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FEATURE COMMENT: 2019's Defective Pricing Forecast: Gusty Audits, Frozen Sweeps, And TINA Hail

As 2018 winds down, the new year brings a host of fresh opportunities: winning proposals, expanding contracts, and growing business. But just like tomorrow's weather, these opportunities may suddenly turn into defective pricing audits, final decisions, and even fraud actions. So what does the 2019 defective pricing forecast look like? Here are five predictions:

- *Audits without scrutiny*: Too many defective pricing audits will be rubberstamped, resulting in avoidable final decisions and litigation.
- *Defective pricing with fraud*: Too many garden-variety audits will be escalated into fraud suits, often without a sound basis for defective pricing.
- *Sweeps in a hurry*: The Pentagon chill on sweeps will lead to hurried certifications and more audits, sprouting more defective pricing disputes.
- *Thresholds with confusion*: Primes and subcontractors will continue to puzzle over when the $2 million threshold applies to older pricing actions.
- *Litigation without decisions*: More final decisions will issue—and then fall apart during litigation, leaving us with one new defective pricing precedent.

This *Feature Comment* addresses (1) the need for contracting officers to scrub defective pricing audits with vigor, (2) the risks to agencies and contractors of parallel defective pricing and fraud proceedings, (3) the drastic impact of clamping down on sweeps, (4) the need for a uniform threshold under the Truth in Negotiations Act (TINA), and (5) the reason that more final decisions will crash and burn before trial.

Audits without Scrutiny—With distressing frequency, auditors lacking TINA experience issue audits to COs who never worked TINA issues. In defective pricing litigation, the testimony typically unfolds like this:

> Q. Have you worked on any defective pricing audits prior to the one before us today?
>
> A. No, I have not.
>
> Q. Have you been involved in any defective pricing litigation before this one?
>
> A. No, I have not.

The effect is predictable: The auditors will often take positions contrary to settled TINA law—and the COs tend to accept them at face value.

Contracting Officer as Gatekeeper: Although inexperience may tempt COs to take audit recommendations without reservation, the law imposes a higher standard. For example, the regulations require the CO to make independent assessments about such basic facts as reasonable availability and submission of cost or pricing data, as well as reliance upon such data and offsets reducing any defective pricing. Federal Acquisition Regulation 15.407-1(b)(2), (4), (d).

For a final decision, the Contract Disputes Act (CDA) requires the CO to not only make the Government's claim, but also "to state the reasons for the decision itself." 41 USCA 7203(a)(3), (e). In this capacity, the CO serves in a "quasi-judicial capacity." *U.S. v. BAE Sys. Tactical Vehicle Sys., LP*, 2017 WL 1457493 (E.D. Mich. Apr. 25, 2017); *Space Age Eng'g, Inc.*, ASBCA 26028, 82-1 BCA ¶ 15766. To do the job right, the CO must "put his mind to the problems and render his own decisions." *Fireman's Fund Ins. Co. v. U.S.,* 92 Fed. Cl. 598, 696 (2010). In short, COs cannot fulfill this statutory and regulatory duty by rubberstamping the audit recommendations.

Contractor's Due Process: By law, the CO has a duty to give the contractor an opportunity to respond to defective pricing allegations. FAR 15.407-1(d). As

a practical matter, contractors must seize this opportunity and respond vigorously before final decisions make litigation inevitable. Nonetheless, 2019 will be marked by some missed opportunities by both COs and contractors, resulting in defective pricing litigation that could have been avoided with some upfront work scrubbing the audit.

Defective Pricing and Fraud—All too often, defective pricing audits turn sour, generating both a CDA dispute and a parallel False Claims Act (FCA) investigation or suit.

Risks to the Contractor: In its audit guide, the Defense Contract Audit Agency tells auditors to be alert for fraudulent defective pricing. DCAA Contract Audit Manual (DCAM) 14-121. Per this manual, fraud indicators include persistent defective pricing, uncorrected systems deficiencies, undisclosed knowledge of cost reductions, and even "Repeated use of unqualified personnel." DCAM 14-121.2. Similarly, the Department of Justice sometimes treats garden-variety defective pricing as a false TINA certificate, thus starting an FCA investigation or litigation and exposing the contractor to treble damages and penalties. In such cases, the contractor may be battling a two-front war with parallel CDA and FCA litigations.

Risks to the Government: While the Government may gain heavy leverage with overlapping CDA and FCA defective pricing actions, such strategies also come with risks.

