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The Clause

A Quarterly Publication of the Boards of Contract Appeals Bar Association, Inc.

The President's Column

Dear BCABA Members:

Welcome to the September 2012 edition of *The Clause*. As usual, Pete McDonald has assembled a variety of timely and interesting articles for government contracts practitioners. We hope that you enjoy this edition.

Since the last edition, the BCABA co-sponsored its annual summer reception for the boards of contract appeals judges. The reception included a panel discussion with Judge Allan Goodman of the CBCA, Judge Sharon Larkin of the GAO CAB, Chief Judge Paul Williams of the ASBCA, and moderated by Susan Ebner. Panelists discussed their respective career paths as government contracts practitioners. The event drew both judges from the boards of contract appeals and government and private practice lawyers, as well as law students and summer interns with an interest in government contracts. Attendees mingled after the reception over gelato and cappuccino, which allowed those interested in a career in government contracts to speak with judges and lawyers about prospective career opportunities. Thanks again to all those who participated, particularly to the judges who spoke on the panel.

The BCABA's next event is our annual program, to be held on **October 24th** at the Renaissance M Street Hotel. Judge Gary Shapiro of the PSBCA has assembled a (*continued on page 3*)

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President's Column (cont'd):

fantastic program including a variety of panel discussions of interest to members of the government contracts bar. We are honored to have Professor Ralph C. Nash, Jr. of George Washington University Law School as our luncheon speaker. The annual program is a highlight of the BCABA's yearly offerings, and we hope that you will attend.

Please look for future announcements regarding the BCABA's executive policy forum, to be held in the Fall, as well as other BCABA events. I look forward to seeing each of you at a BCABA event.

Best regards,

Francis "Chip" Purcell
President
BCABA, Inc.

Annual Meeting Announcement

The BCABA is excited to host its annual conference at the **Washington Renaissance DuPont Circle Hotel** on **October 24, 2012**. As you have come to expect, we anticipate a full day of discussions of timely issues of interest to our membership on a variety of topics. New this year will be a review of selected BCA decisions from the last year. We are pleased to announce that Professor Ralph Nash has agreed to speak during the lunch (which is included with the conference fee), and that Professor Daniel Gordon has agreed to lead a session about government contract litigation from a different perspective. Registration materials are included in the next pages of this issue, and may be found on BCABA's website (www.bcaba.org). For more information, please contact Judge Gary E. Shapiro at 703-812-1900.

BCABA ANNUAL PROGRAM

October 24, 2012

Renaissance M Street Hotel
1143 New Hampshire Avenue, NW
Washington, D.C 20036

8:30-9:00 Registration

Welcoming Remarks: Francis E. Purcell, Jr. (Cooley, LLP), President, BCABA, Inc.
Hon. Gary E. Shapiro (PSBCA), Vice-President and Program Chair

9:00 - 10:00 LEGAL ISSUES INVOLVING SUBCONTRACTING IN BOARD AND COURT LITIGATION

The panel will discuss from all relevant perspectives topics related to the relationship between prime contractors and subcontractors, including how that relationship impacts claims presented to the boards of contract appeals.

Panel Chair/Moderator: Thomas Mason, Partner, Cooley, LLP

Panelists: Chief Judge Paul Williams, ASBCA (invited)**; Rodney Grandon**, Esq., U.S Coast Guard; **Peter Johnsen,** Esq., Corporate Counsel, Federal Services, URS Corporation; **Christopher J. Kimball**, Esq., Cooley LLP

10:00 -11:00 PRACTICAL COMPARISON OF BID PROTESTS AT THE GAO AND COURT OF FEDERAL CLAIMS

Panelists will compare and contrast the procedures, dynamics, practices, and tactics of bid protest litigation at the U.S. Government Accountability Office and the U.S. Court of Federal Claims.

Panel Chair/Moderator: David Black, Partner, Holland & Knight

Panelists: Hon. Thomas C. Wheeler, Judge, U.S. Court of Federal Claims; **Sharon L. Larkin**, Assistant General Counsel, Government Accountability Office; **Jonathan D. Shaffer**, Partner, Smith Pachter McWhorter PLC; **Kathleen Martin**, Attorney Adviser, U.S. Department of State, **William J. Grimaldi**, Trial Attorney, Dept. of Justice

11:00-11:15 BREAK

11:15-12:15 WHAT JUDGES AND LAWYERS DO: PERSPECTIVE OF NON-ATTORNEYS IN THE ACQUISITION WORKFORCE AT AGENCIES

Senior agency officials will discuss how non-attorneys in the acquisition workforce view what attorneys do, from decisions of the Boards, the Courts, and GAO, to the drafting of regulations, to day-to-day collaboration.

Panel Chair/Moderator: Daniel I. Gordon, Associate Dean for Government Procurement Law, GWU Law School

Panelists: Hugh Hurwitz, Assistant Inspector General for Management and Planning, NASA; **Debra E. Sonderman**, Director, Office of Acquisition and Property Management, Department of the Interior; **Laura Auletta**, Director, Office of Government wide Acquisition Policy, GSA; **Barry E. Berkowitz**, Director, Office of Acquisition Management, Department of Commerce

12:15 - 1:30 LUNCHEON

Speaker: Ralph C. Nash, Jr., Professor Emeritus, Government Procurement Law, George Washington Univ. Law School

(*continued on next page*)

1:30 - 2:45 BCA JUDGES PANEL

Board Judges will discuss the special challenges involved in litigating unusually large, long, or complex cases before the Boards of Contract Appeals. The panel will relate best practices, pointers, and lessons learned from their past experience with "The Big Case."

Panel Chair/Moderator: Donald M. Yenovkian, Director, Acquisition ADR Program, Office of Army General Counsel

Panelists: Judge Cheryl L. Scott, ASBCA; **Judge Anthony Borwick**, CBCA; **Chief Judge Marc D. Loud, Sr**., DCCAB; **Judge Peter F. Pontzer**, PSBCA

2:45-3:00 BREAK

3:00-4:00BCA DECISIONS: YEAR IN REVIEW

Panelists WILL discuss significant decisions from the Boards of Contract Appeals in the past year. Inspired by BCA case digests included in *The Clause*.

Panel Chair/Moderator: Ryan Roberts, Sheppard Mullin Richter & Hampton LLP

Panelists: Thomas H. Gourlay, Jr., Chief Trial Attorney, U.S. Army Corps of Engineers; **Louis D. Victorino**, Partner, Sheppard Mullin Richter & Hampton LLP; **Susan Warshaw Ebner**, Asmar, Schor & McKenna, PLLC

4:00-4:30 BCABA, INC. ANNUAL MEETING

BCABA ANNUAL PROGRAM

REGISTRATION FORM

Registration Deadline*: *October 12, 2012

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Title: ____________________________

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Address:____

City, State, Zip:___________________________________

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Email Address:____

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gary.e.shapiro@usps.gov

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BCABA MEMBERSHIP DISCOUNT

Add just $10 to the program fee, and you will receive BCABA membership for 2012-2013. *(Regular membership for those not attending the program is $45 for private practice attorneys and $30 for government employees.)*

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Gold Medal Firm Attendees	$175
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Law Students (registered in advance)	$ 50

BCABA ANNUAL PROGRAM

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If you wish to pay for the BCABA Annual Program registration fee(s) and/or membership due(s) __by credit card__ (VISA or Master Card only) *in lieu of check*, please provide the following information:

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Bored of Contract Appeals
(a.k.a. The Editor's Column)

by
Peter A. McDonald
C.P.A., Esq.
(A nice guy . . . basically.)

Leading this issue are Mike Davidson's highlights about the dangers of bad advice related to mandatory disclosures, while Tamir Damari discusses the current issues in intellectual property (IP) under government contracts. Don Carney and John Henault tackle the difficult problems involving the intent element under FCA cases related to TINA violations. Finally, Dave Metzger, Kate Cloonan and myself advise contractors about preparing for the period of budget austerity we are about to enter.

The annual meeting is coming next month, and I look forward to seeing many of you there. One high point is the awards presentation at the end of the luncheon. To add sparkle to this event, a few years ago I recommended to the BCABA Board that awards also be presented for the following categories: "Sleepiest Judge"; "Worst Dressed Attorney (Government)"; "Worst Dressed Attorney (Law Firm)"; and "Most Obnoxious Pro Se." As usual, however, the BCABA Board failed to see any merit in my suggestions . . .

The Clause will reprint, with permission, previously published articles. We are also receptive to original articles that may be of interest to government contracts practitioners. But listen, everybody: Don't take all this government contract stuff too seriously — Get a life. In that regard, we again received some articles that were simply unsuitable for publication, such as: "Drones Follow Pete!"; "ASBCA Receives Error-Free Transcript!!"; and "Pete Wins BCABA Air Guitar Contest!!!"

Reminder of Cheap Annual Dues

This is to remind everyone about the BCABA, Inc., dues procedures:

- ☺ Dues notices will be emailed on or about **August 1st**.
- ☺ Annual dues are **$30** for government employees, and **$45** for all others.
- ☺ Dues payments are due NLT **September 30th**.
- ☺ There are no second notices.
- ☺ Gold Medal firms are those that have all their government contract practitioners as members.
- ☺ Members who fail to pay their dues by September 30th do not appear in the Directory and do not receive *The Clause*.
- ☺ Members are responsible for the accuracy of their information in the Membership Directory, which is maintained on the website.

Bad Advice on Mandatory Disclosure

by

*Michael Davidson**

In what has been characterized as a "sea change" from the earlier federal policy of encouraging contractor voluntary disclosure of misconduct,[1] the federal government imposed mandatory disclosure requirements on contractors and subcontractors. Many contractors will rely on the advice of their attorneys when implementing the mandatory disclosure requirements of the Federal Acquisition Regulation (FAR), including determining whether credible evidence exists to trigger a disclosure. Corporate or outside counsel may conduct time-consuming internal investigations into possible misconduct by corporate employees and may ultimately recommend that a corporate client not disclose the alleged misconduct because of insufficient evidence or because, as a matter of law, no reportable violation occurred.

An agency suspension and debarment official (SDO) may challenge a contractor's determination that the available evidence was not "credible" so as to require disclosure, question the timeliness or completeness of a disclosure, or disagree with a contractor's legal position that disclosure was not required because the facts did not implicate a significant overpayment or show a violation of Title 18 or the civil False Claims Act (FCA). When this occurs, the contractor may need to defend its actions by pointing to the advice it received from counsel.

Well established in other areas of the law, an advice of counsel defense is new to the world of suspension and debarment. In suspension or debarment proceedings where the contractor's present responsibility is called into question because it relied on questionable (or bad) legal advice concerning its disclosure obligations, the attorney's advice may likely be offered to explain or excuse a contractor's inaction. Invoking the advice of counsel defense does not come without cost, however, because invoking the defense traditionally results in waiver of the attorney-client privilege and certain attorney work product.

The Mandatory Disclosure Rule: An Overview

On November 12, 2008, the FAR was amended to impose certain mandatory disclosure requirements involving fraud and overpayments on contractors and subcontractors, effective December 12, 2008.[2] The disclosure requirements apply to contracts worth more the $5 million with a performance period greater than 120 days,[3] including commercial item procurements and contracts and subcontracts performed overseas.[4]

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Bad Advice on Mandatory Disclosure (cont'd):

Specifically, FAR 52.203-13 requires the timely disclosure, based on credible evidence, of any "violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code" or a violation of the civil FCA, 31 U.S.C. §§3729–3733, committed by any contractor "principal, employee, agent, or subcontractor."[5] Disclosure must be made, "in writing, to the agency Office of the Inspector General (OIG), with a copy to the Contracting Officer."[6] Generally, the disclosure should be made to the OIG/CO of the agency that awarded the contract, but if the disclosure relates to multiple contracts the disclosure should follow the money and be made to the OIG/CO whose agency has the largest dollar value contract.[7] If the disclosed violation relates to an order against any multiagency procurement vehicle (e.g., Federal Supply Schedule), the contractor must notify both the OIG/CO of the ordering agency and the agency responsible for the basic contract.[8] Changes to the FAR impose a three-year reporting requirement, measured from the date of "final payment on a contract."[9]

Unfortunately, the term "credible evidence" is undefined. The FAR Councils, however, have offered some guidance, noting that the "term indicates a higher standard [than reasonable grounds to believe], implying that the contractor will have the opportunity to take some time for preliminary examination of the evidence to determine its credibility before deciding to disclose to the Government."[10] Further, the FAR Councils pointed out that until the contractor has had an opportunity to determine if credible evidence exists, "there can be no 'knowing failure to timely disclose.'"[11]

The FAR's suspension and debarment provisions were also amended to establish a mandatory reporting requirement for significant overpayments, "other than overpayments resulting from contract financing payments as defined in FAR 32.001, Definitions."[12] The FAR change was linked to the requirement, contained for years in several payment clauses, "to immediately notify the contracting officer if the contractor becomes aware of any overpayment on a contract financing or invoice payment."[13] The FAR Councils excluded contract financing payments as defined in FAR 32.001 under the rationale that "these ongoing payments that are not the final payments on a contract are often based on estimates, and are subject to correction as the contract progresses."[14] The FAR Councils posited that the mandatory disclosure rule was "aimed at the type of overpayment that the contractor knows will result in unjust enrichment, and yet fails to disclose it."[15]

