sup>169</sup> Fourteen years later, Chief Justice Taft defined the "conspire to defraud the United States" phrase in the following manner:

To conspire to defraud the United States means primarily to cheat the government out of property or money, but it also means to interfere with or obstruct one of its lawful governmental functions by deceit, craft or trickery, or at least by means that are dishonest. It is not necessary that the government shall be subjected to property or pecuniary loss by the fraud, but only that its legitimate official action and purpose shall be defeated by misrepresentation, chicane, or the overreaching of those charged with carrying out the governmental intention.<sup>170</sup>

The most wide ranging aspect of the definition of defrauding the United States is the "obstruct or impair legitimate Government activity" standard.<sup>171</sup> Proof that the government has been defrauded, however, does not require any showing of pecuniary or proprietary loss.<sup>172</sup> In fact, one court has noted that section 371 requires only "mission attempted," not

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167. See *Hamling*, 418 U.S. at 124; *Glasser v. United States*, 315 U.S. 60, 80 (1942); *United States v. Hickerson*, 732 F.2d 611, 614-15 (7th Cir.), *cert. denied*, 469 U.S. 846 (1984); *Richmond*, 700 F.2d at 1190; *United States v. Moss*, 591 F.2d 428, 435 (8th Cir. 1979); *United States v. Pelton*, 578 F.2d 701, 712 (8th Cir.), *cert. denied*, 439 U.S. 964 (1978).

168. 216 U.S. 462 (1910); see also *Dennis*, 384 U.S. at 861; *United States v. Johnson*, 383 U.S. 169, 172 (1966).

169. *Haas*, 216 U.S. at 479-80.

170. *Hammerschmidt*, 265 U.S. at 188.

171. See *Harney v. United States*, 306 F.2d 523 (1st Cir.) (diversion of federal funds from their true and lawful object), *cert. denied*, 371 U.S. 911 (1962); *United States v. Glasser*, 116 F.2d 690, 696 (7th Cir. 1940) (bribery of a government official to breach a duty owed to the government), *modified*, 315 U.S. 60 (1942); *Wallenstein v. United States*, 25 F.2d 708 (3d Cir.) (misuse of a right or privilege given by the government), *cert. denied*, 278 U.S. 608 (1928).

172. See *Hyde v. Shine*, 199 U.S. 62, 72 (1905); *United States v. Jacobs*, 475 F.2d 270, 283 (2d Cir.), *cert. denied*, 414 U.S. 821 (1973); *United States v. Peltz*, 433 F.2d 48, 51 (2d Cir. 1970), *cert. denied*, 401 U.S. 955 (1971).

"mission accomplished."<sup>173</sup>

In addition, the government must generally establish that at least one of the conspirators took some "overt act" in furtherance of the conspiracy.<sup>174</sup> In the case of defective pricing, such an act can arguably be established by the submission of inaccurate, incomplete and noncurrent cost or pricing data as part of an overall scheme to defraud the government into paying an inflated contract price. Moreover, the subsequent submission of claims for payment, based on an inflated contract price resulting from defective pricing, can also be viewed as a further overt act.

The Courts of Appeals for the Third and Fifth Circuits, perceiving a liberal trend in Supreme Court decisions with respect to proof requirements for conspiracy charges, have upheld conspiracy to defraud convictions even where no deceit, trickery or dishonest means have been charged.<sup>175</sup> Other circuits, however, have interpreted recent Supreme Court decisions as reaffirming the deceit or trickery requirement.<sup>176</sup>

Once the existence of a conspiracy is shown, even slight evidence connecting a particular individual to a conspiracy may be sufficient to sustain a conspiracy conviction.<sup>177</sup> Moreover, the government need not prove that the alleged conspirators had knowledge of every detail or phase of the conspiracy.<sup>178</sup> However, neither mere association with individuals engaged in illegal conduct nor mere knowledge of the existence or acquiescence in the object of a conspiracy is sufficient to sustain a conviction.<sup>179</sup> Instead, there must exist some element of "affirmative cooperation or at least an agreement to cooperate in the object of the conspiracy,"<sup>180</sup> but a conscious avoidance of knowledge may not shield a defendant from conspiratorial involvement.<sup>181</sup> Once an individual has entered into a conspiracy, he may be able to escape liability for future

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173. *United States v. Root*, 366 F.2d 377, 383 (9th Cir. 1966), *cert. denied*, 386 U.S. 912 (1967); *see also* *Cross v. United States*, 392 F.2d 360, 363 (8th Cir. 1968).

174. *United States v. Everett*, 692 F.2d 596 (9th Cir. 1982), *cert. denied*, 460 U.S. 1051; *United States v. Kupper*, 693 F.2d 1129 (5th Cir. 1982); *United States v. Conlon*, 481 F. Supp. 654 (D.D.C. 1979).

175. *See* *United States v. Shoup*, 608 F.2d 950, 963-64 (3d Cir. 1979); *United States v. Porter*, 591 F.2d 1048, 1055 (5th Cir. 1979).

176. *See Pintar*, 630 F.2d at 1277-79; *Peltz*, 433 F.2d at 51-52.

177. *Richmond*, 700 F.2d at 1190.

178. *McCarty*, 611 F.2d at 222-23; *Fuel*, 583 F.2d at 981.

179. *United States v. Wrehe*, 628 F.2d 1079, 1085 (8th Cir. 1980); *United States v. Brown*, 584 F.2d 252, 262-63 (8th Cir. 1978), *cert. denied*, 440 U.S. 910 (1979).

