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FEATURE COMMENT: Competition Trumps Defective Pricing Claim In The Great Engine War

United Technologies Corp., ASBCA Nos. 51410, 53089, 53349, 04-1 BCA ¶ 32,556, *modified on recon., 2005 WL 147601* (Jan. 21, 2005)

In a $299 million claim characterized by a Government pleading as "Garden Variety" defective pricing, the Air Force advanced novel, often unprecedented, propositions that would have transformed the Truth in Negotiations Act (TINA) from a disclosure statute into a *post facto* repricing exercise. Key Air Force propositions included the following:

- A contractor certifies its proposal, not just the cost or pricing data;
- An escalation estimate constitutes cost or pricing data;
- A contractor must not just *disclose*, but must *use*, cost or pricing data;
- The certification covers data created after the certification date;
- The Government may rely upon cost data that it never reviewed; and
- Competitive prices are inflated prices.

The Armed Services Board of Contract Appeals rejected most of these propositions in its initial February 2004 decision and denied the rest in a reconsideration decision issued in January 2005. *United Technologies Corp.,* ASBCA Nos. 51410, 53089, 53349, 04-1 BCA ¶ 32,556, *modified on recon., 2005 WL 147601* (Jan. 21, 2005).

This FEATURE COMMENT describes (1) the historic procurement—the Fighter Engine Competition—giving rise to this defective pricing case; (2) the ASBCA's initial decision sustaining the contractor's appeal; and (3) the reconsideration decision rejecting the Air Force's conclusory, "unpersuasive" assertions of reliance upon the cost data at issue.

The Great Engine War—In the 1980s, the Air Force decided to hold a competition between Pratt & Whitney (Pratt) and General Electric (GE) for the $10 billion market for F15 and F16 fighter jet engines needed for the six-year period spanning 1985-90. Air Force Secretary Verne Orr told Congress in 1983 that "we are going to have competition" with "two fine manufacturers who are going to be at each other's throats." *Department of Defense Appropriations for 1984: Hearings Before the House Subcomm. on Defense Appropriations,* 98th Cong., 1st Sess. (1999). Although officially called the Fighter Engine Competition, this engine buy became known as "The Great Engine War" due to the competitive and political firestorm ignited on Capitol Hill, in the Pentagon and within industry. See, e.g., Robert W. Drewes, *The Air Force and the Great Engine War* (1987).

After Secretary Orr made his award decision in February 1984, the Air Force proclaimed the competition a great success, as it yielded $2 billion in competitive savings, generated the "classical benefits of competition" and provided the "competitive leverage to drive the prices down as we have." *Defense Department Authorization and Oversight Hearings on H.R. 5167 Before the House Armed Services Comm., Part 2*, 98th Cong., 2nd Sess. 224-225, 255 (1984) (statement of Air Force Assistant Secretary Cooper). Indeed, Secretary Orr testified to Congress that it was "a great competition, probably the finest that I've experienced in the 3 years in the Air Force." Id., Part 1 at 760. However, Secretary Orr's decision only covered the first year of the six years subject to competition. For the subsequent years of the Fighter Engine Competition, Secretary Orr promised that "we will be competing again," with "new offerings," new assessments and new decisions each year. Id. at 829.

When the Defense Contract Audit Agency sought to initiate a post-award audit in 1984, the Air Force

initially resisted, saying that the contracts to Pratt and GE "were awarded solely on a competitive basis consistent with the decision made by the Source Selection Authority. …" 04-1 BCA ¶ 32,556 at 161,013. In 1985, the Air Force "took the position that a defective pricing audit was inappropriate." Id. at 161,017. As the years passed, Air Force resistance faded and DCAA commenced a post-award audit generating over 30 audit reports spanning more than a decade. By 1998, the Air Force issued a final decision seeking $95 million for defective pricing (99-2 BCA ¶ 30,444 at 150,425), but the asserted amount continued to escalate through the litigation until it reached $299 million. 04-1 BCA ¶ 32,556 at 161,009.

The Initial ASBCA Decision—Although the ASBCA had previously denied an Air Force motion to knock out adequate price competition as an issue in the case (99-2 BCA ¶ 30,444 at 150,428), the February 2004 decision concluded that adequate price competition did not exist in the Fighter Engine Competition. 04-1 BCA ¶ 32,556 at 161,023-24. However, the ASBCA sustained the contractor's appeal, finding no merit in some of the Air Force claims and recognizing offsets exceeding the remaining claims. 04-1 BCA ¶ 32,556 at 161,029.