Although the term "significant overpayment" is undefined, the FAR Councils noted that the term covers something more than "routine contract payment issues," and envisions some form of "a materiality requirement."[16] Significant overpayment "implies more than just dollar value and depends on the circumstances of the overpayment as well as the amount."[17] Reasoning that contractors are required to report any overpayment, the FAR Councils left it to the relevant agency suspension and debarment official to determine if an overpayment was "significant" and, if so, whether further administrative action is appropriate.[18]

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Bad Advice on Mandatory Disclosure (cont'd):

"Full Cooperation" Required

For contracts valued over $5 million with a performance period of 120 days or more, FAR 52.203-13, Contractor Code of Business Ethics and Conduct, also requires "[f]ull cooperation with any Government agencies responsible for audits, investigations, or corrective actions."[19] FAR 52.203-13(a) defines "full cooperation" as "disclosure to the Government of the information sufficient for law enforcement to identify the nature and extent of the offense and the individuals responsible for the conduct. It includes providing timely and complete response to Government auditors' and investigators' request for documents and access to employees with information." The FAR does not, however, require a contractor to foreclose any legal, regulatory, or contractual rights it may have; waive the attorney-client privilege or attorney work product doctrine; or require that any individual waive any attorney-client privilege or Fifth Amendment rights. Nor does it preclude a contractor from conducting an internal investigation or otherwise restrict the contractor from defending itself in any associated legal or administrative proceeding.[20]

The FAR Councils noted that such disclosure exceptions "should not be used as an excuse by a contractor to avoid disclosing facts required by this rule."[21] The final rule specifically emphasized that the underlying facts are not privileged and that a corporation has no Fifth Amendment rights.[22] Further, the FAR Councils expected contractors to encourage their employees to cooperate with a government investigation, not take steps to block the access to information of government auditors and investigators, and to provide a timely and thorough response to any reasonable government request for documents.[23]

No Lost Incentives

Some commentators to the proposed rule were concerned that various incentives for voluntary disclosure would be lost, such as "favorable consideration in debarment proceedings," the ability to foreclose future qui tam lawsuits, favorable treatment under the US Sentencing Guidelines, and positively influencing Department of Justice charging decisions.[24] On a positive note for contractors, the FAR Councils rejected concerns that the mandatory nature of disclosures would preclude contractors from taking advantage of previous incentives for voluntary disclosure. Specifically, the FAR Councils posited: "There is nothing in this rule that removes any of the existing incentives."[25] In addition, the FAR Councils noted that the incentives contained in the FAR's debarment procedure and in the sentencing guidelines only required "disclosures," rather than "voluntary disclosures," and further opined that the earlier incentives would remain available "to promote compliance."[26] For purposes of debarment, the normal SDO consideration of mitigating factors under FAR 9.406-1(a) is unaffected "and a contractor's timely disclosure to the Government will continue to be a mitigating factor."[27]

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Bad Advice on Mandatory Disclosure (cont'd):

Suspension and Debarment: Adding Teeth to the Rule

The rule's enforcement teeth are contained in the suspension and debarment provisions. The knowing failure by a principal to disclose credible evidence of applicable Title 18 criminal and civil FCA violations, and significant overpayments, "in connection with the award, performance, or closeout of a Government contract performed by the contractor or subcontractor," constitute grounds for suspension and debarment.[28] At least for violations of Title 18 and the civil FCA, a contractor may be suspended or debarred for violating the mandatory disclosure requirements even if FAR 52.203-13 is inapplicable.[29]

The mandatory disclosure rule places the reporting requirement on a "principal," which FAR 52.203-13(a) defines broadly as "an officer, director, owner, partner, or a person having primary management or supervisory responsibilities within a business entity (e.g., general manager; plant manager; head of a division or business segment; and similar positions)."[30] The FAR Councils concurred with the concern of at least one commentator that, for purposes of suspension and debarment, a contractor's knowledge should not be determined through the doctrine of respondeat superior, which provides that knowledge of criminal misconduct by an employee may be imputed to the corporate entity.[31]

Placement of the reporting requirement on a contractor's principal would appear to preclude the contractor from receiving credit for employee reports of misconduct directly to the government when such reports are not rendered on behalf of the contractor, either directly to law enforcement agents or through qui tam actions. Indeed, during the period that a qui tam is under seal, the contractor will not likely even know that the disclosure of alleged misconduct occurred.[32]

Given that the FAR Councils anticipated that a contractor will conduct an investigation to determine if credible evidence exists,[33] the timeliness of a disclosure should serve as a relatively infrequent basis for suspension or debarment. The FAR Councils did envision at least one such circumstance warranting action; that is, when "the Government independently discovers that there has been a significant overpayment, a violation of the civil FCA, or a violation of Federal criminal law to be disclosed, that the Contractor knew about and elected to ignore."[34] Even then, the FAR Councils believed it "unlikely" that the government would take such action absent a determination that the contractor had actually violated criminal law or the civil FCA or that a significant overpayment occurred.[35] An agency SDO may take a contrary view, however, of the present responsibility of a contractor that receives information of a possible violation, but follows a path of deliberate ignorance and elects not to investigate.

The Advice of Counsel Defense

Recognized by the United States Supreme Court since 1908, the advice of counsel

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Bad Advice on Mandatory Disclosure (cont'd):

defense is not a stand-alone defense; instead it is used to show a party's good faith and to negate the requisite mental state of the relevant crime,[36] and potentially certain civil or administrative actions. In the criminal context, the defense is limited to negating willfulness and specific intent.[37] The defense is further unavailable when the attorney actively participates in the charged misconduct[38] or when the attorney provides general advice rather than having advised "the specific course of action with which the accused is charged."[39] Reliance on the advice must also be reasonable.[40] The defense will not shield a party who knows or should know that the advice is bad.[41]

Cases in various civil and administrative contexts reflect a mixed application of the defense. It has been offered to negate willfulness in patent infringement cases,[42] and it has been used to negate other forms of mens rea below willfulness and specific intent. For example, in *Johnson v. Rauland-Borg. Corp*. an employer in a Title VII case involving alleged sexual harassment by a superior, was permitted to present the testimony of outside counsel hired to investigate the allegations in an effort to establish that the employer took reasonable action once informed of the alleged harassment.[43] In *Farias v. Instructional Systems, Inc*., however, the appellate court upheld the lower court's determination that the advice of counsel defense was not available in a discrimination case.[44]

In what has been described as "a rare decision accepting the so-called 'advice of counsel' defense" in a qui tam case, a federal court dismissed an FCA case against a physician who had received legal advice on compliance with Medicare's regulatory requirements, holding that, based on the advice of counsel, he had not *knowingly* submitted false Medicare claims.[45] In contrast, courts in attorney discipline cases generally reject the defense as a bar to discipline and limit its application to a mitigating circumstance when determining the appropriate sanction.[46]

The traditional elements of the defense are: "(1) full disclosure of all pertinent facts to counsel, and (2) good faith reliance on counsel's advice."[47] In the Seventh Circuit, however, the elements of the defense are more exacting. There, the defendant must show:

> "(1) before taking action (2) he in good faith sought the advice of an attorney whom he considered competent, (3) for the purpose of securing advice on the lawfulness of his possible future conduct, (4) and made a full and accurate report to his attorney of all material facts which the defendant knew, (5) and acted strictly in accordance with the advice of his attorney who had been given a full report."[48]

Generally, invoking an advice of counsel defense results in the waiver of the attorney-client privilege.[49] One rationale for this waiver is that the party has placed the advice at issue.[50] The waiver extends to "all otherwise privileged communications on the subject of the advice,"[51] and may also extend to other attorneys who provided advice on the same matter.[52] Moreover, a

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Bad Advice on Mandatory Disclosure (cont'd):

party invoking the advice of counsel defense cannot use the attorney-client privilege as both a sword and as a shield, disclosing some communications and concealing others.[53] In addition, courts have determined that invoking an advice of counsel defense may result in the waiver of certain attorney work-product, including any relied-upon legal advice that was communicated to the defendant.[54]

Application of the Defense in the Mandatory Disclosure Context

Prior to the mandatory disclosure rule with its attendant exposure to suspension or debarment, there were few occasions when a contractor would need to point to the legal advice it received when explaining its actions to a SDO. Usually, a contractor is subject to suspension or debarment because of some form of misconduct it was alleged to have committed or poor performance it rendered. Indeed, the factors considered when making a debarment determination, as described in FAR 9.406-1(a), do not mention reliance on advice of counsel.

In the suspension and debarment context, however, the FAR does contemplate several situations when a contractor would likely rely on legal advice. For example, the FAR views favorably the release of information regarding its investigation of alleged misconduct to the SDO. Indeed, FAR 9.401-1(a)(3) states: "Whether the contractor has fully investigated the circumstances surrounding the cause for debarment and, if so, made the result of the investigation available to the debarring official." Similarly, when crafting the mandatory disclosure rule, the FAR Councils anticipated that a contractor would conduct an internal investigation to determine if the requisite credible evidence existed, thereby triggering a disclosure obligation.[55] Often, such investigations are conducted by in-house or outside counsel.

In addition, the FAR Councils recognized that there may be occasions when a legitimate factual or legal dispute, including conflicting judicial interpretations, exists as to whether the civil FCA[56] has been violated. In response to the concerns of several commentators, the FAR Councils stated: "Genuine disputes over the proper application of the civil FCA may be considered in evaluating whether the contractor knowingly failed to disclose a violation of the civil FCA." Such disputes over violations of the civil FCA will most commonly be raised by attorneys.

The applicability of the advice of counsel defense in the suspension and debarment context will likely be a question of first impression for most SDOs. Because a violation of the mandatory disclosure rule only requires a "knowing" violation, an SDO would not likely be required to entertain an advice of counsel defense, but would appear to have the discretion to do so. In doing so, the SDO would presumably require the contractor to establish the traditional elements of the defense and further make an independent assessment as to whether reliance on the legal advice was reasonable.

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Bad Advice on Mandatory Disclosure (cont'd):

Additionally, an SDO should be able to require waiver of the attorney-client privilege and of relevant attorney work-product to preclude a contractor from unfairly using the attorney-client privilege as both a sword and shield. A contractor should not be able to disclose some privileged material and withhold other potentially damaging material when responding to a challenge that the contractor failed to make a full and/or timely disclosure. When a contractor relies on the legal advice it received concerning its disclosure obligations, the substance of the communications between contractor and attorney are now at issue and a contractor may no longer selectively maintain the confidentiality of those communications.

Conclusion

The FAR's mandatory disclosure obligations create potentially fertile ground for a contractor to invoke an advice of counsel defense when an SDO challenges the contractor's failure to make a full and/or timely disclosure under the rule. Establishing that the contractor reasonably relied on its attorneys' advice in good faith, after full disclosure of relevant facts, may serve to excuse or explain any real or perceived disclosure deficiencies and to establish the contractor's present responsibility. Bad legal advice may also contribute to the suspension/ debarment decision, or its length, such as counseling a contractor against cooperating with the government during its investigation or fully participating or cooperating in the administrative debarment proceeding. Under such circumstances, an advice of counsel defense may serve as a basis for an SDO to consider reducing the period or extent of the proposed suspension/ debarment.[57] Conversely, if the facts show that nondisclosure was purely for tactical reasons, because of parallel litigation concerns for example, to avoid the potential consequences of disclosure (e.g., suspension/debarment), made in bad faith, or based on frivolous legal positions, then an SDO may view the contractor's conduct as indicative of a lack of present responsibility and take appropriate administrative action.

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* - Michael J. Davidson is a retired Army judge advocate and is currently an attorney with Immigration and Customs Enforcement. Davidson holds a Masters of Law (LL.M.) and a Doctor of Juridical Science (S.J.D) in government procurement law from George Washington University Law School. Any opinions are those of the author and do not reflect the position of any federal agency.

Endnotes

1. Contractor Business Ethics Compliance Program and Disclosure Requirements, 73 Fed. Reg. 67,064, 67,069 (Nov. 12, 2008) ("There is no doubt that mandatory disclosure is a 'sea change' and 'major departure' from voluntary disclosure. . . .")
2. Id. at 67,064.
3. FAR 3.1004(a); 52.203-13(d) (subcontracts).

