THE Procurement LAWYER
SECTION OF PUBLIC CONTRACT LAW • AMERICAN BAR ASSOCIATION VOLUME 40, NUMBER 4 • SUMMER 2005

The Strange Notion of Estimates as Fraud: Will Weather Predictions Be Next Under the False Claims Act?

BY DAVID Z. BODENHEIMER

Some qui tam relators and federal agencies have pushed the curious proposition that estimates of future costs can be fraudulent, thus triggering liability under the False Claims Act. At its core, this notion of "false" estimates seems as bizarre as recent headlines about Russian officials who would hold weather forecasters liable for bad predictions:

> "Forecasters Feeling Some Official Heat: Moscow's Mayor Directs Displeasure at Weather Bureau, Proposes Fines for Inaccuracy," WASHINGTON POST (Mar. 1, 2005) at A10.[1]

While the courts have yet to premise False Claims Act liability upon purportedly "false" estimates of future costs,[2] the language in some decisions has given courage to plaintiffs and agencies to proceed with "false estimate" theories, thus vexing defendants with the risk and expense of prolonged litigation and investigations. This concept of a false estimate, however, fails even the simplest test: Who knows the future? For at least three reasons the door should be closed upon this strange notion that good faith estimates or predictions can be false:

(1) The theory rests upon a misapplication of common law to federal procurements;

(2) Truth or falsity depends upon objective, not subjective, proof; and

(3) The theory conflicts with the basic rules of estimating in federal procurements.

Misapplication of the Common Law

The "false estimates" theory gained traction in the appellate decision *Harrison v. Westinghouse Savannah River Co.*, citing common law on whether opinions can be a basis for fraud.[3] *Harrison*, however, is not legally sound as a basis for stretching the common law to cover federal procurements.

In *Harrison*, the Fourth Circuit addressed inter alia the dismissal of a claim that proposed subcontractor training costs had been knowingly underestimated. As a general rule, the court acknowledged that "[e]xpressions of opinion are not actionable as fraud" because such statements cannot be empirically verified.[4] In support of this rule, *Harrison* cited *Presidio Enterprises, Inc. v. Warner Brothers Distributing Corp.*, 784 F.2d 674, 681 (5th Cir. 1986), in which the Fifth Circuit compared a fraud suit based upon a prediction to "suing the weatherman because rain spoiled a picnic when he predicted fair skies."

After setting forth the general rule, *Harrison* purported to describe a common law exception:

> However, an opinion or estimate carries with it "an implied assertion, not only that the speaker knows no facts which would preclude such an opinion, but that he does know facts which justify it." W. Page Keeton, et al., Prosser & Keeton on the Law of Torts, § 109, at 760 (5th ed. 1984).[5]

Inexplicably, however, the court omitted the critical

David Z. Bodenheimer is a partner in the Washington, D.C., office of Crowell & Moring LLP (www.crowell.com) where he specializes in government contracts and False Claims Act litigation, investigations, and counseling. *He thanks Crowell & Moring associate Charlotte E. Gillingham for her assistance in preparing this article and also the partners W. Stanfield Johnson and Peter B. Work for their valuable insights.*

qualifier ("the expression of an opinion *may carry* with it an implied assertion") demonstrating that this exception only applies in certain limited situations and does not supplant the general rule against fraud cases that are based upon opinions or predictions.

For the common law exception to apply, the courts have imposed significant restrictions that render the exception nonsensical in federal procurements involving arm's-length negotiations between sophisticated parties. First, Prosser ties this common law exception to circumstances where the defendant has "special knowledge of the matter which is not available to the plaintiff" and "the parties do not purport to be dealing on an equal footing as to available information."[6] Second, plaintiffs may recover "when the disparity of knowledge arises, not from any special information on the part of the defendant, but from the ignorance or illiteracy of the plaintiff."[7] The classic example for applying this common law exception involves a punch-drunk boxer relying upon an experienced businessman's assertion that an unsanitary backroom would be "ideal" for making ice cream.[8] Notably absent from Prosser's and Keeton's litany of cases are any examples of the common law exception being applied to arm's-length dealings between parties "competent to look after their own interests."[9]

What plaintiff's attorney could credibly say that a "disparity of knowledge" exists due to "the ignorance or illiteracy" of the United States government? Or compare federal officials to "punch-drunk" boxers? Likewise, what does a rule designed to protect laypersons from fiduciaries and professionals (for example, attorneys, doctors, and stockbrokers) have to do with the United States government—the largest buyer in the world? In short, if even a gigantic monopsony qualifies for a common law exception created to protect the weak from the strong, then nothing remains of the general rule barring fraud claims based on opinions and predictions.

Objective—Not Subjective—Falsity

By its nature, a "false estimate" is oxymoronic. On one hand, falsity requires an objective bright line that clearly separates truth from fiction. On the other hand, an estimate is inherently subjective, as it necessarily demands guesswork about the future.