180. *Brown*, 584 F.2d at 262 (quoting *United States v. Collins*, 552 F.2d 243, 245 (8th Cir.), *cert. denied*, 440 U.S. 910 (1979)).

181. *United States v. Cincotta*, 689 F.2d 238, 243 (1st Cir.), *cert. denied*, 459 U.S. 991 (1982); *cf.* *United States v. Jewell*, 532 F.2d 697, 699-704 (9th Cir.), *cert. denied*, 426 U.S. 951 (1976) (evidence of conscious avoidance is merely circumstantial evidence of knowledge).

acts of the conspiracy by withdrawing from the conspiracy. In order to constitute a bona fide withdrawal from the conspiracy, however, he must generally take some affirmative action inconsistent with the object of the conspiracy or communicate his withdrawal in a manner reasonably calculated to reach his co-conspirators.<sup>182</sup>

With regard to corporations, it is well settled that corporations can be convicted of criminal violations, including conspiracy.<sup>183</sup> However, a corporation and an unincorporated division of that corporation cannot be guilty of conspiring with each other.<sup>184</sup> While courts have traditionally held that officers and employees of a corporation are unable to conspire with the corporation since they are in actuality its agents, a few courts are beginning to uphold convictions of corporations for conspiring with their own employees to commit an offense or to defraud the government.<sup>185</sup>

### 3. False claims

The crime of false claims is used by the government to prosecute conduct that goes beyond mere false statements.<sup>186</sup> Here, unlike false statements, the government must prove that: (1) there was a claim upon the government for money or property,<sup>187</sup> and (2) the claim was actually presented.<sup>188</sup> Specifically, 18 U.S.C. section 287 provides that:

Whoever makes or presents to any person or officer in the

182. *United States v. Steele*, 685 F.2d 793 (3d Cir. 1982).

183. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1939); *United States v. American Grain & Related Indus.*, 763 F.2d 312 (8th Cir. 1985); *United States v. Hartley*, 678 F.2d 961 (11th Cir. 1982), *cert. denied*, 459 U.S. 1170 (1983); *United States v. Consolidated Coal Co.*, 424 F. Supp. 577 (D. Ohio 1976).

184. *Packaged Programs, Inc. v. Westinghouse Broadcasting Co.*, 156 F. Supp. 76 (W.D. Pa. 1957), *rev'd on other grounds*, 255 F.2d 708 (3d Cir. 1958).

185. *See American Grain*, 763 F.2d at 320; *United States v. Peters*, 732 F.2d 1004, 1007-08 (1st Cir. 1984); *United States v. S & Vee Cartage Co.*, 704 F.2d 914, 920 (6th Cir.), *cert. denied*, 464 U.S. 935 (1983); *United States v. Hartley*, 678 F.2d 961, 972 (11th Cir. 1982), *cert. denied*, 459 U.S. 1170 (1983).

186. *See* 18 U.S.C. § 286 (1982), which provides that:

Whoever enters into any agreement, combination, or conspiracy to defraud the United States, or any department or agency thereof, by obtaining or aiding to obtain the payment or allowance of any false, fictitious or fraudulent claim, shall be fined not more than \$10,000 or imprisoned not more than ten years, or both.

*Id.*

187. *United States v. Neifert-White Co.*, 390 U.S. 228 (1968) (the False Claims Act reaches beyond claims which might be legally enforced to all fraudulent attempts to cause the government to pay out sums of money); *McNinch*, 356 U.S. 595 (the conception of a claim against the government under the False Claims Act, normally connotes a demand for money or for some transfer of public property).

188. *United States ex rel. Marcus v. Hess*, 317 U.S. 537, 544-45 (1953); *see also United States v. Rainwater*, 244 F.2d 27, 28 (8th Cir. 1957), *aff'd*, 356 U.S. 590 (1958).



civil, military, or naval service of the United States, or to any department or agency thereof, any claim upon or against the United States, or any department or agency thereof, knowing such claim to be false, fictitious, or fraudulent, shall be fined not more than \$10,000 or imprisoned not more than five years, or both.<sup>189</sup>

In order for the government to establish the offense of "false, fictitious or fraudulent" claims, it must prove each of the following elements: (1) that the defendant knowingly and willfully made or presented a claim<sup>190</sup> to a government agency;<sup>191</sup> (2) that such claim was false, fictitious, or fraudulent; and (3) that the defendant knew that such claim was false, fictitious, or fraudulent.<sup>192</sup>

Initially, the government must establish the existence of a "claim." The Supreme Court has held that the definition of "claim" reaches beyond claims which might be legally enforced to all fraudulent attempts to cause the government to pay out sums of money.<sup>193</sup> As a result, the term "claim" can arguably include false statements contained in a contractor's certification of its cost or pricing data. The government might support such an allegation by reasoning that the contractor's false certification constitutes a fraudulent attempt to cause the government to pay an inflated contract price. Moreover, courts have not required the government to prove any actual injuries stemming from the false factual information.<sup>194</sup>

While the second element of the offense—"the presentation of such claim to a department or agency of the government"—requires more than a mere plan to make a claim, it has been broadly construed by the courts.<sup>195</sup> While more than a mere intent to make a claim must be shown

189. 18 U.S.C. § 287.

190. A claim is generally defined as an attempt to secure money or property from the United States Treasury. *Neifert-White Co.*, 390 U.S. at 233; see also U.S. DEP'T OF JUSTICE, UNITED STATES ATTORNEY'S MANUAL § 9-42.181 (1977) [hereinafter ATTORNEY'S MANUAL].