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Bad Advice on Mandatory Disclosure (cont'd):

Endnotes (cont'd)

4. 73 Fed. Reg. at 67,065, 67,071 ("the overseas and commercial item exemptions have been eliminated"), 67,083.
5. FAR 52.203-13(b)(3)(i). Noticeably absent from the new disclosure requirements are violations of the Procurement Integrity Act, 41 U.S.C.A. §§2101–2107.
6. FAR 52.203-13(b)(3)(i). For purposes of avoiding suspension or debarment, FAR 3.1003(a)(2) requires timely disclosure "to the Government."
7. FAR 52.203-13(c)(2)(F)(1); 73 Fed. Reg. at 67,076.
8. FAR 52.203-13(c)(2)(F)(2); 73 Fed. Reg. at 67,076.
9. FAR 3.1003(a)(2); 9.406-2(c)(iv); 9.407-2(a)(8); 52.203-13(c)(2)(ii)(F)(3); 73 Fed. Reg. at 67,074
10. 73 Fed. Reg. at 67,073.
11. *Id.* at 67,074.
12. *Id.* at 67,065, 67,066, 67,080.
13. *Id.* at 67,066 (citing FAR 52.212-4, 52.232-25, 52.232-26, 52.232-27); *see also* FAR 3.1003(a)(3).
14. 73 Fed. Reg. at 67,080.
15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.* at 67,080.
19. FAR 52.203-13(G).
20. FAR 52.203-13(a); *see also* 73 Fed. Reg. at 67,076-67,077. The FAR Councils noted, for example, that "attorney memoranda reflecting their interviews . . . normally are covered by the work product doctrine."
21. 73 Fed. Reg. at 67,077.
22. *Id.*
23. *Id.* at 67,078.
24. 73 Fed. Reg. at 67,072. *But cf. id.* at 67,082 (might not foreclose subsequent *qui tam* cases).
25. 73 Fed. Reg. at 67,073; *see also id.* at 67,082 (eligible for reduced civil FCA damages).
26. *Id.* at 67,073.
27. *Id.* at 67,079.
28. FAR 3.1003(a)(2)-(3); 9.406-2(c)(vi); 9.407-2(a)(8).
29. FAR 3.1003(a)(2) ("Whether or not the clause at 52.203-13 is applicable. . . .").
30. FAR 52.203-13(a); *see also* FAR 2.101. The FAR Councils envisioned that the definition of a principal "should be interpreted broadly." 73 Fed. Reg. at 67,079.
31. 73 Fed. Reg. at 67,076.
32. *See* 31 U.S.C. § 3730(b)(2) ("The complaint shall be filed in camera, shall remain under seal for at least 60 days, and shall not be served on the defendant until the court so orders").
33. 73 Fed. Reg. at 67,074 ("contractor will have the opportunity to take some time for preliminary examination of the evidence to determine its credibility before deciding to disclose to the Government").
34. *Id.* at 67,078.
35. *Id.*
36. Williamson v. United States, 207 U.S. 425, 453 (1908); United States v. Joshua, 648 F.3d 547, 554 (7th Cir. 2011) ("not a stand-alone defense; rather, information about advice of counsel sheds light on the question whether the defendants had the required intent to defraud"): *see also* Bisno v. United States, 299 F.2d 711, 719 (9th Cir. 1961).
37. United States v. Ragsdale, 426 F.3d 765, 778 (5th Cir. 2005) ("only applicable where it will negate willful violation of the law"); United States v. Cross, 113 F. Supp.2d 1253, 1262 (S.D. Ind. 2000) ("available only as against specific intent crimes"); *id.* at 1263 (unavailable for general intent crimes); *see Williamson*, 207 U.S. at 453 ("willful and unlawful intent").
38. United States v. Roti, 484 F.3d 934, 935 (7^{th} Cir. 2007).
39. *Bisno*, 299 F.2d at 720; *see also*, United States v. Impastato, 543 F. Supp. 2d 569, 580 (E.D. La. 2008).
40. Chiron Corp. v. Genentech Inc., 179 F. Supp. 2d 1182, 1185 (E.D. Calif. Dec. 10, 2001).

(*continued on next page*)

Bad Advice on Mandatory Disclosure (cont'd):

Endnotes

41. United States v. Mathes, 151 F.3d 251, 255 (5th Cir. 1998); United States v. Sorbera, 43 M.J. 818, 822 (A.F. Ct. Crim. App. 1996); *see* United States v. Armstrong, 781 F.2d 700, 706 (9th Cir. 1986) ("good faith reliance on the advice of counsel to disobey a court order" not a defense).
42. *See e.g.*, *In re* Echostar Comm. Corp., 488 F.3d 1294 (Fed. Cir. 2006).
43. 961 F. Supp. 208, 210 (N.D. Ill. 1997) (noting that the employer would have been liable for the sexual harassment "if it knew or should have known about the harassment and failed to take appropriate remedial action").
44. 259 F.3d 91, 100-101 (2d Cir. 2001).
45. *District Court Upholds "Advice of Counsel" Defense In Qui Tam Suit*, 43 GOV'T CONTRACTOR ¶102 (March 7, 2001) (discussing U.S. ex rel. Bidani v. Lewis, 2001 WL 32868 (N.D. Ill. Jan. 12, 2001).
46. Douglas R. Richmond, *Advice of Counsel as a Defense to Sanctions and Professional Discipline,* 27 ABA/ BNA LAWYERS MANUAL ON PROFESSIONAL CONDUCT 418, 419 (BNA, June 22, 2011)).
47. United States v. Lindo, 18 F.3d 353, 356 (6th Cir. 1994); *see* Covey v. United States, 377 F.3d 903, 908 (8th Cir. 2004) ("made full disclosure of all material facts to his [or her] attorney before receiving the advice at issue; and (2) he [or she] relied in good faith on the counsel's advice that his [or her] course of conduct was legal"); United States v. Mathes, 151 F.3d 251, 253 (5th Cir. 1998).
48. United States v. Cheek, 3 F.3d 1057, 1061 (7th Cir. 1993).
49. *In re* Echostar Commo. Corp., 448 F.3d 1294, 1299 (Fed. Cir. 2006) (patent infringement case); *see also* United States v. Evanston, 584 F.3d 904, 914 (10th Cir. 2009); Eli Lilly & Co. v. Zenith Goldline Pharm., Inc., 149 F. Supp. 2d 659, 661 (S.D. Ind. 2011)**;** *see* Johnson, 961 F. Supp. at 211.
50. *See* SEC v. McNaul II, 277 F.R.D. 439 (D. Kan. 2011); Beneficial Fran. Co. Inc. v. Bank One, N.A., 205 F.R.D. 212, 216 (N.D. Ill. 2001); Peterson v. Wallace Computer Serv., 984 F. Supp. 821, 825 (D. Vt. 1997)**;** Richmond, *supra* note 46, at 422.
51. Eli Lilly & Co., 149 F. Supp. 2d at 661; *see also In re* Echostar Commo. Corp., 488 F.3d at 1299 ("widely applied standard"); *see* SNK Corp. v. Atlas Dream Enter., 188 F.R.D. 566, 571 (N.D. Calif. 1999) ("as to communications and documents relating to the advice").
52. Chiron Corp., 179 F. Supp. 2d at 1187; *see also* Autobytel, Inc. v. Dealix Corp., 455 F. Supp. 2d 569, 572 (E.D. Tex. 2006).
53. Chiron Corp., 179 F. Supp. 2d at 1186; *see also* Eli Lilly & Co., 149 F. Supp. 2d at 661 ("may not merely pick and choose, disclosing favorable communications and concealing unfavorable ones"); SNK Corp., 188 F.R.D. at 571 ("may not use the attorney-client privilege as both a sword and shield").
54. Autobytel, Inc. v. Dealix Corp., 455 F. Supp. 2d 569, 572 (E.D. Tex. 2006) (patent infringement); *see* Brennan v. Western Nat. Mut. Ins. Co., 199 F.R.D. 660, 663 (D.S.D. 2001) (work product waived).
55. 73 Fed. Reg. at 67,074.
56. *Id.* at 67,081.
57. *See* FAR 9.406-4(c)(5).

Buying the Better Mousetrap: Patent Law Issues in Federal Acquisition

by
*Tamir Damari**

[Note: Used with permission from the National Contract Management Association, *Contract Management*, July 2012.]

During the course of many government contracts, valuable intellectual property is created. In the research and development arena in particular, U.S. federal contracts can lead to new inventions or even entirely new technologies. For example, a 1968 federal contract between BBN and ARPANet ultimately led to the development of the Internet. Given the monetary (and other) stakes, it is important for contracting professionals to be aware of the basics of patent law and how patent rights are treated under relevant statutes and the Federal Acquisition Regulation (FAR). This article provides an introduction to these principles.

An Overview of Patent Protection

Patents grant inventors 20-year monopolies to use and sell their inventions. This allows inventors to commercialize their inventions free of competition for a limited duration, either by developing the inventions themselves or by licensing them to businesses that are best situated to commercially exploit them. By providing inventors this form of intellectual property protection, patents help to incentivize innovation.

Patents have existed since medieval times, but the importance of patent protection has also been recognized virtually from the inception of the United States. In 1790, only one year after the U.S. Constitution was ratified, Congress passed the first Patent Act, "to promote the progress of the useful arts." Over the course of the next two centuries, the Patent Act has been amended and revised to keep up with the rapid technological advancement of U.S. industry. Patents are distinguishable from copyrights and trademarks in terms of the types of intellectual property they protect. In very simplified terms, copyrights protect works of art, trademarks protect trademarks and servicemarks, and patents protect any "[p]rocess, machine, manufacture or composition of matter."[1] For example, a chemical alloy would be a patentable composition of matter, a jet engine would be a patentable machine, and a method by which titanium is purified would be a patentable process.

Inventors apply for patents with the U.S. Patent and Trademark Office (USPTO), which has the exclusive authority to issue patents. Patent examiners at the USPTO then examine each patent application to determine whether the invention is "useful," "novel," and "non-obvious," and therefore patentable.[2] An invention is useful if "it provides some identifiable benefit."[3] An invention is novel if it has not previously been patented, used, or published.[4] An invention is non-obvious if the differences between the subject matter sought to be patented and

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prior inventions are such that the subject matter as a whole would not have been obvious at the time the invention was made to a person having ordinary skill in the art to which the subject matter pertains.[5]

If the patent application is approved and a patent is issued by the USPTO, that patent permits an inventor to exclude others from making, using, offering for sale, or selling the invention throughout the United States for 20 years.[6] In effect, the disclosure of the invention in the patent application is the quid pro quo for a 20-year monopoly. After the term of the patent expires, businesses and entities have the unfettered right to practice the invention described in the patent.

Patents and Federal Procurement
The Framework Established by the Bayh-Dole Act

The statutory framework governing patentable inventions developed during a government contract is found in the Bayh-Dole Act (BDA).[7] The BDA was passed in 1980 in the wake of the rapid pace of technological innovation associated with the Cold War. During this period, the U.S. government spent a great deal of money to support public research in military, defense, and medical technologies. Under the rules in place until 1980, the federal government owned the patents to inventions created during a government contract. Economic inefficiency resulted, since the government lacked the commercial incentive to maximize the profits associated with the patents it had obtained. By 1980, the government had accumulated 28,000 patents; however, fewer than 5 percent of those patents were commercially licensed.[8] The BDA sought to rectify this by allowing government contractors to retain the patent rights developed during a government contract.

In 1984, the FAR was amended to ensure that the BDA was properly implemented. Part 27 of the FAR ("Patents, Data, and Copyrights") contains a comprehensive set of regulations describing how intellectual property (including patents) developed during a government contract is to be treated. These regulations are designed to further certain public policies set forth in FAR 27.302(a), including to:

1) Use the patent system to promote the use of inventions arising from federally supported research or development;
2) Encourage maximum participation of industry in federally supported research and development efforts;
3) Ensure that these inventions are used in a manner to promote free competition and enterprise without unduly encumbering future research and discovery;
4) Promote the commercialization and public availability of the inventions made in the United States by United States industry and labor;
5) Ensure that the government obtains sufficient rights in federally supported inventions

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to meet the needs of the government and protect the public against nonuse or unreasonable use of inventions; and

6) Minimize the costs of administering patent policies.

In short, the BDA and FAR Part 27 seek to balance the needs of industry and government within the framework of the existing patent law scheme to encourage the maximum possible innovation.

Ownership of Patentable Inventions Developed During Government Contracts

The BDA and FAR Part 27 permit either the government or the contractor to own the patents underlying government-contract associated inventions. Depending on the circumstance, either arrangement may be advantageous to a contracting party. For example, a contractor may wish to grant patent ownership rights to the federal government if it believes that it will obtain additional consideration by doing so that will likely exceed the revenue the contractor is likely to receive by producing or licensing the invention itself. In any event, whenever a patentable invention is likely to be created during the performance of a government contract (e.g., when the contract calls for research and development), it is essential for contracting officers and contractors to specify which party owns the patent rights to these inventions at the outset of the contracting process. This is typically memorialized in the "patent rights clause" of the contract. FAR 52.227 has two alternative patent rights clauses: one that provides for government ownership of patentable inventions and the other that provides for contractor ownership of such inventions.[9]

➢➢ Contractor Ownership of Patentable Inventions

Under FAR 27.302(b), a contractor may choose to retain title to inventions developed during a government contract,[10] subject to certain limited exceptions.[11] In order to memorialize this right, the contractor must ensure that the patents rights clause of FAR 52.227-11 is contained in the applicable contract. Additionally, the contractor must:

- Disclose the invention,
- Elect to retain title, and
- File a patent application with the USPTO.