Disclosure versus Use of Vendor Quotes: While not contesting the disclosure of vendor quotes, the Air Force "contends that the data were not used by Pratt to develop its [Best and Final Offer] price." 04-1 BCA ¶ 32,556 at 161,017. In rejecting this argument, the ASBCA concluded that "TINA is a disclosure statute" and its plain language "does not obligate a contractor to use any particular cost or pricing data to put together its proposal." Id. at 161,024. In doing so, the ASBCA reaffirmed not only its own well-established precedents, but also the standards set forth in the DCAA Contract Audit Manual (DCAM). See, e.g., *Hughes Aircraft Co.,* ASBCA No. 30144, 90-2 BCA ¶ 22,847 at 114,761 ("contractor does not have to either itself use the cost information or analyze it for the Government"); DCAM § 14-104.7 (Jan. 2001) (TINA "does not require a contractor to use such data in preparing its proposals.").

Proposal Not Certified: With regard to vendor quotes and certain engineering changes, the Air Force also argued that Pratt certified its BAFO proposal, thus triggering TINA liability for alleged "misstatements" or "inaccuracies" in the proposal itself. 04-1 BCA ¶ 32,556 at 161,024-25. Although not directly addressed in prior precedents, the ASBCA readily disposed of this argument: "We are aware of no statute, regulation, or contract provision that obliges a contractor to certify its BAFO proposal." Id. at 161,025. Furthermore, the ASBCA found the proposal not to be cost or pricing data because it was "a mix of judgments" about how to perform work at a price covering "anticipated cost and a satisfactory profit." Id.; see also DCAM § 14-104.7 (Jan. 2001) ("The offeror does not certify its proposal.").

Escalation Estimate as a Judgment: For material escalation, the Air Force did not contest disclosure, but asserted that Pratt used inconsistent escalation rates by failing to update the rate for one set of engineering changes. The ASBCA found "this material escalation factor was in essence a judgment as to the future movement of material costs" and therefore "not cost or pricing data." Id. at 161,019; see also DCAM § 14-104.4 (Jan. 2001) ("Escalation applied to the purchase order or vendor quote is most likely an estimate.").

Data Not Available Prior to Certification: During the post-award audit in 1993, the contractor prepared a summary retrospectively explaining the 1983 pricing of unquoted parts. Such assistance can be risky, as the Air Force then asserted defective pricing for alleged errors in this contractor summary prepared nearly a decade after the certification date. The ASBCA did not agree that "1993 reconciliation errors" had any connection to cost or pricing data certified in 1983. 04-1 BCA ¶ 32,556 at 161,018; see also *Muncie Gear Works, Inc.,* ASBCA No. 18184, 75-2 BCA ¶ 11,380 at 54,177 (no defective pricing for data unavailable until after contract award); *Rosemount, Inc.,* ASBCA No. 37250, 95-2 BCA ¶ 27,770 at 138,455 (contractor not required to create documents). Although the ASBCA has previously denied claims for data unavailable at the time of certification, this case appears to the first instance involving data not available until a decade after certification.

Offsets Upheld as Valid: Although DCAA had previously conceded offsets in excess of $153 million, the Air Force sought to disallow these offsets on two separate theories. First, the Air Force complained that the contractor had not preserved certain records for a portion of the engineering changes unrelated to the offsets. Upholding offsets as "a well-settled practice sanctioned by law," the

ASBCA concluded that it could not disregard evidence of offsets:

> For us to strike or to ignore such evidence – which is memorialized in DCAA audit reports and CO decisions as part of the AF's evidence before this Board – would constitute a Board-order sanction or penalty that we believe is unsupported by the Board's rules, the contract or the law.

04-1 BCA ¶ 32,556 at 161,027.