191. "Government agency" has been broadly interpreted to include the executive branch, the judicial branch, the legislative branch, independent government agencies, and wholly owned government corporations. *McNinch*, 356 U.S. at 598; *Rainwater v. United States*, 356 U.S. 590, 591-92 (1958); *United States v. Bramblett*, 348 U.S. 503, 509 (1955); *United States v. Michener*, 152 F.2d 880, 886 (3d Cir. 1945); *United States v. MacEvoy*, 58 F. Supp. 83, 86-87 (D.N.J. 1944).

192. *United States v. Slocum*, 708 F.2d 587, 596 (11th Cir. 1983); *United States v. Computer Sciences Corp.*, 511 F. Supp. 1125, 1134 (E.D.Va. 1981), *rev'd on other grounds*, 689 F.2d 1181 (4th Cir. 1982), *cert. denied*, 459 U.S. 1105 (1983).

193. *Hess*, 317 U.S. at 542.

194. See *United States v. Coachman*, 727 F.2d 1293 (D.C. Cir. 1984).

195. See *United States v. Precision Medical Laboratories, Inc.*, 593 F.2d 434 (2d Cir. 1978);

in order to satisfy the "making or presenting" element, there is no requirement that the claim actually be honored.<sup>196</sup> In *United States v. Blecker*,<sup>197</sup> a subcontractor was convicted for submitting invoices to the prime contractor based on falsified resumes that inflated the compensation due under the contract. Although there was no contract between the government and the subcontractor and the claim was actually presented to the government by the prime contractor, the court found that the subcontractor had submitted false claims to the government because he had knowledge that the prime contractor would transmit similarly inflated invoices.<sup>198</sup> A defendant will not be liable under section 287 unless he presents his claim "knowing such claim to be false, fictitious or fraudulent." Courts, however, have disagreed on the intent necessary to constitute a "knowing" presentation of a false claim under section 287. Some courts define the requisite state of mind as "knowledge of falsity,"<sup>199</sup> while others require a specific intent to deceive.<sup>200</sup> Finally, several courts have held that knowledge can be inferred from a reckless disregard for the truth of the claim coupled with a conscious purpose to avoid learning the truth.<sup>201</sup> Furthermore, while "willfulness" does not appear in section 287, the standard of willfulness is frequently required by the courts in section 287 indictments and jury instructions.<sup>202</sup>

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*United States v. Beasley*, 550 F.2d 261 (5th Cir.), *cert. denied*, 434 U.S. 863 (1977); *United States v. Catena*, 500 F.2d 1319 (3d Cir.), *cert. denied*, 419 U.S. 1047 (1974).

196. *See Coachman*, 727 F.2d at 1302; *United States v. Miller*, 545 F.2d 1204, 1212 n.10 (9th Cir. 1976), *cert. denied*, 430 U.S. 930 (1977); *United States v. Lopez*, 420 F.2d 313, 315 (2d Cir. 1969); *see also* ATTORNEY'S MANUAL § 9-42.181 (1977).

197. 657 F.2d 629 (4th Cir. 1981), *cert. denied*, 454 U.S. 1150 (1982).

198. *Id.* at 634; *see also United States v. Montoya*, 716 F.2d 1340, 1344 (10th Cir. 1983) (a defendant's awareness that the funds ultimately would be provided by a federal agency is irrelevant); *Precision Medical Laboratories*, 593 F.2d at 442-43; *Beasley*, 550 F.2d at 271-73 (18 U.S.C. § 287 covers claims submitted to the state where the claimant "knew the state would rely on the claims for reimbursement from the government"); *Catena*, 500 F.2d at 1321-22 (doctors violated 18 U.S.C. § 287 by submitting false claims to insurance carriers which then submitted such claims to the government for reimbursement); *United States v. Jacobson*, 467 F. Supp. 507, 508 (S.D.N.Y. 1979) (payment by a state agency, which is partially funded by the government, is a claim against the United States).

199. *Precision Medical Laboratories*, 593 F.2d at 443.

200. *United States v. Rifen*, 577 F.2d 1111, 1113 (8th Cir. 1978) (a jury may infer an intent to defraud if it finds that the defendant knew his claim was false).

201. *See United States v. Gold*, 743 F.2d 800, 821-22 (11th Cir. 1984), *cert. denied*, 469 U.S. 1217 (1985); *United States v. Holloway*, 731 F.2d 378, 380-81 (6th Cir.), *cert. denied*, 469 U.S. 1021 (1984); *United States v. Cook*, 586 F.2d 572, 578-80 (5th Cir. 1978), *cert. denied*, 442 U.S. 909 (1979).

202. *See United States v. Milton*, 602 F.2d 231, 233 n.6 (9th Cir. 1979) (approved jury instruction on knowing and willful element in indictment); *Precision Medical Laboratories*, 593 F.2d at 444 (words "willfully" and "unlawfully" in indictment did not lower the government's

Courts have also disagreed over whether a materiality requirement should be applied to section 287. On the one hand, the Courts of Appeals for the Fourth and Eighth Circuits have concluded that materiality of the alleged false claim must be proven.<sup>203</sup> However, the Eighth Circuit Court of Appeals has held that the question of materiality is a matter of law.<sup>204</sup> On the other hand, the Courts of Appeals for the Second and the Tenth Circuits have refused to adopt materiality as an element of a section 287 violation.<sup>205</sup>

In *Johnson v. United States*,<sup>206</sup> the contractor submitted a claim containing an implied misrepresentation of compliance under a government contract. The contractor argued that "his submission amounted to nothing more than a statement that according to his understanding of the contract between him and the Government, he was entitled to receive a payment."<sup>207</sup> The Eighth Circuit Court of Appeals rejected the argument and held that the claim was false.<sup>208</sup>