Objective Falsity

To sustain a False Claims Act suit, a plaintiff must establish that the claim or statement at issue is objectively false:

> The critical allegation for a false claim under the FCA is a charge of an objective falsehood. . . . Expressions of opinion, scientific judgments, or statements as to conclusions about which reasonable minds may differ cannot be false as required by the FCA.[10]

In order to be objectively true or false, the claim or statement must rest upon a verifiable fact: "A statement of fact is one that (1) admits of being adjudged true or false in a way that (2) admits of empirical verification."[11] Such "empirical verification" simply cannot happen when a fraud allegation involves an estimate or prediction of future events.

> The weatherman does not know whether it will in fact rain tomorrow. No one does. Thus no one knows whether the statement ["It will rain tomorrow"] is true or false; perhaps it would be better to say that it is *neither true nor false*. A statement about the future can be verified only in the future; but then, of course, it is no longer a statement about the future as such. When tomorrow finally comes, and it is indeed raining, one no longer says "It will rain tomorrow" but rather "It is now raining." *That* statement can be empirically verified as true or disconfirmed as false.[12]

The objective nature of falsity contrasts sharply with the subjective nature of estimates of future events.

Subjective Estimates

In its practical guidelines to government and contractor estimators alike, the Defense Department long ago recognized the subjectivity inherent in estimating. Indeed, the department acknowledged two distinct types of subjectivity: (1) the uncertainties inherent in predicting future events and costs; and (2) the differences arising from the different points of view of the buyer and seller.

With regard to the vagaries of predicting the future, the Defense Department expressly rejected verifiable empiricism in the fuzzy world of contract pricing, as stated in the *Armed Services Pricing Manual* (ASPM):

> Contract pricing is an art. Many would reduce this art to routine by emphasizing the accounting view of price that price equals direct cost and overhead plus a fair profit. If contract pricing is the art we believe it to be, the test of a price requires more than a weighing of past and estimated costs. Subjective evaluation is necessary because of the error inherent in estimates and because it is necessary to test for reasonableness, economy, relevancy, probability and materiality.[13]

Similarly, the ASPM recognized that contract pricing deals with "estimates of future events" and that "[a]n estimate is a prediction of what the cost of future events will or should be."[14] Although much has changed in the last 30 years, no one has argued that contract pricing is now a precise science that has eliminated "the error inherent in estimates." Such subjectivity and uncertainty runs directly counter to the empirical verification and objective falsity necessary to prove a violation of the False Claims Act.

Just as estimates are subjective due to the guesswork intrinsic to predicting the future, estimates also vary because the buyer and seller naturally have differing points of view about what constitutes a reasonable estimate. Again, the ASPM summarized this subjectivity as follows:

> You can conclude, with reason, that in any given procurement situation, there is usually no one price that is fair and reasonable from all viewpoints.
>
> * * *
>
> "Reasonable," however, is subjective and implies a personal viewpoint; there is a price that is reasonable to the seller and a price that the buyer thinks is reasonable. As a result, you should consider fair and reasonable in three dimensions: fair under current market conditions; reasonable to the seller; and reasonable to the buyer.[15]

Given that viewpoints of the buyer and seller will inevitably diverge about what constitutes a reasonable estimate, the parties should deal with such differences in the negotiation process, not through a post facto judicial review under the guise of a False Claims Act suit.

Conflicts with Basic Rules for Estimating and Pricing

If the False Claims Act did penalize "bad" estimates based upon poor predictions, plaintiffs would have virtually unlimited opportunities to use 20/20 hindsight and second-guess good faith judgments made by contractors and accepted by agencies during the negotiations. Turning estimates or predictions into fraud in such a manner would violate the basic federal procurement rules for estimating and pricing in at least three ways:

(1) The federal government's own pricing guidelines recognize the propriety of using judgment;

(2) Not even administrative sanctions exist under current statutes and regulations for poor judgments or estimating; and

(3) Just as the contractor has discretion to develop its estimate, no duty exists for the contractor to use any particular cost data to support its proposal.

Thus, allegations based simply on disagreements about estimate outcome or estimating methodology have no place in a fraud case, particularly where the underlying data have been disclosed.