Second, the Air Force sought to disallow a $36 million "understatement" resulting from the contractor's deletion of the wrong part in an engineering change. In particular, the Air Force asserted nearly $19 million in defective pricing for one-half of the error (the part that should have been deleted), while disregarding $55 million in understatements resulting from the other half of the error (the part that was deleted twice). The ASBCA rejected the Government's "disparate treatment of overstatements and understatements arising from this single error" where the Government "relies only upon that aspect of the data error that is to its advantage" and "refuses to consider the countervailing effects of the double-deletion" resulting in understatements of price. 04-1 BCA ¶ 32,556 at 161,028; *see also Sparton Corp.,* 67-2 BCA ¶ 6539 at 30,379 (Government "may not choose one bit of defective data and close its eyes to other data and evidence which may represent the true state of the facts"). The ASBCA also found the Air Force's assertion of an "intentional" offset to be unproven. 04-1 BCA ¶ 32,556 at 161,028.

Initial Findings on Reliance: In its initial decision, the ASBCA found reliance upon the cost or pricing data even though the Air Force price analyst "did not review the cost or pricing data at this time, nor did the contracting officer or the DCAA." 04-1 BCA ¶ 32,556 at 161,011 and 161,026. This, and other, anomalies served as the basis for the later request for reconsideration.

The ASBCA Decision on Reconsideration—In March 2004, the Air Force sought reconsideration on approximately $30 million of alleged defective pricing relating to vendor quotes and material escalation. The contractor cross-moved for reconsideration of the ASBCA's findings relating to reliance. Upon further consideration, the ASBCA determined that the Air Force failed to prove reliance either during the initial competition in 1983 or during the subsequent rounds of competition for the remaining five years of the Fighter Engine Competition. *2005 WL 147601* (Jan. 21, 2005) at 3-5.

Non-Reliance During the Initial Competition: On reconsideration, the ASBCA drew a clear distinction between the contractor's initial August 1983 proposal (for which the Government apparently did review some cost data) and the December 1983 BAFO (for which the Government did not review the cost data at issue). *2005 WL 147601* (Jan. 21, 2005) at 2-3. This distinction proved to be pivotal because (1) Pratt's "BAFO price was considerably lower than initially proposed" (04-1 BCA ¶ 32,556 at 161,001); and (2) the defective pricing allegations related solely to Pratt's BAFO, not its initial proposal. 04-1 BCA ¶ 32,556 at 161,017, *2005 WL 147601* (Jan. 21, 2005) at 2-3.

The ASBCA's holding of non-reliance rested upon three major findings. First, the contractor "provided evidence—and we so found at findings 17 and 18—that neither the [DCAA], the AF price analyst, the [CO] nor the cost panel reviewed the BAFO cost or pricing data prior to award." *2005 WL 147601* (Jan. 21, 2005) at 3. Second, the Air Force's own instruction required documentation of "cost/price information relied upon" by the Government, but the Air Force did not document any such reliance. Id. Third, the Air Force failed to offer any evidence that anyone reviewed the BAFO cost or pricing data. Id. As the ASBCA summed it up, "[w]e are hard pressed to understand how the AF could have relied on BAFO cost or pricing data—defective or otherwise—that no one reviewed." Id. at 3-4.

In this competition, the Air Force did not need to rely upon the BAFO cost or pricing data because competition and the Government independent estimate validated the reasonableness of the BAFO prices. For example, the ASBCA found that "Pratt's BAFO was significantly *lower* than the Government's unconstrained MPC" and the Air Force "resolved this concern by considering the impact of competition." 04-1 BCA ¶ 32,556 at 161,012 (emphasis in original); see also id. at 161,026 ("The AF considered competition and the MPC [independent estimate] for sure."). In similar cases where the agency used price analysis to determine the reasonableness of prices, the ASBCA has often found lack of reliance on cost data. See, e.g., *General Dynamics Corp.,* ASBCA Nos. 32660-61, 93-1 BCA ¶ 25,378 at 126,396 (agency based position on independent review of contractor's records);

Luzon Stevedoring, ASBCA No. 14851, 71-1 BCA ¶ 8745 at 40,607 (no reliance due to "independent price analysis based on market conditions," coupled with a "complete disinterest in checking any cost"). Thus, the ASBCA's decision on reconsideration rests upon facts often found to be dispositive in prior decisions finding non-reliance upon cost or pricing data.