In *Imperial Meat Co. v. United States*,<sup>209</sup> the Court of Appeals for the Tenth Circuit held that delivery of goods to the government at quality levels below contract specifications constituted a false claim.<sup>210</sup> The contractor argued that the invoices did not represent the goods to be of any particular quality.<sup>211</sup> The court, however, found sufficient reference in the invoices to the contract documents to establish a false claim.<sup>212</sup>

#### 4. Aiding and abetting

In the event that the government is unable to establish the requisite elements of any of the above criminal offenses, a contractor might still be criminally liable for aiding and abetting the commission of any such offense. Section 2 of 18 U.S.C. provides that:

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burden of proof); *United States v. Maher*, 582 F.2d 842, 846-47 (4th Cir. 1978), *cert. denied*, 439 U.S. 1115 (1979) (approved jury instruction on willfulness).

203. *See United States v. Adler*, 623 F.2d 1287, 1291 n.5 (8th Cir. 1980); *United States v. Snider*, 502 F.2d 645, 652 n.12 (4th Cir. 1974); *United States v. Johnson*, 410 F.2d 38, 46 (8th Cir.), *cert. denied*, 396 U.S. 822 (1969).

204. *United States v. Pruitt*, 702 F.2d 152, 155 (8th Cir. 1983).

205. *See United States v. Elkin*, 731 F.2d 1005, 1009 (2d Cir.), *cert. denied*, 469 U.S. 822 (1984); *United States v. Irwin*, 654 F.2d 671 (10th Cir. 1981), *cert. denied*, 455 U.S. 1016 (1982).

206. 410 F.2d 38, 41-44 (8th Cir.), *cert. denied*, 396 U.S. 822 (1969).

207. *Id.* at 44.

208. *Id.* at 44-45.

209. 316 F.2d 435 (10th Cir.), *cert. denied*, 375 U.S. 820 (1963).

210. *Id.* at 439-40.

211. *Id.*

212. *Id.* at 440.

(a) Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal.

(b) Whoever willfully causes an act to be done which if directly performed by him or another would be an offense against the United States, is punishable as a principal.<sup>213</sup>

In order to gain a conviction under section 2, the government must establish that the defendant aided or abetted the principal to violate the predicate criminal statute (e.g., 18 U.S.C. section 1001).<sup>214</sup> For example, conduct on the part of the defendant amounting to counseling or other assistance in the prohibited activity might be sufficient if proven.<sup>215</sup> However, there must be some proof of "affirmative participation which at least encouraged the perpetrators."<sup>216</sup>

#### D. Monetary Penalties

The monetary penalties contained in the above statutes apply to all offenses committed before December 31, 1984. For offenses committed after December 31, 1984, 18 U.S.C. section 3623 provides that an individual may be fined not more than the greatest of:

- (1) the amount specified in the law setting forth the offense;
- (2) the applicable amount under subsection (c) of this section;
- (3) in the case of a felony, \$250,000;
- (4) in the case of a misdemeanor resulting in death, \$250,000; or
- (5) in the case of a misdemeanor punishable by imprisonment for more than six months, \$100,000.<sup>217</sup>

A corporation or other business entity may be fined in a similar manner, except that the maximum fine for a felony or a misdemeanor resulting in death is \$500,000.<sup>218</sup> However, if the defendant derives pecuniary gain from the offense, or if the offense results in pecuniary loss to another

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213. 18 U.S.C. § 2.

214. *United States v. Aarons*, 718 F.2d 188, 193 (6th Cir. 1983); *Logsdon v. United States*, 253 F.2d 12, 14 (6th Cir. 1958).

215. *Grimes v. United States*, 379 F.2d 791, 795 (5th Cir.), *cert. denied*, 389 U.S. 846 (1967).

216. *United States v. Crow Dog*, 532 F.2d 1182, 1195 (8th Cir. 1976) (quoting *United States v. Thomas*, 469 F.2d 145, 147 (8th Cir. 1972)), *cert. denied*, 430 U.S. 929 (1977).

217. See Criminal Fine Enforcement Act of 1984, Pub. L. No. 98-596, § 6(a), 98 Stat. 3134 (1984).

218. 18 U.S.C. § 3623(b) (Supp. III 1985).

person, the defendant may be fined up to twice the gross gain or twice the gross loss, unless the imposition of such a fine would unduly complicate or prolong the sentencing process.<sup>219</sup> Moreover, the maximum aggregate fine "that a court may impose on a defendant at the same time for different offenses that arise from a common scheme or plan, and that do not cause separable or distinguishable kinds of harm or damage, is twice the amount imposable for the most serious offense."<sup>220</sup>

In the Sentencing Reform Act of 1984,<sup>221</sup> the above section 3623 was repealed effective November 1, 1986. Under this act, 18 U.S.C. section 3571 will apply to all offenses committed on or after November 1, 1986.<sup>222</sup> Section 3571(b) provides that an individual may be fined:

(A) for a felony, or for a misdemeanor resulting in the loss of human life, not more than \$250,000;

(B) for any other misdemeanor, not more than \$25,000;

and

(C) for an infraction, not more than \$1000.<sup>223</sup>

A corporation or other business entity may be fined not more than \$500,000, \$100,000 or \$10,000, respectively.<sup>224</sup>

#### *E. Statute of Limitations*

Section 3282 of 18 U.S.C. provides that: "Except as otherwise expressly provided by law, no person shall be prosecuted, tried, or punished for any offense, not capital, unless the indictment is found or the information is instituted within five years next after such offense shall have been committed."<sup>225</sup> All of the above statutes proscribe different illegal conduct subject to the same five-year statute of limitations applicable to non-capital felonies. Frequently, the government has been able to effectively lengthen the five-year statute of limitations under the "last act" theory. For example, because conspiracy is a continuing offense, the statute of limitations for conspiracy runs from the date of the last overt act committed in furtherance of the conspiracy.<sup>226</sup> Thus, if at least one overt act is shown to have occurred within the statute of limitations, evidence

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219. *Id.* § 3623(c)(1).