The disclosure requirement obligates the contractor to disclose in writing each invention to the government's contracting officer within two months after the inventor discloses it in writing to the contractor's personnel responsible for patent matters.[12] The disclosure must identify the inventor(s) and must be sufficiently complete in technical detail to convey a clear understanding of the invention.[13] The disclosure "shall also identify any publication, on sale… or public use of the subject invention, or whether a manuscript describing the subject invention has been submitted for publication and, if so, whether it has been accepted for publication."[14] In

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addition, after disclosure to the agency, the contractor shall promptly notify the contracting officer of the acceptance of any manuscript describing the subject invention for publication and any on sale or public use.[15]

The election requirement obligates the contractor to “elect in writing whether or not to retain ownership of any subject invention by notifying the contracting officer within two years of disclosure to the agency.”[16] However, “in any case where publication, on sale, or public use has initiated the one-year statutory period during which valid patent protection can be obtained in the United States, the period for election of title may be shortened by the agency to a date that is no more than 60 days prior to the end of the statutory period.”[17]

The filing requirement obligates a contractor to “file [a] patent application…on an elected subject invention within one year after election.”[18] However, in any case where a publication, on sale, or public use has initiated the one-year statutory period during which valid patent protection can be obtained in the United States, the contractor shall file the application prior to the end of that statutory period.”[19]

The contractor may request extensions of time to comply with its disclosure, election, or filing requirements under FAR 52.227-11(c)(1–3). Nevertheless, a contractor who disregards these deadlines runs the risk of losing the patent rights for which it contracted with the government.[20] It is therefore important for contracting personnel in the research and development field to be educated on the consequences of not being familiar with FAR 52.227-11.

If the contractor properly exercises its right to retain ownership of patentable inventions, the government will likely still need to make or use that invention (particularly if the invention is a deliverable under the contract). In order to do so, the government will need a license from the inventor/contractor. Indeed, in many circumstances, the issuance of such a license is essential for the government to obtain the value for which it has contracted. Thus, the BDA and FAR Part 27 state that in the event the contractor elects to retain ownership of inventions, the government, at a minimum, has a “non-exclusive, nontransferable, irrevocable, paid-up license to practice” the invention.[21] The term “non-exclusive” means that the contractor has the right to license the invention to entities other than the government. The term “paid up” means that the contractor cannot require the government to pay royalties for the use of the invention (in order words, the original contract price is deemed to be the full consideration for the license).

➢➢ Government Ownership of Patentable Inventions

As discussed, there are also circumstances in which it may be mutually desirable for the government to own any patentable inventions developed during the course of a government contract. This scenario is contemplated by the alternative patent rights clause contained in FAR 52.227-13, which grants the government the ownership of inventions developed during the

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contract term while providing the contractor with a license to practice the invention. The customary terms of this license are described in FAR 27.302(i)(1), stating that "[w]hen the government acquires title to a subject invention, the contractor is normally granted a revocable, non-exclusive, royalty-free license to that invention throughout the world." Note that the contractor license is *revocable* by the government (unlike the irrevocable license the government obtains when the contractor elects to retain title).[22] This "license is transferable [by the contractor] only with the approval of the contracting officer."[23] Finally, "the contractor's license extends to its domestic subsidiaries and affiliates…and includes the right to grant sublicenses of the same scope to the extent the contractor was legally obligated to do so at the time the contract was awarded."[24]

Infringement and Indemnity

It may be surprising to learn that the issuance of a patent only confers upon the patent-holder the right to *exclude others* from "making, using, offering for sale, or selling"[25] the invention described in the patent. It does *not* necessarily mean that the patent-holder has the right to practice the invention described in the patent.[26] Other entities may have rights that are superior to the patent-holder by virtue of their own patents. Thus, a patent-holder may infringe another's patent even when it was simply practicing the invention described in its own patent. In the private sector, patent infringement carries some heavy potential penalties, including compensatory damages, treble damages, and attorneys' fees.[27] Even more potentially crippling is the right of the patent-holder to enjoin the infringer from using the infringing invention.[28]

In the government acquisition context, these potential penalties are mollified. Under 28 U.S.C. §1498(a), "[w]henever an invention…covered by a patent of the United States…is used or manufactured by or for the United States without license of the owner thereof…the owner's remedy shall be by action against the United States…for the recovery of his reasonable and entire compensation for such use and manufacture." This section further states that "[f]or the purposes of this section, the use or manufacture of an invention…covered by a patent of the United States by a contractor… with the authorization or consent of the government, shall be construed as use or manufacture for the United States."

In government procurement contexts, Section 1498 limits patent infringement remedies in several important ways. First, the statute limits the claims that may be brought by an aggrieved patent holder to "an action against the United States." Thus, as long as the contractor has acted "with the authorization or consent of the government" in the course of using the patent, it is generally insulated from liability.[29] Second, the remedies that are recoverable against the United States for patent infringement are limited to "reasonable and entire compensation" (i.e., a fair licensing fee). The plaintiff may not obtain treble damages, court costs, attorneys' fees, or an injunction under 35 U.S.C. §283–285. Importantly, the putative government infringer also gets to continue using the invention. These provisions allow

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contracting parties in a government procurement context to better predict the risks associated with contracting. Note, however, that §1498(a) only applies to a "patent of the United States." Thus, if the contractor elects to retain ownership of patents, it could potentially remain subject to all of the remedies described in 35 U.S.C. §283–285.

Notwithstanding §1498, the FAR also permits the contractor to indemnify the government in the event of infringement. In this regard, FAR 27.201-1 states that "[t]he liability of the government for damages in any such suit against it may, however, ultimately be borne by the contractor or subcontractor in accordance with the terms of any patent indemnity clause also included in the contract." Patent infringement indemnification clauses are typically used in contracts for commercial items but are not typically used in research and development contracts. *See* FAR 27.203-1(b).30. This implicitly reflects the recognition that research and development contracts are more likely to involve the use of cutting-edge technologies that may potentially infringe upon third-party patents.

Conclusion

The FAR affords contracting parties considerable leeway in allocating patent rights and liabilities. However, with this leeway comes an attendant responsibility upon contracting professionals to understand the obligations and strictures of the BDA and FAR Part 27.

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Endnotes

1. 35 U.S.C. §101.
2. 35 U.S.C. §101 (discussing how patent protection only extends to "new and useful" inventions), 35 U.S.C. §103.
3. *Brenner v. Manson*, 383 U.S. 519, 534 (1966).
4. 35 U.S.C. §102.
5. *See* 35 U.S.C. §103.
6. *See* 35 U.S.C. §154.
7. Codified in 35 U.S.C. §§200–212.
8. *See* K. Duecker, "Biobusiness on Campus: Commercialization of University-Developed Biomedical Technologies," *Food and Drug Law Journal* (1997): 453–510.
9. Compare FAR 52.227-11 (providing for a contractor's ownership of patent rights) and FAR 52.227-13 (providing for the government's ownership of patent rights).
10. *See* FAR 27.302(b), stating that "each contractor may, after disclosure to the government as required by the patent rights clause included in the contract, elect to retain title to any invention made in the performance of work under the contract."

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Endnotes (cont'd)

11. *See* FAR 27.302(b)(1)-(4) for a list of these exceptions.
12. FAR 52.227-11(c)(1).
13. *Ibid*.
14. *Ibid*. Publication, sale, or public use of the invention more than one year prior to the filing of a patent application results in waiver of patent rights by the inventor.
15. *Ibid*.
16. FAR 52.227-11(c)(2).
17. *Ibid*.
18. FAR 52.227-11(c)(3).
19. *Ibid*.
20. *See Campbell Plastics Engineering & Mfg. Inc. v. Brownlee*, 389 F.3d 1243, 1249–1250 (Fed. Cir. 2004).
21. 35 U.S.C. 202(c)(4).
22. *See also*, FAR 27.302(i)(2) (noting that "the contractor's domestic license may be revoked or modified to the extent necessary to achieve expeditious practical application of the subject invention….").
23. *Ibid.*
24. FAR 27.302(i)(1).
25. Under 35 U.S.C. §§154 and 271.
26. *See* www.uspto.gov/patents/resources/general_info_concerning_patents.jsp ("The right conferred by the patent grant is…'the right to exclude others from making, using, offering, for sale, or selling' the invention in the United States or 'importing' the invention into the United States. What is granted is not the right to make, use, offer for sale, sell, or import, but the right to exclude others from making, using, offering for sale, selling, or importing the invention.").
27. 35 U.S.C. §284–285.
28. 35 U.S.C. §283.
29. *See also*, FAR 27.201-1 ("In those cases where the government has authorized or consented to the manufacture or use of an invention described in and covered by a patent of the United States, any suit for infringement of the patent based on the manufacture or use of the invention by or for the United States by a contractor (including a subcontractor at any tier) can be maintained only against the government in the U.S. Claims Court and not against the contractor or subcontractor.").
30. *See* FAR 27.203-1(b) ("A patent indemnity clause shall not be used…[w]hen the contract is for supplies or services (or such items with relatively minor modifications) that clearly are not or have not been sold or offered for sale by any supplier to the public in the commercial open market....").

Applying the Intent Element to FCA Claims from Alleged TINA Violations: Not a 'Slam Dunk' for the Government

by
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and
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I. Introduction

In 2011, the United States Attorney for the Western District of New York stated that the government ''will continue to use the *False Claims Act* . . . to address contractors that seek to *avoid their disclosure obligations* when selling products to the United States government.''[1] The Truth in Negotiations Act (''TINA'') is a critical disclosure statute covering negotiated government contracts and subcontracts over $700,000 in value unless an exception applies, including where prices are based on adequate price competition, prices are set by law or regulation, a commercial item is being acquired, or a waiver has been granted.[2] Pursuant to TINA, contractors are strictly liable under their contracts for failure to meet their TINA disclosure obligations.[3] Consistent with the U.S. Attorney's statement above, however, it appears that the U.S. government is increasingly targeting False Claims Act4 (''FCA'') actions based upon problematic TINA certifications. This should not be surprising given the government's increased emphasis on using fixed price contracts[5] and the cost or pricing data used to negotiate those contracts,[6] as well as its efforts to become more aggressive in its use of the FCA to battle fraud.[7]

TINA violations do not constitute fraud, however, unless the defendant possessed the requisite scienter under the FCA. To establish an FCA case based upon the ''avoidance'' of TINA disclosure obligations, the government must prove: (1) that the information at issue was cost or pricing data; (2) that the defendant's disclosures were not current, accurate, and complete; and (3) that the defendant acted with knowledge of these conditions.
As the government increasingly uses the FCA to target TINA violations, it will also likely adopt a more expansive view of the type of information that is allegedly cost or pricing data in a given negotiation, and therefore required as part of a contractor's ''complete'' submission.

Of course, contractors wishing to avoid potential TINA or FCA liability should err on the side of expansive disclosure of all potential categories of information during negotiations. Nevertheless, should a defective pricing allegation arise as the basis for an FCA claim, contractors should be aware of the legal standards applicable to the requisite intent required for a violation of the FCA. This article examines the legal standards applicable to an FCA action premised upon TINA allegations. In specific, it focuses on the correct application of the FCA's intent requirement when TINA disclosures are allegedly incomplete, or the contractor's records

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or statements are allegedly false or fraudulent by failing to disclose complete cost or pricing data. In such instances, the government should be held to its proof, and assertions of essentially automatic liability for invoices on a ''defectively priced contract'' should be challenged. The FCA is a fraud statute, and should not be used to target mere mistakes in interpreting TINA. Challenging alleged FCA violations is especially appropriate in pricing situations involving unique or novel categories of purported cost or pricing data, since even good faith efforts may not result in the identification or disclosure of all information that could potentially be cost or pricing data.