- *Layered Burdens of Proof*: In an FCA action, DOJ will need to prove not only the basic elements of its FCA claim, but also the underlying elements of defective pricing. See, e.g., *U.S. ex rel. Thacker v. Allison Engine Co.,* 471 F.3d 610, 626 (6th Cir. 2006), *rev'd on other grounds*, 553 U.S. 662 (2008) (data at issue did not qualify as "cost or pricing data").
- *Disjointed Litigations*: If the CO withdraws the final decision for lack of merit, the FCA action based on the same facts may collapse as well. *U.S. v. BAE Sys. Tactical Vehicle Sys., LP,* 2017 WL 1457493 (E.D. Mich. Apr. 25, 2017).
- *Dispositive Judicial Findings*: Even if not given preclusive effect, a judicial finding in a CDA defective pricing decision may choke off DOJ's arguments in an FCA suit. See *Wynne v. United Techs. Corp.*, 463 F.3d 1261, 1263 (Fed. Cir. 2006) (no defective pricing based on competitive pricing);48 GC ¶ 338; *U.S. v. United Techs. Corp.*, 782 F.3d 718, 731-34 (6th Cir. 2015) (FCA damages limited by fair market value and competitive pricing); 57 GC ¶ 115.

Despite these risks, the lure of treble damages flowing from "false" TINA certificates will continue to tempt DOJ into bringing risky FCA suits on top of CDA actions in 2019.

Sweeps in a Hurry—On June 7, the Department of Defense's Defense Pricing Director reversed more than three decades of DOD policy by effectively killing sweeps—*i.e.,* a contractor's submission of cost or pricing data concurrently with—or after—the date of price agreement. See DOD Director of Defense Pricing memorandum ("Reducing Acquisition Lead Time by Eliminating Cost or Pricing Data Submissions After Price Agreement ('Sweep Data')).'' In this drastic policy shift, DOD now requires COs to demand a TINA certificate within five business days after price agreement. For any cost or pricing data submitted after price agreement, DOD tells COs to defer consideration until the post-award audit:

> Contracting Officers shall defer consideration of the impact of any cost or pricing data submitted by a contractor after price agreement is reached until after award of the contract action in order to avoid delays in awarding the contract. Any cost or pricing data submitted after price agreement shall be reviewed and dispositioned after award of the contract action, pursuant to FAR 15.407-1, to establish whether it is rendered that the certified cost or pricing data submitted up to the point of price agreement was defective, and to determine whether the Government is entitled to a price adjustment in accordance with FAR 52.215-10 or FAR 52.215-11.

Aside from offering no supporting data for this policy reversal, DOD's anti-sweep policy comes down on the wrong side of administrative and TINA law.

Scrutiny for Policy Reversals: Acquisition lead time has been a thorn in the DOD procurement process for decades—and well before "sweeps" became commonplace in the 1980s and 1990s. Once contractors began regular sweeps, DOD issued a policy directive telling its COs to accept such data. For example, the December 2017 version of the DCAM states:

> It is DoD policy to accept certified cost or pricing data after agreement on price but before contract award, if the data existed before agreement on price or, if applicable, another date agreed upon between the parties that is close as practicable to the date

of agreement on price. See 14-120.4 on Defective Pricing "Sweeps."

DCAM 14-105.5(a). While agencies may change policy, the courts apply tougher scrutiny when an agency reverses course. As the Supreme Court has stated, "an agency changing its course by rescinding a rule is obligated to supply *a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance*." *Motor Vehicle Manu. Assoc. v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 29, 42 (1983) (holding the agency's actions to be "arbitrary and capricious" where the agency failed to explain the basis for rescinding its prior position) (emphasis added). Other than a conclusory assertion about acquisition lead time, DOD's anti-sweep memo offers virtually no support for reneging on its multi-decade approval of the sweep process.

TINA Law to Contrary: Ironically, DOD's new attack on sweeps may backfire in defective pricing disputes. When the Government learns of defective data prior to award, such knowledge may refute a critical element of proof—*i.e.,* detrimental reliance upon such data. See, e.g., *Texas Instruments, Inc.*, ASBCA 30836, 89-1 BCA ¶ 21,489 at 108,269 (rejecting defective pricing claim where contractor informed CO of error in proposed G&A rate three days after price agreement); *Ocean Technology, Inc.*, ASBCA 21,363, 78-1 BCA ¶ 13204 at 64,585 ("if the contracting officer, prior to the finalization of a modification, determines that the cost or pricing data is inaccurate, he shall negotiate on the basis of the new data"). But DOD's policy switch does not acknowledge this long-standing law requiring consideration of data disclosures even after price agreement.