Non-Reliance During the Subsequent Competitions: As Secretary Orr told Congress, the Air Force did not cease the competition after the initial decision in February 1984, but instead proceeded to recompete the remaining five years of engine requirements between Pratt and GE. Each year, the Air Force requested improvements and received new offers from the competitors: "[Pratt] offered improvements in terms and conditions from its BAFO each year—in some years offering more generous improvements than others—with the hope of obtaining a larger share of the work each year." *2005 WL 147601* (Jan. 21, 2005) at 4. Each year, the Air Force evaluated the new offers and the Air Force Secretary made new decisions: "The AF evaluated the improvements offered by both competitors, and those improvements the AF decided to accept were considered by the source selection authority to determine the new allocation decisions each year." Id. During the post-award audit, an Air Force CO aptly summed up this process in correspondence with DCAA:

> "[T]his contract is very unique in that it is basically a perpetual competition using a split award technique decided by the [Air Force Secretary] annually. In this process, *the Contractor's originally submitted certified Cost or Pricing Data has been subjected to an annual Call for Improvements letter requesting improvements in prices as well as terms and conditions.* Over the years, dramatic improvements have been experienced in almost all areas." [Emphasis added]

Id. at 5 (emphasis in decision).

During each of these subsequent rounds of competition, the Air Force did not obtain new cost or pricing data in support of the revised offers. 04-1 BCA ¶ 32,556 at 161,016. Instead, the Air Force documented the prices as being "fair and reasonable" based upon "a market test between the competitors." *2005 WL 147601* (Jan. 21, 2005) at 4. Relying on these contemporaneous records and agency admissions, the ASBCA concluded that "competitive forces, rather than the defective 1983 BAFO cost or pricing data were relied upon to make the awards and to exercise the options for additional purchases for FYs 86-90." Id. at 5. Given such contemporaneous evidence of reliance upon competition, the ASBCA found the Air Force CO's "unsupported trial statements to the contrary" to be "unpersuasive." Id.

During the litigation, the Air Force argued that the 1983 BAFO cost data remained valid for exercising options for the remaining five years (Fiscal Years 1986-90). However, the governing regulations severed any possible reliance upon the 1983 cost data because the Air Force did not—and could not—exercise the original options relating to such cost data. First, the Air Force had to get new cost or pricing data (or rely upon competition) for these subsequent rounds of procurement unless the Air Force could show the "exercise of an option at the price established in the initial negotiation." Defense Acquisition Regulation (DAR) § 3-807.6(e) (1982). However, the ASBCA found that the Air Force did not exercise the original options: "With respect to the awards made, and the options exercised by the AF in the out years—FY 86 through FY 90—neither party disputes that the AF did not exercise these options at the same terms and conditions offered by appellant in the BAFO for these options." *2005 WL 147601* (Jan. 21, 2005) at 4. Second, even if the Air Force had attempted to exercise the original options, the regulations barred such an exercise unless a "market" investigation "indicates clearly that the option is the most advantageous offer obtainable." DAR § 1-1505(f)(3) (1983); see also 04-1 BCA ¶ 32,556 at 161,013 (CO "understood that the AF could not exercise the original BAFO options prices if they were not the most advantageous method of fulfilling the Government's need."). As the Air Force records showed and the ASBCA found, the Air Force not only received more "advantageous offers" during these subsequent competitions, but these new offers resulting from "competitive forces" represented "dramatic improvements" that superceded the original BAFO options. Thus, both the admitted facts and the governing regulations cut off any connection between these FY 1986-90 "Call for Improvement" competitions and the 1983 BAFO cost data.

Conclusion—The Great Engine War—the "finest competition" of Air Force Secretary Orr's tenure—provides an unusual context for one of the largest TINA cases in history. In sustaining the contractor's appeal in the first decision, the ASBCA

addressed a host of traditional defective pricing issues—such as disclosure, definition, and availability of cost or pricing data—and rejected the Air Force's efforts to stretch the scope of TINA in these areas. In the reconsideration decision, the ASBCA focused upon reliance and causation, finding that the agency could not establish reliance upon cost or pricing data with "unpersuasive" and "unsupported trial statements" contrary to the contemporaneous records showing validation of the prices based upon "the impact of competition" and "competitive forces." Now that more than two decades have passed since the beginning of the Great Engine War, perhaps the ASBCA's latest decision will bring peace to this historic competition.

This FEATURE COMMENT was written for THE GOVERNMENT CONTRACTOR by David Z. Bodenheimer, a partner at the law firm of Crowell & Moring LLP in Washington, D.C. Mr. Bodenheimer, who specializes in Government contracts, participated in litigating this matter on behalf of the contractor.