II. FCA Actions Based Upon Fraud or False Claims In Contract Negotiation

Negotiations of government contracts have been fertile ground for FCA claims in the past. The case law is replete with examples of successful FCA actions arising from ''actual fraud'' in the negotiation of a contract, or the making of false statements or transmission of false documents during negotiations.[8] Depending on the factual circumstances, the government will often allege both the submission of false claims and the making of false statements or false representations in connection with a ''false negotiation.''[9]

To prove liability for a false claim, the government must show that a defendant submitted, or caused the submission of, a false or fraudulent claim with knowledge of the falsity of the claim.[10] Liability for a false record or statement is established by proving that a defendant submitted, or caused the submission of, a false or statement material to a false or fraudulent claim.[11] Under the statute, ''material'' means having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property.[12] ''Knowledge'' of false information is defined as: (1) actual knowledge; (2) deliberate ignorance of the truth or falsity of the information; or (3) reckless disregard of the truth or falsity of the information, and no specific intent to defraud is required.[13]

An invoice, which itself does not contain a falsity, may nevertheless form the basis of a FCA action if it is submitted in connection with a fraudulently obtained contract.[14] The ''archetypal fraud-in-the-inducement case''[15] is *United States ex rel. Marcus v. Hess*, in which the Supreme Court held contractors liable under the FCA for bid rigging that artificially inflated the bid price on a public works project, thereby inducing the government to pay more than it otherwise would have.[16] The specific elements of fraud in the inducement are satisfied with proof that: ''(1) there was a false statement or fraudulent course of conduct; (2) made or carried out with the requisite scienter; (3) that was material; and (4) that caused the government to pay out money or to forfeit moneys due (*i.e.*, that involved a 'claim').''[17] In addition to bid rigging situations, the fraud in the inducement theory has been applied to FCA actions premised upon false information, fraudulent pricing, or false estimates.[18] Where a contract or extension of government benefit was obtained originally through false statements or fraudulent contract, each resulting claim submission is actionable under the FCA.[19] The Department of Justice has taken the position that actual damages under a fraudulently induced contract equate to the total

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Applying the Intent Element to FCA Claims (cont'd):

amount paid to the contractor, even when the government has not lost any money as a result of the alleged fraud.[20]

The fraud in the inducement theory appears potentially applicable to a defective pricing case, but there is little authority specifically on point.[21] Rather than bring an FCA action under a fraud in the inducement theory, or an action for damages under TINA, the government appears to have more frequently or successfully applied simpler fraud theories to the facts of a negotiation, such as a facially false record or statement, without regard to TINA compliance.[22] Nevertheless, an FCA action premised upon express false certification of a TINA certificate appears to be a viable cause of action against a contractor.[23] When a government contract requires compliance with certain conditions as prerequisites to payment or participation, and the defendant failed to comply with those requirements and falsely certifies that it had complied to induce payment from the government, courts have found a violation of the FCA.[24] Recent settlements indicate that the government is employing this theory in threatening to bring TINA-related FCA actions,[25] and therefore may do so in litigation as well.

III. FCA Suits Will Likely Increasingly Target Fraud or False Claims Stemming From Defective Pricing

The FCA has become an increasingly favored tool of the government and has resulted in ever-greater recoveries for the government—including more than $3 billion in settlements in 2011.[26] The Department of Justice recently reiterated its continued ''aggressive pursuit of fraud in government procurement.''[27] The government's anti-fraud efforts have included intervening in FCA cases alleging overbilling by contractors using inflated overhead rates.[28] It stands to reason that the increased scrutiny of government contracts will include TINA-covered contracts requiring the disclosure of certified cost or pricing data.

As mentioned above, the government is increasingly turning to fixed-price contracts to reduce the perceived risk of non-fixed price contracts. In moving towards fixed-price contracts, the government is increasingly seeking to bolster its front-end ability to negotiate such contracts where competition is not likely to be adequate. For example, in November 2009, the Defense Contract Management Agency established a new Cost and Pricing Center to bolster the agency's cost and pricing capability. DOD's Director of Defense Policy and Procurement Shay Assad recently stated that the ''reality is we're stepping up the game'' on contract costs.[29] While DOD is not ''looking to suppress contractors' profits,'' according to Mr. Assad, DOD does have a goal of being ''more informed about what makes up a program's costs and how to drive down those costs without affecting profit.''[30]

It is on the back-end of the negotiation cycle where the government's dedication of resources is most notable. Even as agencies brace for budgetary cutbacks, audit and investigative offices may see stable or even increased funding. DOD is planning on

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Applying the Intent Element to FCA Claims (cont'd):

significantly ramping up its audit arm, adding as many as 1,612 employees to oversee and audit contracts.[31] The $574 million DCAA is seeking from Congress for fiscal 2013 is a 16 percent increase from fiscal 2012.[32]

While in an ideal world all certified cost or pricing data would be addressed during negotiations, TINA provides a post-negotiation mechanism for the government to accomplish the same result. To more aggressively target fraud, however, the government may seek to characterize as cost or pricing data ever-more expansive categories of information that was not disclosed under TINA. Alternatively, the government may allege that, even if a category of information was disclosed, the backup information provided was not sufficiently detailed. As practitioners in this area and affected contractors know, increased government emphasis in an area can result in government investigations of extended duration. These investigations can generate subpoenas and prolonged fact-finding, requiring contractors to perform internal investigations and negotiations to reach a resolution or to set the stage for FCA litigation. The result is additional expense, and delay in closing out contracts where performance has long been completed.

IV. The Existence of Cost or Pricing Data Is A Threshold Issue To Defective Pricing

The government does not need to prove that a contractor acted with ''knowledge'' to establish liability under TINA, although the government may obtain treble damages under the FCA if it establishes that the defendant knowingly withheld cost or pricing data.[33] TINA is a contract statute; it is intended to place the government on equal footing with the contractor during negotiations, not to target fraud *per se*. As the ASBCA explained, ''TINA requires the equalizing of cost or pricing data knowledge and does not require the creation of new cost or pricing data, a new analysis of furnished data, or the re-organization of furnished data.''[34]

TINA requires contractors to certify to the submission of accurate, complete and current cost or pricing data when negotiating contracts with the government.[35] The form of certification, located at FAR 15.406-2, states as follows:

Certificate of Current Cost or Pricing Data

> This is to certify that, to the best of my knowledge and belief, the ***cost or pricing data*** (as defined in section 2.101 of the Federal Acquisition Regulation (FAR) and required under FAR subsection 15.403-4) ***submitted***, either actually or by specific identification in writing, to the Contracting Officer or to the Contracting Officer's Representative in support of ________* ***are accurate, complete, and current*** as of ________**. 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.[36]

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Applying the Intent Element to FCA Claims (cont'd):

TINA and its implementing regulations also provide the government with a price reduction remedy if a contractor fails to comply, and they include provisions for interest and penalties.[37] The price reduction remedy takes effect when the contractor does not submit accurate, complete, and current data for a contract and the government relied on that defective data in determining the contract price.

To establish a TINA violation under the Contract Disputes Act,[38] the government must demonstrate that: (1) the information in dispute is ''cost or pricing data;'' (2) the cost or pricing data was not meaningfully disclosed; and (3) it relied to its detriment on the inaccurate, noncurrent or incomplete data presented by the contractor.[39] Once nondisclosure is established, a rebuttable presumption arises that a contract price increase was a natural and probable consequence of the nondisclosure.[40] The ultimate burden of showing the causal connection between the incomplete or inaccurate data and an overstated contract price remains with the government.[41]

Obviously, a threshold issue for any TINA contract action is the existence of cost or pricing data. Whether information is cost or pricing data ''typically involves a fact-intensive inquiry and case-by-case analysis of the nature and significance of the data in dispute and the adequacy of the disclosure.''[42] Consequently, whether information is cost or pricing data can be a difficult question.[43] The TINA statute defines ''cost and pricing data'' as all facts that, as of the date of agreement on the price of a contract or contract modification or, if applicable, another date agreed upon by the parties, ''***a prudent buyer or seller would reasonably expect to affect price negotiations significantly***.''[44] While the term excludes judgmental information, it includes factual information from which a judgment was derived.[45] In other words, contractors need not certify the accuracy of their judgment about estimated future costs or projections, but must provide the data forming the basis for that uncertified judgment.[46] Even though the test is an objective one,[47] judicial authorities still consider the conduct and subjective expectations of the individual negotiators as evidence of what a prudent buyer or seller would think or would expect to influence price negotiations.[48]

The FAR definition of cost or pricing data explains that while TINA disclosures 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, but are not limited to, such factors as—
> (1) Vendor quotations;
> (2) Nonrecurring costs;

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<u>Applying the Intent Element to FCA Claims (cont'd):</u>

> 3) Information on changes in production methods and in production or purchasing volume;
> (4) Data supporting projections of business prospects and objectives and related operations costs;
> (5) Unit-cost trends such as those associated with labor efficiency;
> (6) Make-or-buy decisions;
> (7) Estimated resources to attain business goals; and
> (8) Information on management decisions that could have a significant bearing on costs.[49]

Certain of these categories, such as information regarding nonrecurring costs, efficiency, projections, and management decisions often relate to complex information. Contractors may not always be aware immediately of the facts causing changes in these factors. In other words, there may be a time lag between when a contractor experiences these changes and identifies or develops the information necessary to analyze these changes.

Of course, with the explosion of computer technology and associated data collection capabilities, contractors may not even be aware of all the information at their disposal that could explain data to be used in estimating a contract's costs. DCAA has designed audit procedures to identify and analyze conditions suggesting possible defective pricing, although these procedures relate to some of the more simple potential cost or pricing factors, thereby limiting their utility regarding analysis of more complex defective pricing issues. Among the items normally examined for indications of defective pricing under these procedures are historical unit cost records, vendor quotes, purchase orders, voluntary refunds or credits from suppliers, cost trend records, sales and manufacturing volume projections, profit and loss statements, and product cost and profit analyses.[50]

DCAA also is mindful of the potential for fraud when conducting its defective pricing audit. It looks for, among other things, a high incidence of persistent defective pricing, repeated defective pricing involving similar patterns or conditions, continued failure to correct known system deficiencies, or undisclosed specific knowledge regarding significant cost issues that will reduce proposal cost.[51] The government may also make a fraud referral based on the denial by responsible contractor employees of the existence of historical records that are later found, repeated use of unqualified personnel to develop cost or pricing data used in the estimating process, continued failure to make complete disclosure to the government of data known to responsible contractor personnel, and continued prolonged delay in the release of data to the government to prevent possible price reductions.[52]

Most of these categories obviously relate to a pattern of conduct suggesting that the contractor's failure to disclose certified cost or pricing data was with ''knowledge'' under the

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Applying the Intent Element to FCA Claims (cont'd):

FCA. As is discussed above, the government appears to be sharpening its pencils to understand in greater detail different varieties of cost or pricing data that may increase contractor exposure to FCA actions predicated on alleged TINA violations.

V. The Government Must Prove That A Contractor Was ''Reckless in Falling Down'' Under TINA For FCA Liability

The following table illustrates the elements for proving an FCA case arising from the submission of a false claim premised upon defective pricing: The left column illustrates the basic FCA element to be proven, and the right column includes sub-elements that would potentially apply to an FCA action based upon a knowing TINA violation.[53]

Table 1
False Claim
Express False TINA Certification

FCA Action - 31 U.S.C. §3729(a)(1)(B)	FCA Action Premised on TINA-related records or statements
1. Present or cause to be presented;	
2. A false or fraudulent claim for payment or approval;	- TINA applies and information at issue is cost or pricing data - Information submitted is not accurate, current, or complete.
3. With knowledge: • Actual knowledge • Deliberate ignorance • Reckless disregard • No specific intent to defraud required	- Knowledge that information submitted is cost or pricing data - Knowledge that information submitted is not: • accurate • current, or • complete

The second element of the FCA claim based on an alleged TINA violation first requires a determination whether ***fraud or falsity*** is present, which requires a two-step analysis. First, it must be determined that the information in question is cost or pricing data. In other words, the government would have to prove that the information was actually cost or pricing data that had to be certified.[54] As discussed above, to meet this threshold, the information in question must have the ability to affect negotiations significantly. Second, once it establishes that the information required certification, the government would have to prove that the contractor failed to make a current, accurate, and complete disclosure of the cost or pricing data.[55] Both of these steps would have to be completed to prove that the contractor's TINA certification was ''objectively false.''[56]

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Applying the Intent Element to FCA Claims (cont'd):

The government must also prove that the contractor executed a false TINA certification with ''knowledge'' of the falsity under the FCA.[57] The case law clearly supports the fact that even when a contractor has committed a TINA violation, the requisite scienter for FCA liability is not necessarily present. For example, in *United States v. United Technologies Corp*., Sikorsky Aircraft Division, the government sued a contractor under the FCA for defective pricing.[58] Even though the contractor admitted not disclosing the data in question, the government failed to prove that the contractor acted with the requisite intent under the FCA. More specifically, the government attempted to impose a ''corporate knowledge'' theory to show that the contractor had the information and did not disclose it. The court rejected that theory, because while it might apply in a criminal context, it did not apply to a civil FCA action. In summary, the court held that defective pricing did not necessarily equate to fraud, absent the requisite intent required for FCA liability.

In *Safeco Ins. Co. of Am. v. Burr*, the Supreme Court more recently examined whether a defendant ''knowingly'' violated a statute.[59] It looked to the clarity of the statute and whether there was a foundation in the statutory text for the contractor's interpretation of the statute, as well as whether there is much authoritative guidance on the issue to determine the reasonableness of the contractor's interpretation of the statute.[60] Particularly if the statute is less than clear, and there is dearth of interpretational guidance, a defendant's alleged statutory violation does not constitute ''reckless disregard of [the statute] unless the action is not only a violation under a reasonable reading of a statute's terms, but shows that the company ran a risk of ***violating the law substantially greater than the risk associated with a reading that was merely careless***.''[61] In *Safeco*, the defendant had not run a more than merely ''careless risk'' and was therefore ''not ***reckless in falling down*** in its duty'' under the statute.