Propriety of Using Judgment

Predictions necessarily entail judgment as estimators must face the unknown, weigh the risks, and deal with a range of possible outcomes. As the Armed Services Board of Contract Appeals explained, "a contractor's offer is a mix of judgments as to how best to accomplish contract work at a price that is developed to cover anticipated cost and a satisfactory profit."[16]

For decades, the Department of Defense has acknowledged the validity and propriety of judgment as a basis for estimating in federal procurements. For example, the *DCAA Contract Audit Manual* has long recognized the use of judgment as part of the "roundtable method" for developing estimates:

> The round-table method is used to estimate the cost of a new item when there is no cost experience or detailed information regarding specifications, drawings, or bills of material. Under this method, representatives of the engineering, manufacturing, purchasing, and accounting departments develop the cost estimates by exchanging views and **making judgments** based on knowledge and experience. This method has the advantage of speed of application and is relatively inexpensive, but may not produce readily supportable or reliable cost estimates.[17]

Such roundtable estimating by its nature inevitably depends upon myriad judgments built upon varied experiences, expertise, and risk tolerances of individuals whose opinions have been winnowed to a consensus value for forecasting future costs.[18] Thus, at its foundation, a roundtable estimate rests upon layers upon layers of judgmental factors not susceptible to empirical verification necessary for proof of objective falsity under the False Claims Act.

No Liability for Poor Estimates or Judgments

Basing False Claims Act claims upon "poor" estimates runs counter to well-established government contracting principles that do not expose contractors to liability for proposing prices based upon poor judgments. Years ago, the General Accounting Office (now the Government Accountability Office) acknowledged that contractors could not be punished for poor estimates: "When overpricing is determined to be caused by poor estimating, the Government has no safeguard such as the Truth in Negotiations Act for reducing the contract prices."[19] Plaintiffs have yet to point to any change in the law that would transform poor estimates into fraud or some other actionable misconduct.

If poor predictions did trigger liability for fraud, contractors would face the anomaly that what is permitted under the administrative rules of the Truth in Negotiations Act (TINA) is outlawed by the False Claims Act.[20] Under TINA, contractors have never been liable for poor estimates or judgments. Indeed, both the statute and regulations have always excluded judgment as a basis for liability under TINA.[21] In applying TINA, both the cases and the DCAA implementation have consistently recognized that defective pricing cannot be premised upon a contractor's judgments.[22] Accordingly, the False Claims Act cannot be reasonably construed as revoking the safe harbor created by Congress and recognized by the case law for estimates based upon judgment.

Contractor Discretion in Preparing Estimates

Except in certain regulated utilities or communist countries, the government does not dictate the pricing for private companies. In federal procurements, the discretion for proposing the price and choosing the estimating methodology rests with the contractor, not the United States government.[23] Likewise, DCAA has consistently recognized that contractors "may justifiably use a variety of methods and procedures" to "prepare prospective price proposals."[24] If plaintiffs could wield the False Claims Act to draw artificial distinctions between "good" and "bad" estimates, such second-guessing would undermine the fundamental premise of contractor discretion in choosing estimating methodologies for predicting future costs.

Moreover, the common law exception in Prosser and *Harrison* ("he does know facts which justify" the opinion) would also contradict the well-established principle that federal contractors have no duty to use particular data to support an estimate. For example, the D.C. Circuit recently stated:

> [T]he complaint seems to allege that Martin-Baker's certificates of cost or pricing data were false because the company failed to use historical actual costs during negotiations with the government. Yet we have found no case or regulation—nor has *Williams* pointed to any—requiring the use of such data *during negotiations*.[25]

The ASBCA has consistently upheld this same principle.[26] How a contractor chooses to support its proposal "is a matter for the contractor to decide, and for the government to evaluate as part of the proposal review process, and is not a mandate under TINA."[27]

Consistent with this well-established legal principle, DCAA acknowledges the absence of a mandate for a contractor's proposal to be based upon specific data or facts, because TINA "does not require a contractor to use such data in preparing its proposals or for there to be a relationship between the proposals and the conclusions that can be drawn from such data."[28] Thus, in light of the broad discretion granted to contractors to choose estimating methodologies and determine how to support proposals, the False Claims Act cannot reasonably be interpreted as overturning long-standing federal procurement law and policy and taking away this discretion.

Conclusion

By misapplying the common law exception in Prosser, *Harrison* opened a crack for False Claims Act allegations of "false estimates" to rain down upon federal contractors. This common law exception, designed to protect the weak and helpless from one-sided deals, has no business in the federal marketplace where the United States government has unequalled clout and muscle as the world's largest buyer. Furthermore, the notion of "false estimates" cannot be squared with either the requirement for proof of objective falsity under the False Claims Act or the well-established discretion bestowed upon contractors to choose estimating methods reflecting judgmental factors to predict future costs and prices. If bad weather predictions result in fines in Russia, what rational person would want to be a Russian weather forecaster? Federal contractors must ask the same question if poor estimates or judgments become fraud under the False Claims Act. PL

Endnotes

1. *See also Russian Weather Forecasters Face Fines over Wrong Information*, ANANOVA (2005) *available at* www.ananova.com/news/story/sm_933086.html?menu=) ("Russian weathermen who get their predictions wrong could face stiff fines if one government minister has his way").