220. *Id.* § 3623(c)(2).

221. Pub. L. No. 98-473, § 202(a)(2), 98 Stat. 1987 (1984).

222. *Id.* § 225.

223. 18 U.S.C. § 3571(b)(1) (1982).

224. *Id.* § 3571(b)(2).

225. 18 U.S.C. § 3282 (1982).

226. See *Grunewald v. United States*, 353 U.S. 391, 396-99 (1957); *United States v. Payne*, 635 F.2d 643, 645 (7th Cir. 1980), *cert. denied*, 451 U.S. 972 (1981); *United States v. Rubin*, 609 F.2d 51, 65-66 (2d Cir. 1979), *aff'd*, 449 U.S. 424 (1981); *United States v. Parker*, 586

of a conspiracy agreement and other overt acts committed outside the limitations period may be admitted as proof of an ongoing conspiracy.<sup>227</sup>

Accordingly, if the government establishes that a contractor conspired to submit a false certification to defraud the government into paying on an inflated contract price, the government would have five years from the contractor's submission of the last claim for payment to bring an indictment. On multi-year contracts, the government could therefore challenge the certification's validity more than five years after it was submitted.

## V. SUSPENSION AND DEBARMENT

In light of the government's campaign against procurement fraud, there has been increasing pressure for "more aggressive" use of the government's suspension and debarment powers.<sup>228</sup> The government's procurement regulations set forth the procedures for suspending or debaring a contractor<sup>229</sup> from bidding on, being awarded or participating in contracts or related subcontracts with the government.<sup>230</sup> Under these regulations, an indictment<sup>231</sup> for fraud or other criminal offenses which involve obtaining, attempting to obtain or performing a public contract may be grounds for suspension until the matter is resolved.<sup>232</sup> Subsequent conviction<sup>233</sup> for fraud or other criminal offenses may result in debarment. Suspension and debarment are discretionary actions to effectuate the government's policy of dealing only with "responsible con-

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F.2d 422, 429-30 (5th Cir. 1978), *cert. denied*, 441 U.S. 962 (1979); *United States v. Charnay*, 537 F.2d 341, 354 (9th Cir.), *cert. denied*, 429 U.S. 1000 (1976).

227. *See United States v. Romano*, 516 F.2d 768, 771 (2d Cir.), *cert. denied*, 423 U.S. 994 (1975); *United States v. Provenzano*, 334 F.2d 678, 684-85 (3d Cir.), *cert. denied*, 379 U.S. 947 (1964); *Imholte v. United States*, 226 F.2d 585, 589 (8th Cir. 1955); *United States v. Lena*, 497 F. Supp. 1352, 1359 (W.D. Pa. 1980), *aff'd*, 649 F.2d 861 (3d Cir. 1981).

228. *See, e.g.*, SUBCOMM. ON OVERSIGHT OF GOV'T. MGMT., SENATE COMM. ON GOV'TL AFFAIRS, 97TH CONG., 1ST SESS., REPORT ON REFORM OF GOVERNMENT-WIDE DEBARMENT AND SUSPENSION PROCEDURES (Comm. Print 1981).

229. A "contractor" is "any individual or other legal entity that (a) submits offers for or is awarded, or reasonably may be expected to submit offers for or be awarded, a Government contract or a subcontract under a Government contract or (b) conducts business with the Government as an agent or representative of another contractor." FAR § 9.403.

230. *See Office of Federal Procurement Policy*, Policy Letter No. 82-1, 47 Fed. Reg. 28,857 (1982).

231. The term "indictment" refers to an "indictment for a criminal offense. An information or other filing by competent authority charging a criminal offense shall be given the same effect as an indictment." FAR § 9.403.

232. *Id.* § 9.407-2(b).

233. A "conviction" means "a judgment or conviction of a criminal offense by any court of competent jurisdiction, whether entered upon a verdict or a plea, and includes a conviction entered upon a plea of *nolo contendere*." *Id.* § 9.403.

tractors."<sup>234</sup> They are to be imposed "only in the public interest for the government's protection and not for purposes of punishment."<sup>235</sup> As a result, suspension and debarment actions are subject to judicial review.<sup>236</sup>

### A. *Suspension*

A contractor may be suspended if there is adequate evidence of:

- (1) Commission of fraud or a criminal offense in connection with (i) obtaining, (ii) attempting to obtain, or (iii) performing a public contract or subcontract;
- (2) Violation of Federal or State antitrust statutes relating to the submission of offers;
- (3) Commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, or receiving stolen property; or
- (4) Commission of any other offense indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a Government contractor or subcontractor.<sup>237</sup>

Moreover, indictment for any of the above causes constitutes "adequate evidence for suspension."<sup>238</sup> If suspension is not based on an indictment, the contractor may, under certain circumstances, have an opportunity to develop a record as to material facts over which there is a genuine dispute.<sup>239</sup> However, no such opportunity will be provided if the Justice Department determines that "substantial interests of the Government in pending or contemplated legal proceedings based on the same facts as the suspension would be prejudiced."<sup>240</sup>

If suspended, the contractor and any affiliates shall receive prompt notice by certified mail: (1) that they have been suspended; (2) that the suspension is for a temporary period pending the completion of an investigation and any subsequent legal proceeding; (3) of the reasons for imposing the suspension; (4) of the effect of the suspension; (5) that, within thirty days after receipt of the notice, the contractor may submit objections to the suspension raising a genuine dispute over the material facts;

234. *Id.* § 9.402(a).