Applying *Safeco* to an FCA claim premised on an alleged TINA violation, the government must prove contractor ''knowledge'' with respect to both of the steps described above (*i.e*., (1) the information fits the definition and (2) it was not disclosed). Whether information in a negotiation meets the definition of cost or pricing data is a question of contract law that is likely the more challenging of the two steps for the government to prove. Determining the answer to this question under TINA can be a complex and fact-intensive exercise. Mistake of law is an oft-used defense to FCA liability. As the 9th Circuit explained in the *Hagood* case, to ''take advantage of a disputed legal question, as may have happened here, is to be neither deliberately ignorant nor recklessly disregardful.''[62]

While TINA clearly requires disclosure of information that could reasonably affect negotiations, its actual application becomes more ambiguous as the level of factual detail increases. In other words, as the level of information examined becomes ever more detailed, yielding ever more minutiae, whether the more detailed information would reasonably be expected to affect price negotiations significantly becomes less clear. Consequently, whether there was a duty to disclose becomes less clear and more ambiguous. Moreover, TINA case law is so fact specific it fails to provide useful bright line rules for determining whether specific data is cost or pricing data in the circumstances of a given negotiation.[63] If two good arguments

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Applying the Intent Element to FCA Claims (cont'd):

can be made for either of two contrary positions as to the meaning of a contract provision, ambiguity exists.[64] As the level of detail in the disclosures allegedly required by TINA increases, ambiguity would increase, as would the ability of contractors to argue that their interpretation was objectively reasonable, or at least not unreasonable.

Categories of information not disclosed at all—*i.e.,* incomplete cost or pricing data—is a special category. FAR Table 15-2, Instructions for Submitting Cost/Price Proposals When Certified Cost or Pricing Data Are Required, contains a (somewhat generic) listing of information that the contractor is to disclose. It is incumbent on the contractor to look beyond merely routine corporate policy, practice, and procedure to determine what constitutes cost or pricing information and to disclose it.[65] On the other hand, it is also the government's responsibility to point out if a contractor has missed some cost or pricing data during negotiations. In specific, the FAR states that, if ''before agreement on price, the contracting officer learns that any certified cost or pricing data submitted are inaccurate, incomplete, or noncurrent, the contracting officer shall immediately bring the matter to the attention of the prospective contractor.''[66]

Logically, therefore, categories or types of information not disclosed by the contractor, nor noted as missing by the government, should not be considered more than evidence of mere negligence or a careless interpretation of TINA, and therefore not create FCA liability, barring the existence of other clear facts indicating willful conduct by the contractor. It is possible that other evidence, separate and apart from the objective reading by the contractor, could suggest fraud, but each case on that issue would have to be evaluated on its own facts. Barring such facts, under *Safeco*, the complete omission of a non-obvious category of information as cost or pricing data should not generally create liability under the FCA.

VI. Contractor Statements Omitting Cost Or Pricing Data Should Likewise Create No FCA Liability If The Contractor Was Not ''Reckless in Falling Down''

As discussed above, the government frequently couples a §3729(a)(1)(A) false claim allegation with a §3729(a)(1)(B) false statement or record allegation. This gives the government the opportunity to plead alternate counts, as well as buttress its case with mutually reinforcing evidence supporting both causes of action. If such alternate FCA counts both allege underlying TINA violations, the requisite elements of FCA liability, including the defendant's knowledge of the TINA violation, must be proven for both counts. Just as is the case with a false claim count, even if a defendant's statements may be inconsistent with its TINA obligations, the defendant will not have acted with knowledge if their interpretation was not unreasonable or actions were not otherwise reckless.

The following table illustrates the elements for proving an FCA case arising from the submission of a false record or statement premised on defective pricing: The left column illustrates the basic FCA element to be proven, and the right column includes sub-elements that would potentially apply to an FCA action for a false record or statement based on a knowing

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Applying the Intent Element to FCA Claims (cont'd):

TINA violation. The false record or statement FCA cause of action is similar to the false claim cause of action described above, but also requires the government to prove the additional element of ''materiality'':

Table 2
False Record or Statement

FCA Action - 31 U.S.C. §3729(a)(1)(B)	**FCA Action Premised on TINA-related records or statements**
1. Makes, uses, or causes to be made or used;	
2. A false record or statement;	
3. Material to; [having a natural tendency to influence, or capable of influencing, the payment or receipt of money or property]	Relating to cost or pricing data, i.e., affirming accuracy, currency, or completeness of cost or pricing data
4. A false or fraudulent claim;	- TINA applies and information at issue is cost or pricing data - Information submitted not: • accurate, • current, or • complete
5. With knowledge: • actual knowledge • deliberate ignorance • reckless disregard • no specific intent to defraud required.	- Knowledge that information submitted is cost or pricing data - Knowledge that information submitted is not: • accurate, • current, or • complete - Knowledge that the record or statement was false.

It is well settled that an FCA defendant could not have made a statement in reckless disregard of its truth or falsity when the relevant underlying legal question is unresolved.[67] To establish reckless disregard under the FCA, the government must show ''aggravated gross negligence''; mere negligence is not enough.[68] Accordingly, where a contractor's belief that information was not cost or pricing data was not objectively unreasonable, a contractor's statements consistent with that belief cannot be false. Consequently, contractor statements disavowing the obligation to submit cost or pricing data are not made with the requisite

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Applying the Intent Element to FCA Claims (cont'd):

knowledge under the FCA and do not buttress the government's underlying false claim. Rather, such statements may reflect a reasonable, even if erroneous, consistency of belief.

Contractor statements to the government omitting cost or pricing information likewise should not create FCA liability where the contractor's underlying understanding of its obligations that was the basis for the statements was reasonable. A statement may violate the FCA by making a misleading half-truth, but only if the speaker intended ''the statement or omission to deceive." the government.[69] A person can also violate the FCA if in omitting information they perpetrate a fraud on the government.[70] The FCA, however, ''does not impose liability for omissions unless the defendant has an obligation to disclose the omitted information.''[71] Applying the teachings of Safeco, a contractor may breach a statutory duty to disclose information, but not be liable for fraud unless it is reckless in doing so.[72] In other words, there is no liability for omissions in statements or records where the defendant's underlying interpretation of the statute at issue did not run an unjustifiably high risk of violating TINA, and was objectively reasonable (even if the interpretation was wrong). Where there is no liability for violation of an underlying ambiguous statute, likewise there should be no liability for statement or records made based upon the statutory ambiguity.

VII. Conclusion

In summary, given its focus on fixed-price contracts, and its increasing use of the FCA, the government is likely to bring more FCA cases in the future based on TINA non-compliance. To prevail in an FCA case based on an alleged TINA violation, the government must prove both the objective falsity of the TINA certification, including the fact that the information was cost or pricing data, and that the contractor knew that the information fell within the definition of cost or pricing data. Such claims are unlikely to be slam dunks in the government's favor because, even if the contractor's contemporaneous interpretation of TINA was not correct, so long as the contractor acted reasonably in attempting to comply with its disclosure obligations, there should be no FCA liability.

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Applying the Intent Element to FCA Claims (cont'd):

Endnotes

1. Department of Justice Office of Public Affairs; Civil Division 11-716, "New York Battery Manufacturer to Pay $2.7 Million for False Pricing Information Provided to U.S. Army" (June 2, 2011) (emphasis added). The U.S. Attorney made the statement in connection with the settlement by Ultralife Corporation of allegations that it failed to provide current, accurate, and complete cost or pricing data related to three contracts with the U.S. Army.
2. 10 U.S.C. §2306a; 41 U.S.C. § 3501 et seq.; FAR 15.403.
3. 10 U.S.C. §2306a(e).
4. 31 U.S.C. §3729 et seq.
5. Memorandum on Government Contracting, 2009 DAILY COMP. PRES. DOC. 3 (Mar. 4, 2009) (''[T]here shall be a preference for fixed-price type contracts.''), available at http://www.gpo.gov/fdsys/pkg/DCPD-200900123/pdf/DCPD-200900123.pdf.
6. DEF. FED. ACQUISITION REGULATION SUPPLEMENT, DFARS Case 2011-D042, Proposal Adequacy Checklist () (Dec. 2, 2011)(''This proposed rule supports one of DOD's Better Buying Power initiatives by incorporating the requirement for a proposal adequacy checklist into the Defense Federal Acquisition Regulation Supplement (DFARS) . . . to ensure offerors take responsibility for submitting thorough, accurate, and complete proposals.'').
7. *See* Statement of Assistant Attorney Gen. for the Civil Div. Tony West Before the Senate Committee on the Judiciary (Jan. 26, 2011), available at http://www.justice.gov/civil/opa/pr/testimony/2011/civ-testimony-110126.html (touting DOJ's ''aggressive civil enforcement actions aimed at rooting out waste, fraud, and abuse''); Statement of Assistant Attorney Gen. for the Civil Div. Tony West Before the Senate Appropriations Subcommittee (Feb. 15, 2011), available at http:// www.justice.gov/civil/opa/pr/testimony/2011/civ-testimony-110215.html (stating that DOJ ''has never been more aggressive—or more successful—in the anti-fraud battle as it has in the last two years'').
8. *United States v. Foster Wheeler Corp*., 447 F.2d 100, 101 (2d Cir. 1971) (actual fraud); *United States v. United Techs. Corp*., 626 F.3d 313, 319 (6th Cir. 2011) (false statements in documents accompanying Best and Final Offer).
9. *United Techs. Corp.*, 626 F.3d at 319 (trial court found liability on prior FCA provisions §3729(a)(1) and §3729(a)(2), now codified at 31 U.S. Code §3729(a)(1)(A) and §3729(a)(1)(B), respectively).
10. 31 U.S. Code §3729(a)(1)(A); *see generally*, DEPARTMENT OF JUSTICE; The False Claims Act: A Primer, *available at* http://www.justice.gov/civil/docs_forms/C-FRAUDS_FCA_Primer.pdf.
11. 31 U.S.C. §3729(a)(1)(B).
12. 31 U.S.C. §3729(b)(4).
13. 31 U.S.C. §3729(b)(1).
14. *United Techs. Corp.,* 626 F.3d at 319.
15. *United States ex rel. Laird v. Lockheed Martin Eng'g & Sci. Servs Co.*, 491 F.3d 254, 259-60 (5th Cir. 2007).
16. 317 U.S. 537, 539, 543 (1943) (''The pattern of the collusion was the informal and private averaging of the prospective bid which might have been submitted by each appellant. An appellant chosen by the others would then submit a bid for the averaged amount and the others all submitted higher estimates. The government was thereby defrauded in that it was compelled to contribute more for the electric work on the projects than it would have been required to pay had there been free competition in the open market,'').
17. *United States ex rel. DeKort v. Integrated Coast Guard Sys,, LLC*, 705 F. Supp. 2d 519, 535-36 (N.D. Tex. 2010) (internal citations omitted).
18. *Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776, 787-788 (4th Cir. 1999).
19. *Id*. at 787.
20. *See, e.g.*, *United States ex rel. Magee v. Lockheed Martin*, No. 1:09cv324 (S.D. Miss., unsealed June 1, 2006). In its Opposition to Defendant Science Applications International Corp.'s Motion for Partial Summary Judgment as to Damages, the government argued that, ''in a fraudulent inducement case, where the defendant had no right to perform the contract, the benefit of the bargain rule does not apply – since the government would never have agreed to the contract but for the defendant's fraud.''

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Applying the Intent Element to FCA Claims (cont'd):

Endnotes (cont'd)