2. Beyond the scope of this article are issues arising from estimating previously incurred or historical costs (similar to estimating how much it rained yesterday) or lying about the basis of an estimate (much like creating a phony weather map), such as in United States *ex rel.* Taxpayers Against Fraud v. Singer Co., 889 F.2d 1327 (4th Cir. 1989).

3. Harrison v. Westinghouse Savannah River Co., 176 F.3d 776 (4th Cir. 1999); *see also* United States *ex rel.* Bettis v. Odebrecht Contractors of Cal., Inc., 393 F.3d 1321, 1328 (D.C. Cir. 2005) (citing, but distinguishing, *Harrison*).

4. 176 F.3d at 792.

5. *Id.*

6. W. PAGE KEETON ET AL., PROSSER & KEETON ON THE LAW OF TORTS 760-61 (5th ed. 1984).

7. *Id.* at 761.

8. Zingale v. Mills Novelty Co., 244 Wis. 144, 11 N.W.2d 644 (Wis. 1943).

9. PROSSER AND KEETON, *supra*, at 755-61.

10. United States *ex rel.* Juan Wong v. Consul-Tech Eng'g, Inc., No. 02-23081-CIV-Seitz/Bandstra (S.D. Fla. Mar. 16, 2005) (citing United States *ex rel.* Wang v. FMC Corp., 975 F.2d 1412, 1420-21 (9th Cir. 1992) and United States *ex rel.* Roby v. Boeing Co., 100 F. Supp. 2d 619, 625 (S.D. Ohio 2000)).

11. *Presidio*, 784 F.2d at 679; *see also Harrison*, 176 F.3d at 792.

12. *Presidio*, 784 F.2d at 680 (internal citation omitted) (italics in original).

13. ARMED SERVICES PRICING MANUAL (ASPM No. 1) at 2(i) (Sept. 15, 1975).

14. *Id.* at 2A4.

15. *Id.* at 2B10.

16. *United Technologies Corp.*, ASBCA Nos. 51410, 53089, 53349, 04-1 BCA ¶ 32,556 at 161,025, *modified on recon.*, 05-1 BCA ¶ 32,860 (Jan. 21, 2005).

17. DCAM § 9-303(d)(3) (Oct. 1984) (emphasis added); *see also* DCAM § 9-303(d)(3) (Jan. 2001); ASPM at 2B28.

18. *See also Litton Systems, Inc., Amecom Div.*, ASBCA No. 36509, 92-2 BCA ¶ 24,842 at 123,945 ("[N]o two industrial engineers or test engineers would estimate either the task or the frequency of the task the same. The ESLH report is therefore pure judgment and is, accordingly, not data and need not be disclosed").

19. *Problems in the Pricing of Negotiated Defense Contracts: Hearing Before House Subcommittee on Government Operations*, 99th Cong., 1st Sess. 7 (statement of Mr. Conahan, GAO).

20. *Cf.* United States v. Southland Mgmt. Corp., 326 F.3d 669, 676 (5th Cir. 2003) (no False Claims Act liability where agency had not exercised administrative remedy for noncompliance).

21. *See, e.g.*, 10 U.S.C. § 2306a; 41 U.S.C. § 254b; FAR § 2.101 ("Cost or pricing data are factual, not judgmental; and are verifiable"); DAR § 3-807.6(b) (1982) (certificate "does not make representations as to the accuracy of the contractor's judgment on the estimated portion of future costs or projections").

22. *See, e.g.*, *Litton Systems, Inc., Amecom Div.*, ASBCA No. 36509, 92-2 BCA ¶ 24,842 at 123,944 (finding that engineering estimates for standard labor hours constituted judgments, not cost or pricing data); DCAM § 14-104.7 ("Errors in estimates generally would not result in defective pricing").

23. *Cf. Texas Instruments, Inc.*, ASBCA No. 23678, 87-3 BCA ¶ 20,195 at 102,270-71 (rejecting auditor's effort to dictate estimating method).

24. DCAM § 9-303(b) (Jan. 2001); *see also* DCAM § 9-303(b) (Jan. 1992).

25. United States *ex rel.* Williams v. Martin-Baker Aircraft Co., 389 F.3d 1251, 1257 (D.C. Cir. 2004) (emphasis added).

26. *See, e.g.*, *Rosemount, Inc.*, ASBCA No. 37520, 95-2 BCA ¶ 27,770 at 138,455; *Hughes Aircraft Co.*, ASBCA No. 30144, 90-2 BCA ¶ 22,847 at 114,761.

27. *United Technologies Corp.*, ASBCA Nos. 51410, 53089, 53349, 04-1 BCA ¶ 32,556 at 161,024, *modified on recon.*, 05-1 BCA ¶ 32,860 (Jan. 21, 2005).

28. DCAM § 14-104.7 (Jan. 2001).