Thresholds with Confusion—In a positive development, Congress raised the TINA threshold to $2 million for many pricing actions. See 2018 National Defense Authorization Act for Fiscal Year 2018 (P. L. 115-91 for Fiscal Year 2018) § 811.

New Contracts and Subcontracts: For prime contracts awarded after June 30, 2018, the $2 million threshold applies to both the prime contract itself and subsequent modifications, as well as subcontracts awarded under that prime contract after July 1, 2018. 10 USCA 2306a(a)(1)(A)(i), (B)(i), (C)(i).

Old Contracts and New (or Old) Modifications: For prime contracts awarded on or before June 30, the $750,000 threshold governs not only the prime contract, but also all of the prime's modifications—even if some modifications occurred after June 30. 10 USCA 2306a(a)(1)(A)(ii), (B)(i), (B)(ii).

Old Contracts and New Subcontracts: For prime contracts awarded on or before June 30, 2018, Congress carved out an exception for subcontracts awarded after July 1, 2018. In such cases, a prime contractor need only to request the $2 million threshold for new subcontracts and subcontract modifications and the agency has no choice but to modify the prime contract to reflect the $2 million threshold for subcontractors. 10 USCA 2306a(a)(1)(C)(ii), (D)(i), (a)(6).

Impact on Defective Pricing: Given that a CO cannot bring a defective pricing action directly against a subcontractor, the prime contractor bears the brunt of any ensuing TINA litigation. See, e.g., *Lockheed Aircraft Corp., v. U.S.*, 432 F.2d 801, 806 (Ct. Cl. 1970). For this reason, prime contractors have a powerful incentive to request the $2 million threshold for subcontracts awarded after July 1. Given the mandatory TINA language (i.e., the agency "shall modify the contract"), any agency refusal to update the TINA threshold would be unlawful. Similarly, once the prime contractor makes the request for the $2 million threshold, any defective pricing action involving subcontracts or modifications below $2 million would presumably be illegal. Cf. *Beta Systems, Inc. v. U.S.*, 838 F.2d 1179, 1185 (Fed. Cir. 1988) (refusing to enforce agency's position where economic price adjustment clause violated the governing regulation). In other words, prime contractors that seek the higher threshold will reduce their exposure for subcontractor defective pricing, while prime contractors that stick with the old subcontractor threshold will open the door to defective pricing audits in 2019 and beyond.

Litigations without Decisions: The bulk of TINA precedent comes from a thirty-year period between the mid-1970s and 2005. While judicial guidance has been sparse during the past 10 years, no one should assume that the auditors' hands have been idle on defective pricing. To the contrary, too many TINA audits have metastasized into final decisions and Board appeals in the last five years.

Decided Appeals: In cases decided by the Boards in the last five years, the Government has not fared well. See, e.g., *Symetrics Indus., LLC*, ASBCA 59297, 15-1 BCA ¶ 36,070 (finding no defective pricing where agency failed to prove nondisclosure of updated rates); *Lockheed Martin Aeronautics Co.*, ASBCA 56547, 13 BCA ¶ 35,220 at 172,815 (holding that Government failed to prove increased prices or damages).

Withdrawn Final Decisions: In other cases, the Government proceeded with a final decision, but withdrew it when the agency lawyers and COs could not back up the defective pricing claims. *BAE Sys. Tactical Vehicle Sys. LP*, ASBCA 59491, 17-1 BCA ¶ 36585; *The Boeing Co.*, ASBCA 58976, 2014 WL 7260702 (Dec. 9, 2014).

Resolution without Litigation: As fewer COs have any TINA experience with audits or litigation, the need to resolve defective pricing disputes without litigation takes on even greater importance. As a core legislative purpose, the CDA sought "to induce resolution of more contract disputes by negotiation prior to litigation." S. Rep. No. 95-1118 (1978). The FAR reinforces this obligation for COs to seek resolution rather than litigation:

> The Government's policy is to try to resolve all contractual issues in controversy by mutual agreement at the contracting officer's level. Reasonable efforts should be made to resolve controversies prior to the submission of a claim.

FAR 33.204. Contractors can greatly assist this process by responding promptly and firmly to draft audit reports, thus providing the CO with a stronger record and rationale for turning down unsupported defective pricing allegations. Tighter controls on the front end of the defective pricing process can save both the Government and contractors from fruitless litigation that serves the interests of no one.

While not a prediction, here's to a 2019 with more pre-litigation scrutiny on defective pricing audits.

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