235. *Id.* § 9.402(b); *Gonzalez v. Freeman*, 334 F.2d 570, 577 (D.C. Cir. 1964); *Roemer v. Hoffmann*, 419 F. Supp. 130, 131 (D.D.C. 1976).

236. *Gonzalez*, 334 F.2d at 576.

237. FAR § 9.407-2(a).

238. *Id.* § 9.407-2(b).

239. *Id.* § 9.407-3(b)(2).

240. *Id.*

and (6) that proceedings to determine disputed material facts will be conducted unless (i) the action is based on an indictment or (ii) the Justice Department advises that substantial governmental interests in pending or contemplated legal proceedings would be prejudiced.<sup>241</sup> In the event proceedings to determine disputed material facts are conducted, the suspending officer's<sup>242</sup> decision must be "based on all the information in the administrative record, including any submission made by the contractor."<sup>243</sup>

If legal proceedings are not initiated within twelve months after the date of the suspension notice the suspension must be terminated unless extended for an additional six months at the request of an Assistant Attorney General.<sup>244</sup> In no case may a suspension extend beyond eighteen months, unless legal proceedings have been initiated.<sup>245</sup> However, the suspending officer may terminate the suspension prior to the expiration of twelve months.<sup>246</sup>

As a result, if a government contractor that relies on new government business for its continued economic survival is suspended, it may be out of business. Thus, in order to end a suspension, a contractor may be willing to plead guilty to crimes it did not commit in return for the government's assurance that the suspension will be lifted and the contractor will not be debarred.

### B. Debarment

Under the FAR, a contractor may be debarred for, among other things, conviction of or civil judgment for the same reasons justifying such contractor's suspension.<sup>247</sup> However, the existence of a cause for debarment "does not necessarily *require* that the contractor be debarred;

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241. *Id.* § 9.407-3(c); *see also* Old Dominion Dairy Prods., Inc. v. Secretary of Defense, 631 F.2d 953 (D.C. Cir. 1980); *Horne Bros. v. Laird*, 463 F.2d 1268 (D.C. Cir. 1972) (due process requires, in the case of a suspension, notice and an opportunity to be heard).

242. The "debaring" or "suspending" official who is empowered to take action under Subpart 9.4 of the FAR, is either the agency head or authorized representative of the agency head. FAR § 9.403. The Department of Defense authorized representatives are identified in DOD FAR Supplement, 48 C.F.R. § 9.470 (1984).

243. FAR § 9.407-3(d)(1). As with debarment, disputed issues of material fact may be referred to another official for the purposes of hearing evidence and argument and of preparing written findings of facts, which shall be binding absent a determination by the suspending official that the findings are "arbitrary and capricious or clearly erroneous." *Id.* § 9.407-3(d)(2).

244. *Id.* § 9.407-4(b).

245. *Id.*

246. *Id.* § 9.407-4(a).

247. FAR § 9.406-2(a). *See supra* text accompanying note 237 for the list of reasons justifying suspension.



the seriousness of the contractor's acts or omissions and any mitigating factors should be considered in making any debarment decision."<sup>248</sup>

If one of the above causes of debarment occurs, the debarring agency will initiate debarment by advising the contractor or subcontractor, and any specifically named "affiliates,"<sup>249</sup> by certified mail:

(1) of the reasons for the proposed debarment; (2) of the agency's procedures governing debarment decisionmaking, including the contractor's right to submit objections raising a genuine dispute over material facts; (3) of the potential effect of the proposed debarment; and (4) if not previously suspended, that the agency will treat the contractor as if it was suspended.<sup>250</sup>

If the debarment action is based on a criminal conviction or civil judgment, or if there is no dispute over material facts, "the debarring official shall make a decision on the basis of all the information in the administrative record, including any submission made by the contractor."<sup>251</sup> If no suspension is in effect, the debarring official must make his decision "within 30 working days after receipt of any information and argument submitted by the contractor, unless the debarring official extends this period for good cause."<sup>252</sup> If the debarring official imposes debarment, the contractor and any affiliates will receive prompt notice by certified mail of the debarment. "[T]he debarment is effective throughout the executive branch of the Government unless the head of an acquiring agency or a designee"<sup>253</sup> states in writing "the compelling reasons justifying continued business dealings between that agency and the contractor."<sup>254</sup>

If the proposed debarment is *not* based upon a criminal conviction or civil judgment, "the cause for debarment must be established by a preponderance of the evidence."<sup>255</sup> In such cases, if the contractor's sub-

248. FAR § 9.406-1(a) (emphasis in original). It should be noted that while FAR § 9.402(a) provides that debarment and suspension are discretionary actions, the court in *Gonzalez v. Freeman*, 334 F.2d 570 (D.C. Cir. 1964), held that the "determination to debar a contractor does not fall within the scope of the second [APA] exception, 'agency action . . . by law committed to agency discretion.'" *Id.* at 575.

249. "Business concerns or individuals are affiliates if, directly or indirectly, (a) either one controls or can control the other or (b) a third controls or can control both." FAR § 9.403.

250. *Id.* § 9.406-3(c); see also *Gonzalez*, 334 F.2d at 578 (due process requires, in the case of a debarment, notice of the specific charges and "an opportunity to present evidence and to cross-examine witnesses, all culminating in administrative findings and conclusions based upon the record so made").