21. While not based on TINA, the General Services Administration (''GSA'') FAR Supplement contains its own ''Price Reductions'' clause relating to the disclosure of certain commercial pricing policies and practices in exchange for participation in the federal Multiple Award Schedule (''MAS'') program. In October 2006, Oracle Corporation agreed to pay $98.5 million to the United States to settle its liability for ''defective'' pricing disclosures made by PeopleSoft Inc. during the negotiation of a GSA MAS contract. In the FCA lawsuit that Oracle settled, the government alleged that PeopleSoft understated the discounts that it provided to commercial customers, resulting in federal agencies overpaying for software and related maintenance. Press Release, United States Department of Justice, ''Oracle Agrees to Pay $98.5 Million for False Pricing Information Provided by PeopleSoft to Obtain Government Contract,'' (Oct. 10, 2006).
22. *See United Techs. Corp*., 626 F.3d 313 (government prevailed on FCA suit based on false statements after government failed to prevail on defective pricing suit for lack of government reliance).
23. In *Communication Equipment and Contracting Company, Inc. v. United States*, No. 72-88C, 1991 WL 288912 (Aug. 23, 1991)(unpublished), the U.S. Claims Court held that ''there is no indication that the'' FCA and TINA are ''incompatible'' or that TINA pre-empts the FCA.
24. *United States ex rel. Hendow v. University of Phoenix*, 461 F.3d 1166 (9th Cir. 2006).
25. Department of Justice Office of Public Affairs; Civil Division 11-716, "New York Battery Manufacturer to Pay $2.7 Million for False Pricing Information Provided to U.S. Army" (June 2, 2011).
26. Department of Justice Office of Public Affairs; Civil Division 11-1665, "$3 Billion in False Claims Act Recoveries in FY 2011" (Dec. 19, 2011), a*vailable at* http://www.justice.gov/opa/pr/2011/December/11-civ-1665.html.
27. *Id*.
28. On November 5, 2010, the U.S. Department of Justice announced that a reconstruction contractor had agreed to pay $50.6 million to resolve allegations that it had violated the FCA by charging inflated overhead rates that were used for invoicing on government contracts. DEPARTMENT OF JUSTICE U.S. ATTORNEY'S OFFICE, BALTIMORE, MD., ''Scheme to Defraud Government on Reconstruction Contracts Leads to Criminal Charges and Civil Penalties for Louis Berger Group, Inc.,'' (Nov. 5, 2010), a*vailable at* http://www.justice.gov/usao/md/Public-Affairs/press_releases/press08/SchemetoDefraudGovernmentLeadstoCriminalChargesandCivilPenaltiesforLouisBergerGroupInc.html.
29. Sarah Chacko, *DOD Looking for 'cost-conscious' contractors*, FEDERAL TIMES, Mar. 23, 2012, *available at* http://www.federaltimes.com/article/20120323/ACQUISITION03/203230301/.
30. *Id.*
31. Nick Taborek, *Pentagon builds auditing army as budget shrinks*, WASHINGTON POST, Feb. 26, 2012, available at http://www.washingtonpost.com/business/economy/pentagonbuilds-auditing-army-as-budget-shrinks/2012/02/22/gIQALbrfcR_story.html.
32. *Id.*
33. 10 U.S.C. §2306a(f)(1)(B).
34. *Lockheed Martin Corp. d/b/a Sanders*, ASBCA No. 50464, 02-1 BCA ¶31,784 at 156,943 (internal citations omitted).
35. 10 U.S.C. §2306a contains the TINA as it applies to the Defense Department, NASA and the Coast Guard. 41 U.S.C. §254b contains similar provisions applicable to other executive agencies. FAR Parts 15 and 52 implement the TINA.
36. FAR 15.406-2 (emphasis added).
37. Defense Contract Audit Agency, DCAAM 7640.1, Contract Audit Manual, pg. 1402.
38. 41 U.S. Code §7101 *et seq*.
39. *See Lockheed Martin Corp*., 02-1 BCA ¶31,784 at 156,943 (citing *McDonnell Douglas Helicopter Sys.*, ASBCA Nos. 50447, 00-2 BCA ¶31,082 at 153,465).
40. *Id*.
41. *Id*.
42. *Humana, Inc*., ASBCA No. 49951, 00-2 BCA ¶31,142.

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Applying the Intent Element to FCA Claims (cont'd):

Endnotes (cont'd)

43. *See*, e.g., *Litton Systems, Inc., Amecom Div*., ASBCA No. 36509, 92-2 BCA ¶24,842 at 123,944-45 (noting that information which is mixed fact judgment presents ''difficult problems'').
44. 10 U.S.C. §2306a(h) (emphasis added).
45. *Id*.
46. DCAA Audit Manual, at 1411.
47. *Hardie-Tynes Mfg. Co*., ASBCA No. 20717, 76-2 BCA ¶12,121 at 58,226.
48. *See*, e.g., *Lockheed Martin*, 02-1 BCA at 156,944; *Plessey Indus, Inc*., ASBCA No. 16720, 74-1 BCA ¶10,603 at 50,280.
49. FAR 2.101.
50. DCAA Audit Manual, at 1420.
51. DCAA Audit Manual, at 1430-31. DCAA generally makes referrals of suspicion of fraud or other suspected irregular conduct by using the DCAA Suspected Irregularity Referral Form 2000 (DCAA Form 2000) or by using the DOD Hotline. Statement of Patrick J. Fitzgerald, Director, Defense Contract Audit Agency before the Commission on Wartime Contracting (Mar. 29, 2010) at 3.
52. *Id*.
53. In the *JT Construction* case, a district court laid out its interpretation of the elements of an FCA action premised on defective pricing. *United States v. JT Constr.Co., Inc*., 668 F. Supp. 592, 593 (W.D. Tex. 1987). Specifically, it stated that the following elements would need to be satisfied: (1) the information was cost or pricing data within the meaning of TINA; (2) the defendant failed to disclose the data as required by the Act; and (3) the defendant acted willfully and with guilty intent. The elements identified by the Court in *JT Construction* are more correctly identified as subelements of the traditional FCA elements, as identified in the FCA Table for express false certification identified in Table 1.
54. FAR 15.406-2
55. *Id*.
56. *United States ex rel. Roby v. Boeing Co*., 100 F. Supp. 2d 619, 625 (S.D. Ohio 2000) (citing *Hagood v. Sonoma County Water Agency*, 81 F.3d 1465, 1477-78 (9th Cir. 1996)).
57. 31 U.S.C. §3729(b)(1).
58. 51 F. Supp. 2d 167 (D. Conn. 1999),
59. 551 U.S. 47 (2007).
60. 551 U.S. at 69-70.
61. 551 U.S. at 69.
62. *United States ex rel. Hagood v. Sonoma Co. Water Agency*, 929 F.2d 1416, 1421 (9th Cir. 1991).
63. *Humana, Inc*., ASBCA no. 49951, 00-2 BCA ¶31,142.
64. *United States ex rel. Norbeck v. Basin Elec. Power Coop*., 248 F.3d 781, 808 (8th Cir. 2001).
65. *United Techs. Corp./Pratt & Whitney*, ASBCA No. 43645, 94-3 BCA ¶27,241.
66. FAR 15.407-1(a).
67. *United States ex rel Hixson v. Health Mgmt. Sys., Inc.,* 613 F.3d 1186, 1190 (8th Cir. 2010).
68. *United States v. Science Applications Int'l Corp.*, 626 F.3d 1257, 1274 (D.C. Cir. 2010) (''Although Congress defined 'knowingly' to include some forms of constructive knowledge, its definition of that term imposes liability for mistakenly false claims only when the defendant deliberately avoided learning the truth or engaged in aggravated gross negligence.''); *United States ex rel. Lamers v. City of Green Bay*, 168 F.3d 1013, 1018 (7th Cir. 1999) (''[I]nnocent mistakes, mere negligence, or even gross negligence (without more) are not actionable under the False Claims Act.'').
69. *Luckey v. Baxter Healthcare Corp.,* 183 F.3d 730, 732 (7th Cir. 1999).
70. *United States ex rel. Milam v. Regents of the Univ. of Ca*, 912 F. Supp. 868, 883 (D. MD. 1995).
71. *Id.*
72. 551 U.S. at 69-70.

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Preparing for Sequestration's Storm

by
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". . .The storm is up, and all is on the hazard."[1]

I. Introduction

A figurative hurricane threatens government contractors. So many will be affected that the potential hurricane of sequestration could devastate not only government contractors, but also the economies of nearly every state in the union. When hurricanes form, people prepare. They board up windows, evacuate low-lying zones, tie down boats, and ready emergency supplies. While sequestration is clearly possible, preparations for it remain minimal, based largely on the assumption that an economic disaster so unthinkable could never happen. While such an attitude in the face of a Level 5 hurricane like Katrina would have been considered foolhardy, it seems the norm for sequestration.

Sequestration, should it occur, will automatically remove more than $1.2 trillion dollars from agencies' budgets over the next ten years in an across-the-board manner -- half from defense and half from civilian agency budgets. These annual cuts in mission funds will disrupt priority and non-priority programs alike. To avoid sequestration, a congressional agreement to cut amounts approximately equal to the "triggered" or sequestered cuts is required. Additionally, sequestration may combine with debt ceiling limitations on spending that would exacerbate these cuts. As budget cuts occur, relations between federal agencies and their contractors will likely fray. To quickly attain curtailed spending objectives, agencies may cancel solicitations, abruptly down-scope work on current contracts, refuse to exercise options, terminate contracts for default on which they had been forbearing, refuse to fund incrementally funded contracts, and take other actions to implement across-the-board cuts. Agencies can be expected to minimize contractor rights to recover costs by avoiding terminations for convenience.

At its core, the concept of sequestration was a threat that Congress imposed on itself to force congressional budget compromise. Sequestration's budget cuts were deemed so draconian that few believed Congress would allow it to happen. Today, however, the threat may become reality as the January 2013 sequestration deadline nears and hope fades for timely congressional

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[1] - William Shakespeare, *Julius Caesar, Act V, Scene I* (Cassius stating: "Why, now blow wind, swell billow, and swim bark … the storm is up, and all is on the hazard.")

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compromise in the politically-charged election year. Each day that passes without an agreement sufficient to avoid sequestration makes contractor preparation increasingly necessary.

For any business, a dramatic reduction in the market means a fight for survival. This article briefly explores the impact of sequestration and budget cuts that contractors should consider. Whether sequestration occurs, or Congress agrees to budget cuts similar in scope, these fiscal decisions have broad implications. Contractors would be prudent to prepare for the day when federal agencies (customers) across the government will have even less funds available for some programs, and none for others.

II. The Impact of Sequestration

The Balanced Budget and Emergency Deficit Control Act of 1985 ("BBEDCA") first authorized sequestration.[1] The Budget Control Act of 2011 recently included sequestration as an enforcement mechanism for spending reductions by agencies.[2] Sequestration can also occur, however, under the Statutory Pay-As-You-Go Act of 2010.[3] The BBEDCA contains a variety of sequestration exemptions: Social Security; certain veterans programs; net interest; unobligated balances carried over from prior years for nondefense programs; low income assistance programs, such as the Children's Health Insurance Program, Supplemental Nutrition Assistance Program, Temporary Assistance for Needy Families, and Supplemental Security Income; a variety of special budget accounts; specified federal retirement and disability accounts; prior legal obligations of the federal government in specified budget accounts; Medicare Part D payments; particular economic recovery programs; refundable tax credits to individuals; and various "split treatment programs," such as federal aid for highways, Highway Traffic Safety Grants, and the like.[4] Special rules also apply for federal employee pay, student loans, federal administrative expenses, Medicare disbursements, and other programs.[5] Because of these exemptions, sequestration will almost exclusively affect programs with discretionary funding, and hit those programs harder because of the exemptions.[6]

Under the Budget Control Act of 2011[7] ("BCA") sequestration is triggered by one of two scenarios: 1) appropriation by Congress of more than the allowed spending limit caps for fiscal years 2012 to 2021; or 2) failure of Congress to enact legislation developed by the Joint Select Committee on Deficit Reduction by January 15, 2012 to reduce the deficit by at least $1.2 trillion.[8] Congress failed to meet this January 15, 2012 deadline, and has yet to reach agreement on allowable spending limits. Congressional inaction has created a looming "hurricane effect" on the economy, including and especially the defense industry. Absent congressional agreement, the sequestration process will begin January 2, 2013. The pernicious effect of sequestration, in addition to the amount of the cuts, will be its across-the-board reduction of spending by all agencies, without concern for existing priorities or the exercise of agencies' business judgments. Even the President is empowered only to prevent sequestration's effects on military personnel.[9]

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Any material reduction in agency funding necessarily disrupts the procurement planning process, and forces agencies to re-examine and reorganize their priorities. Not surprisingly, mission essential (or core) work will be accorded precedence over work that is not as necessary. The re-direction of available funds toward agency priorities will assuredly impact existing contracts, particularly those that are deemed less important, which will cause service and supply disruptions for contractors. Agency officials will seek to do more with less. In short, federal contractors will be competing for a shrinking pool of discretionary funds.

With respect to the Department of Defense budget, estimated cuts of $54.7 billion will occur in 2013.[10] War costs, emergency disbursements, and unobligated balances carried over from prior years are all subject to sequestration.[11] For 2013, the president will have the option to exempt some military personnel, but at the expense of cuts in other defense programs.[12]

By all accounts, the effects of these defense budget cuts are projected to be drastic. The National Association of Manufacturers ("NAM"), in a report attempting to project the effect of the defense cuts alone, projected a loss in excess of 1.2 million jobs by 2014, including a loss of 200,000 federal civilian and military positions.[13] The NAM report also predicted an increase in the unemployment rate of 0.7 percent.[14] Unlike a hurricane, few states would be spared from the devastation. The NAM report projected that ten states would bear the brunt of the projected job losses, with California bearing the largest loss (148,000), followed by Virginia (114,000), Texas (109,000), Florida (56,600), New York (42,100), Maryland (40,200), Georgia (38,700), Illinois (35,400), Pennsylvania (34,700), and North Carolina (34,200).[15]

Sequestration was intended to be so unthinkable that it would force Congress to act. It is not Congress, however, that will suffer the effects of its own inaction. Federal agencies will be left to re-construct shattered agency acquisition plans and upended budget priorities. To date, agency preparations for these wide-scale budget changes remain largely nonexistent, or at least undisclosed. For instance, Fred Vollrath, Principal Deputy Assistant Secretary for Readiness and Force Management, testified before Congress that the Department of Defense ("DoD") was not preparing for sequestration, primarily because DoD could not come to grips with the devastating effects of the cuts.[16] On July 31, 2012, the Office of Management and Budget ("OMB") issued a memorandum to agency heads ("Memorandum") that discussed sequestration.[17] The Memorandum, however, did not express any sense of urgency regarding sequestration.[18] Rather, it stated that: "The President has made clear that the Congress should act to avoid such a sequestration." The Memorandum further stated that "…OMB will be holding discussions on these [sequestration] issues with you and your staff in the coming months…In the meantime, agencies should continue normal spending and operations since more than 5 months remain for Congress to act."[19] This portends that agencies' reactions to sequestration, if and when it occurs, will be abrupt, largely unplanned, and uncoordinated at the contracting level. Contractors will be on the receiving end of these chaotic cost reductions. In short, federal agencies may react differently to an abrupt decline in available funds and contractors cannot expect any cushion resulting from agency preparations for these cuts. Given this uncertainty, contractors should begin to prepare for sequestration.