251. FAR § 9.406-3(d)(1).

252. *Id.*

253. *Id.* § 9.406-3(e)(iv).

254. *Id.* § 9.406-1(c).

255. *Id.* § 9.406-3(d)(3).

mission in opposition to debarment raises a genuine dispute over material facts, the contractor, with counsel, may be allowed to "submit documentary evidence, present witnesses, and confront any person the agency presents."<sup>256</sup> Following such proceeding, the presiding official must prepare written findings of fact regarding the disputed facts.<sup>257</sup> However, the debarring official "may reject any such findings, in whole or in part, only after specifically determining them to be arbitrary and capricious or clearly erroneous."<sup>258</sup>

In applying the above administrative procedures, the following language of Judge Sirica is particularly pertinent:

The starting point for determining whether a person should be debarred must be the statement of Chief Justice Burger when he was a judge for the U.S. Court of Appeals for the District of Columbia Circuit:

Disqualification from bidding or contracting . . . directs the power and prestige of Government at a particular person and . . . may have a serious economic impact on that person.

. . . .

[Here] the plaintiff has suggested a number of factors which appear to diminish the force of that conviction as an indication of Roemer's present responsibility. These factors touch on Roemer's character before the offense occurred, the circumstances surrounding the offense, the deterrent effects of the prior 29-month suspension, of the conviction, and of the payment to the government of \$3,600 in restitution, the length of time which has passed since the offense and since the conviction, and Roemer's character since the offense and conviction.

It is clear from the memorandum that Coggins wrote at about the time he issued the order debarring Roemer that he was aware of at least the most important of these factors. But what is less clear is why Coggins attributed little or no importance to them, and what it was about the offense which necessitates, despite these factors, a debarment of three years. The Court must have specific answers to these questions if it is to exercise properly its limited review of the substance of the ad-

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256. *Id.* § 9.406-3(b)(2)(i).

257. *Id.* § 9.406-3(d)(2)(i).

258. *Id.* § 9.406-3(d)(2)(ii).

ministrative decision.<sup>259</sup>

The length of the debarment is for a period commensurate with the seriousness of the cause for debarment.<sup>260</sup> The Department of Defense FAR Supplement states that the debarment period should afford adequate time for the contractor to correct those problems that led to its conviction.<sup>261</sup> Any mitigating factors may be considered in making the debarment decision.<sup>262</sup> However, "for any decision not to debar or to debar for one year or less, the mitigating factors must demonstrate clearly to the debarring official's complete satisfaction, that the contractor has eliminated such circumstances and has implemented effective remedial measures."<sup>263</sup> The FAR indicates that a debarment should generally not exceed three years.<sup>264</sup> Moreover, any period of suspension preceding the debarment will be considered in determining the debarment period.<sup>265</sup>

The fraudulent, criminal or other seriously improper conduct of any individual associated with the contractor may be imputed to the contractor when the conduct occurred in connection with the individual's performance of duties for or on behalf of the contractor, or with the contractor's knowledge, approval, or acquiescence.<sup>266</sup> Similarly, the con-

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259. *Roemer v. Hoffmann*, 419 F. Supp. 130, 131-32 (D.D.C. 1976) (quoting *Gonzalez v. Freeman*, 334 F.2d 570, 578 (1964)).

260. FAR § 9.406-4(a).

261. DOD FAR Supp. § 9.406-1(d).

262. *Id.*

263. *Id.*

264. FAR § 9.406-4(a). The debarring official may extend the debarment period, if he determines that an extension is "necessary to protect the Government's interest." *Id.* § 9.406-4(b). However, such extension may not be based solely on the facts and circumstances upon which the initial debarment action was based. *Id.* The debarment period may also be reduced, "upon the contractor's request, supported by documentation, for reasons such as: "(1) Newly discovered material evidence; (2) Reversal of the conviction or judgment upon which the debarment was based; (3) Bona fide change in ownership or management; (4) Elimination of other causes for which the debarment was imposed; or (5) Other reasons the debarring official deems appropriate." *Id.* § 9.406-4(c).

265. *Id.* § 9.406-4(a).

266. *Id.* § 9.406-5(a). Furthermore, the FAR provides that "[t]he contractor's acceptance of the benefits derived from the conduct shall be evidence of such knowledge, approval, or acquiescence." *Id.* For example, in one board of contract appeals case, a contractor challenged the government's right to suspend it based upon the conviction of one of its employees for conspiracy and extortion. The contractor argued that its employee's wrongful acts could not be imputed to it and that, in any event, the employee had been terminated and there was no evidence of subsequent improper conduct by the contractor. In rejecting the contractor's defense, the board noted that: "(1) there was no evidence that the contractor's management was insulated from the employee's illicit activities; (2) the employee was acting within the scope of his authority; and (3) his wrongful actions were designed to benefit the company and did, in fact, benefit the company." Given these facts, the board decided that the employee's

duct of the contractor may be imputed to any individual associated with him and the conduct of one contractor participating in a joint venture or similar arrangement with another participating contractor.<sup>267</sup>

### C. *Effect of Suspension and/or Debarment*

Agencies are prohibited from soliciting offers from, or awarding contracts to, or consenting to subcontracts with suspended or debarred contractors, unless the head of the agency determines that there is a compelling reason to do so.<sup>268</sup> In this regard, the suspension or debarment applies to "all divisions or other organizational elements of the contractor, unless the debarment decision is limited by its terms to specific divisions, organizational elements, or commodities."<sup>269</sup>