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III. Potential Agency Actions

Faced with the looming threat of sequestration, agencies will consider strategic ways to mitigate these extreme budget pressures. To do so, agencies may pursue any number of contractual options. In an April 2012 report, the Congressional Research Service ("CRS") identified many actions agencies could use to respond to sequestration reductions using existing contractual methods. According to CRS, agencies could:

1. Cancel solicitations;
2. Decline to exercise options;
3. Use the Limitation of Funds clause (FAR 52.232-22);
4. Place minimum orders under ID/IQ contracts;
5. Increase the use of the contract Changes clause;
6. Reduce the level of work under contracts (i.e., "down-scoping");
7. Revise the contract period of performance;
8. Order stop work/stop shipment (a form of down-scoping);
9. Accelerate completion of performance;
10. Terminate contracts for default;
11. Cancel multi-year contracts; and
12. Terminate contacts for convenience.[20]

Agencies can be expected to utilize any or all of these methods to achieve cost savings and respond to revised funding levels.

To implement sequestration, agencies will strain to conserve funds whenever possible. Indeed, "do more with less" is already a mantra at some agencies. This policy may result in more aggressive contract administration actions, such as the use of terminations for default instead of convenience (in whole or in part), in order to save the government the cost of paying for work already performed. Also, contracting officers may pursue liquidated damages for failure to meet small business goals, a remedy which up to now has been largely ignored. In addition, agencies may adopt more aggressive negotiation positions with federal contractors, and request detailed cost or pricing information, even when not required by law, to attain the lowest proposed prices. As federal dollars become scarce, agencies may increasingly rely on audit and investigative authority to ensure that contractors have systems in place to monitor and control contract costs, and are compliant with all contract accounting and reporting requirements. Such audits could potentially lead to other investigations and allegations (false statements, false certifications, counterfeit parts). Contractor resentment against such actions will be misplaced – contracting offices will be acting either out of necessity or mandates from upper echelons of their agencies.

Congress could delay sequestration, and push it months into the future. For government contractors, this will not alter the need for preparation, whether sequestration is delayed or takes place as scheduled early in January 2013. A delayed sequestration will be no less economically devastating, but will allow prudent contractors more time to prepare.

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IV. Contractor Considerations and Preparations

There are a wide variety of actions contractors can take to prepare for sequestration and its lasting effects. We list some of them below.

- Contractors should conduct an internal self-assessment of their government business, examining each contract in its inventory. Because a contract's significance is directly related to its size, contracts should be listed by the amount of their remaining revenues. This exercise will also list contracts in order of their risk of loss, because larger contracts present bigger targets for budget-cutting agency officials. In many instances, agency perspectives on such contracts will run inversely proportional to contractor interests, i.e., larger contracts enable agencies to make the greatest cuts, while to contractors they represent the potential for the greatest revenues. A thorough self-assessment will help to prioritize efforts and assess risk.

- To the extent possible, contractors should preserve and build on work that supports an agency's core capabilities. Specifically, contractors should assume that the less mission-essential activities will soon be phased out (options not exercised, contracts terminated).

- Contractors should review their dependence on subcontracts versus prime contracts. Subcontracts with large primes that have likely program continuity have a good chance of survival. On the other hand, subcontracts in higher risk areas could prove problematical if the prime contract ends. Generally, however, subcontractors have little to no control over continuation of work, are prohibited from talking directly to the Government, and have little to no program input. Prime contracts or subcontracts performing in core mission areas are safest, while those in lesser priority areas carry the highest risks of termination or cancellation.

- Contractors should perform, perform, and perform. Nothing strengthens relations with program and contracting offices like performance that is on time and within budget. Part of the self-assessment described above should include a determination about which contracts are most crucial. Management teams should also visit their core teams to address and resolve schedule or performance issues.

- As always, customer relations are critical, and during this period of uncertainty contractors should work to maintain or strengthen relations with agency program officials and contracting offices. Initiating contract disputes "for the sake of a principle" or "to send a signal" or "to gain respect" would be counterproductive at this time. Now more than ever, contractors should keep relationships as sound as possible with federal contracting and program offices. Open communications channels are a valuable asset when budgets are in flux.

- Public companies will face very difficult decisions with respect to projected contracts and revenue targets. Given the expected disruptions and possible chaos in some sectors of the

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government contract marketplace, carefully worded qualifications concerning the lack of reliability of revenue projections should be crafted now, before the pressure of real cuts begins.

- For contractors who also perform commercial work, judicious asset determinations should be made vis-a-vis non-government markets. In this regard, contractors need to ascertain what equipment, machinery, facilities, and so forth would be leveraged in pursuit of commercial opportunities. Skill sets of employees should be similarly evaluated. A contractor seeking to preserve or even increase its commercial marketplace share should accord such assessments a priority.

- For some contractors, it would be worthwhile to conduct a compliance review. A careful compliance review may reveal internal problems unknown to management. Such a review may detect and correct business system deficiencies or risks prior to discovery by government auditors, and avoid the impact on the contractor's competitiveness.

- Contractors should not assume that *any* of their contracts will be terminated for convenience. In all likelihood, only a lucky few will benefit from the cost recovery provisions applicable to terminations for convenience. The Termination for Convenience clause[21] is one of the more liberal relief-granting clauses in the Federal Acquisition Regulation ("FAR"), and provides for significant contractor cost recoveries. For that reason, agencies will be unwilling to direct terminations for convenience.

- Contractors should prepare for the fact that agencies may have no choice but to curtail programs by non-renewing contracts, or simply not exercising options, barring contractors' rights to recover additional payments. Thus, when reviewing existing contracts, contractors should ascertain which of its contracts may be vulnerable to non-renewal or non-exercise of options. Contractors should be aware that marketing efforts to persuade contracting officers not to end a contract/program may be challenging if funding decisions are made several layers above the contracting officer/program manager level.

- Faced with untenable budget realities, agencies may be forced to minimize liability for unreimbursed expenses, such as costs that were capitalized/amortized over the contract term. As mentioned above, agency officials may either let certain programs expire when the contract ends, or choose not to exercise options. Even where this is not done, agencies will administer contracts in a manner that precludes contractor recovery of any unbilled capitalized/amortized expenses.

- Contractors facing contract performance disputes or Government claims should consider creative negotiation and alternative dispute resolution strategies. Since cost reductions will be inevitable anyway, non-monetary solutions may, in some cases, be more effective than protracted and costly claims litigation (i.e., contractors may agree to "no-cost" terminations in exchange for removal of negative performance ratings, or upgrading to more favorable ratings).

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<u>Preparing for Sequestration's Storm (cont'd):</u>

- Contractor indirect cost projections, such as overhead or general and administrative ("G&A") expenses may be subjected to major downward pressures. For this reason, contractors should carefully review the cost elements in their indirect pools and prepare to alter them as necessary. Contractors should also develop business case scenarios that will reflect the base changes in anticipation of agency actions. Similarly, contractors should examine the terms of any Forward Price Rate Agreements ("FPRA") for possible revisions.[22]

- Just as individuals who anticipate losing their jobs will cut expenses, so too businesses expecting a precipitous decline in revenues should look immediately for costs to cut. There is evidence that this has already begun at some contractors, where funds for travel, training, R&D, machinery and equipment, new leases and other accounts have recently been withdrawn. Monies saved should, of course, be accumulated into financial reserves.

- Contractors should reduce debt now, to the extent possible, as a vital part of self-preservation. During this period of great market turmoil, flexibility will be key as the magnitude and timing of budget cuts and program curtailments cannot be predicted, even by agency officials. A critical factor for the survival of any business will be its debt level. On this point, the greater the debt service burden is to constrained cash flow, the more difficult it will be for a business to survive.

- Legally, contractors must have a strategy for implementing the Worker Adjustment and Retraining Notification ("WARN") Act.[23] The WARN Act requires employers with more than 100 employees (excluding part-time), or having employees working more than 4,000 hours, to issue sixty (60) days written notice prior to mass lay-offs.[24] Whether to issue WARN notices must be the subject of very careful assessments because such notices almost inevitably cause severe disruptions in the workforce. Failure to provide timely notice in some instances has been found excusable. For example, in one case where employees sued their employer for failure to provide timely WARN notices, the Eighth Circuit entered judgment in favor of the contractor after finding that the cancellation of a government contract was not "foreseeable."[25] In light of all the publicity surrounding sequestration, however, an argument that it was not foreseeable carries a high risk of failure. Uncertainty in this area heightened when the Department of Labor recently announced that WARN Act notices would not be required as a result of sequestration.[26] It will remain for the courts ultimately to decide if such an announcement can waive the requirements of a statute. In any event, it would seem prudent for employers to establish full communication with employees and their union representatives regarding WARN Act issues.

- Contractors should regularly communicate with their employees anyway, and not merely in the context of WARN Act compliance. Management teams that continually inform their workforce -- the greatest asset of almost all companies -- about developments are better poised to weather the fiscal storm than firms that keep employees in the dark.

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- Contractors should approach claim filings carefully. In a period where money is tight, programs may have limited funds to pay claims. However, filing a formal claim before the Boards of Contract Appeals or the Court of Federal Claims provides the government access to the judgment fund, which is an immediate source of funds to pay the claim, even if settled. The agency can repay the judgment fund out of program funds over the next three years. As discussed earlier, the mere act of filing litigation runs counter to maintaining strong relations with the agency. Presenting the litigation as a strategy for the agency to access the judgment fund could help preserve, and not disrupt, relations.

VI. Conclusion

If sequestration occurs, it will impose devastating effects on contractors. Even if Congress acts to avoid sequestration, it will nevertheless be forced to make deep cuts in federal programs, across defense and non-defense sectors alike. Federal contractors urgently need to prepare now for these developments, reviewing and adopting the recommendations set forth above as applicable. Many contractors will not survive the perfect storm of intense competition, dramatic reductions in agency spending, harsh regulatory oversight, and agencies dedicated to making budget cuts that severely reduce badly needed contactor revenues. Chances of survival will most assuredly be higher for those prepared for these impending revenue reductions.

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Endnotes

1. *See* Title II of P.L. 99-177, 1985.
2. *See* P.L. 112-25.
3. *See* Title I of P.L. 111-139.
4. *See* Title II of P.L. 99-177, 1985; see also "Budget "Sequestration" and Selected Program Exemptions and Special Rules, Congressional Research Service ("CRS"), Report for Congress, 7-5700, April 27, 2012 ("Report for Congress") at Summary.
5. *Ibid*., at 5-6.
6. CRS, Report for Congress at 7.
7. P.L. 112-25.
8. *Ibid*.
9. CRS, Report for Congress at 9.
10. *See* "How Across-the-Board Cuts in the Budget Control Act Will Work," Center on Budget and Policy Priorities, by Richard Kogan, at 5.

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Endnotes (cont'd)

11. *Ibid*.
12. *Ibid*.
13. *See* "Defense Spending Cuts: The Effect on Economic Activity and Jobs," National Association of Manufacturers, by Jeffrey Werling, Inforum / University of Maryland at v.
14. *Ibid*.
15. *Ibid*., at vii.
16. *See* "Defense Department Has Not Begun Planning For Sequestration, Official Tells House Panel," by Louis C. LaBrecque, BNA *Federal Contracts Report*, Vol. 95., No. 5, July 31, 2012..
17. *See* "Memorandum For the Heads of Executive Departments and Agencies," from Jeffrey D. Zients, Acting Director of Office of Management and Budget .
18. *Ibid.,* at 1.
19. *Ibid*., at 2.
20. "Government Procurement in Times of Fiscal Uncertainty," Kate M. Manuel and Erika K. Lunder, Congressional Research Service, Report No. R42469, April 6, 2012. The Report did not address the impact on government contractors (see footnote 217).
21. FAR 52.249.1 through 52.249-7.
22. *See* FAR 42.1701.
23. 29 U.S.C. §§ 2101-2109 (1994).
24. *Ibid*., at §§ 2101(a) and 2101(3)(B).
25. *See Loeher v. McDonnell Douglas Corp.,* 98 F.3d 1056 (8th Cir. 1996).
26. "Labor Department: Sequester Layoff Notices Not Required by WARN Act," by Paul M. Krawzak, *Congressional Quarterly*, July 30, 2012. While not covered by the WARN Act, federal civil servants may receive layoff notices for agency downsizings related to program curtailments. *See* "Pentagon Official Says Civilian Workforce Could Get Layoff Notices 4 Days Before Election," National Contract Management Association *Contract Management*, July 27, 2012.