Despite debarment or suspension, agencies may continue existing contracts or subcontracts, unless the agency head determines otherwise "after review by agency contracting and technical personnel and by counsel to ensure the propriety of the proposed [termination] action."<sup>270</sup> However, agencies cannot renew or extend such contracts or subcontracts, with suspended or debarred contractors, "unless the acquiring agency's head or a designee states in writing the compelling reasons for renewal or extension."<sup>271</sup>

## VI. PREVENTIVE MEASURES

With regard to defective pricing, a contractor's best defense to both criminal and civil liability is to submit to the government *all* factual data relating to the negotiations. If the contractor has any doubt as to whether particular data should be submitted to the government, the safest approach is to resolve all such doubts in favor of its submission. Any disadvantage from such broad disclosure can be minimized by distinguishing such data during negotiations and by taking a firm position vis-a-vis the contractor's proposed cost elements during negotiations.

Furthermore, contractors should institute review procedures to ensure that the most accurate, complete and current cost or pricing data has been submitted to the government prior to the close of negotiations

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actions could be the basis for the government's suspension of the company from contracting with the government, even though there was no evidence of any subsequent misconduct by the contractor.

267. *Id.* § 9.406-5(b)-(c).

268. FAR § 9.405(a).

269. *Id.* § 9.406-1(b).

270. *Id.* § 9.405-1(a).

271. *Id.* § 9.405-1(b).

and certification. In the long run, a delay in concluding negotiations in order to allow the submission of more accurate, complete and current cost or pricing data may minimize the possibility of future civil and criminal liability. Even assuming that the government is unable to obtain a criminal conviction for the alleged defective pricing, the economic consequences of a grand jury investigation and of a possible suspension greatly outweigh the cost of implementing a more comprehensive review procedure.

In the event the contractor discovers after the close of negotiations that the most accurate, complete and current cost or pricing data was not submitted to the government, it should seriously consider the post-certification submittal of such data. Arguably, for those contractors adopting the "Defense Industry Initiatives on Business Ethics and Conduct,"<sup>272</sup> such disclosure is ethically required. In any case, the voluntary disclosure of such information, while possibly resulting in a contract price adjustment in favor of the government, may support a contractor's defense to criminal charges that it lacked the requisite intent. Similarly, a decision not to disclose such information may enhance the government's argument that the contractor intended to deceive or defraud the government into paying an inflated contract price.

## VII. CONCLUSION

Contractors seeking to do business with the government must be especially wary of the perils of defective pricing. Under the above criminal provisions, the Justice Department may be able to seek multiple indictments for the same defective pricing conduct. Submission of a false certification to the government may constitute a violation of 18 U.S.C. section 1001. The later submission of claims for payment, under such

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272. The "Defense Industry Initiatives on Business Ethics and Conduct" were adopted by a number of major defense contractors in order to create an environment in which compliance with federal procurement laws and free, open and timely reporting of violations become the responsibility of individual employees in the defense industry. In order to accomplish these objectives, the Initiatives require adherence to a set of six principles of business ethics and conduct. The first, second and third principles require a written code of business ethics and conduct, training of employees in their ethical obligations, and an opportunity to report suspected violations of the code without fear of retribution. The fourth principle requires contractors to voluntarily report violations of federal procurement laws to the appropriate government authorities. Thus, while employees are responsible for reporting suspected violations to the contractor, it is the contractor's responsibility, if an investigation determines that a violation has occurred, to notify the appropriate governmental authorities and to institute any necessary corrective action. Finally, the fifth and sixth principles provide for the establishment of both an annual intercompany forum to discuss ways to implement the industry's principles of accountability and an external, independent review of each contractor's adherence to these six principles.

contract, may constitute false claims for money under 18 U.S.C. section 287. The Justice Department may also be able to allege a conspiracy under 18 U.S.C. section 371 on the basis that the claims being submitted are part of a contractor's scheme to defraud the government into paying an inflated contract price. If the contractor transmits its certification or contract claims by mail or wire, it could also be charged with mail or wire fraud under 18 U.S.C. sections 1341 or 1343. Finally, civil provisions of the False Claim Act (31 U.S.C. section 3729) may also apply to what in essence amounts to inadvertent defective pricing.

While public outrage over a \$7600 coffeemaker has caused Congress and the American public to closely examine the government contracting process, such scrutiny still does not warrant the use of criminal sanctions for what are otherwise civil violations. This is not to say that a contractor who intentionally sets out to defraud the government should not be criminally prosecuted. However, a contractor's innocent failure to submit the most accurate, complete and current cost or pricing data should not be allowed to form the basis for a criminal prosecution.

If the government remains determined to criminalize the contracting process, this will only further increase the cost of the products it buys. As contractors attempt to ensure the propriety of their actions, they will be forced to implement more costly administrative controls on their operation. The cost of such increased controls will be passed on to the government as overhead expenses. Thus, notwithstanding that such controls may result in some savings to the government, the savings may well be outweighed by overhead costs associated with the new micromanagement control mechanisms.

As discussed above, an excellent and cost effective mechanism for resolving contract claims now exists. If the government is found to have been overcharged by a contractor, it is entitled to recover any or all amounts that it overpaid. In the meantime, the system recognizes that contractors not only make mistakes with overpricing the contract, but also routinely make mistakes in underpricing the contract. As a result, the system currently allows a contractor to offset the amount the government claims it overpaid by the amount the contractor can prove the government underpaid. Under the Justice Department's approach, however, a contractor may be guilty of a criminal violation even if the inaccurate, incomplete or noncurrent data resulted in the underpricing of the contract.

