In **Part 1** of this article, we discussed compliance risks associated with "defective pricing" in general, and then focused on the Government's roles and responsibilities. In Part 2, we want to focus on the contractor's roles and responsibilities, as established by solicitation provisions and by contract clauses. Then we'll wind up with a business case discussion, in which we apply what we learned.

As noted at the end of Part 1, the government contracting officer is responsible for inserting the appropriate provisions and clauses into the RFP and into the awarded contract. FAR 15.408 lists the required provisions and clauses, and prescribes when they are to be used. As relevant to this article, they include:

- 52.215-10, Price Reduction for Defective Certified Cost or Pricing Data

- 52.215-11, Price Reduction for Defective Certified Cost or Pricing Data—Modifications

- 52.215-12, Subcontractor Certified Cost or Pricing Data

- 52.215-13, Subcontractor Certified Cost or Pricing Data—Modifications

- 52.215-20, Requirements for Certified Cost or Pricing Data and Data Other than Certified Cost or Pricing Data

- 52.215-21, Requirements for Certified Cost or Pricing Data and Data Other than Certified Cost or Pricing Data—Modifications

Those provisions and clauses establish the contractor's duties with respect to providing certified cost or pricing data to the government. To the extent they invoke or reference FAR requirements, those individual regulatory requirements also become part of the contractor's duties. Let's look at those duties.

Contractor and Subcontractor Roles and Responsibilities

The first thing one notices is that there is a set of provisions/clauses for initial contract proposals and another set for post-award modifications. Looking first at the set that applies to initial contract proposals, we can see that the contractor (and its subcontractors, and its prospective subcontractors) are responsible for providing accurate, complete, and current certified cost or pricing data, and that any such certified data that was not accurate, complete, and current subjects the contract price to a unilateral price reduction, so long as the price was increased by a "significant amount" based on the government's reliance on that defective certified cost or pricing data.

The math can get complicated. There are special rules for calculating the impact of defective certified cost or pricing data received from a prospective subcontractor that never actually received a subcontract. (See 52.215-10(b).)

If the contracting officer has determined that there has been defective pricing, then the contractor is prevented, by the language in the provision/clause, from raising the following defenses:

-

The Contractor or subcontractor was a sole source supplier or otherwise was in a superior bargaining position and thus the price of the contract would not have been modified even if accurate, complete, and current certified cost or pricing data had been submitted

-

The Contracting Officer should have known that the certified cost or pricing data in issue were defective even though the Contractor or subcontractor took no affirmative action to bring the character of the data to the attention of the Contracting Officer

-

The contract was based on an agreement about the total cost of the contract and there was no agreement about the cost of each item procured under the contract

-

The Contractor or subcontractor did not submit a Certificate of Current Cost or Pricing Data

As we noted in Part 1, it is the responsibility of the contracting officer to ensure that the contractor executes a CCCPD; however, it doesn't matter whether or not one is actually executed, since the contractor is prevented from using the omission of an executed CCCPD (when it was required) at as a defense. (Further, the provision/clause language also requires a contractor to submit a CCCPD, so there's really no getting out of it when required.]

Any payments made by the government to the contractor that were inflated, based on the defective pricing, entitles the government to repayment with interest (compounded daily). Further, if the contractor knowingly submitted a false CCCPD—i.e., it knew it had committed defective pricing but executed the CCCPD anyway—then the government is entitled to impose an additional penalty equal to the amount of the overpayment. (This is the administrative remedy prescribed by the provision/clause language; but as we've noted before, the government has a propensity to consider those invoices/requests for payment as being false claims.)

The prime contractor is responsible for standing in the government's shoes and obtaining certified cost or pricing data (in the required format) from any subcontractor whose pricing action trips the threshold at 15.403-4—before award of that subcontract. The certified cost or pricing data is to be submitted in the format of FAR Table 15-2, and the prime contractor is

required to obtain a CCCPD from the subcontractor, certifying that the cost or pricing data was accurate, complete, and current as of the date of price agreement. (We note that the clause does not seem to give the parties leeway to agree on a different date, as the CCCPD between prime and government permits.)

If the subcontract value is greater than 10% of the prime's (or higher tier subcontractor's) contract value then the certified cost or pricing data becomes part of the prime's cost or pricing data, and must be submitted to the government. Further, the prime contractor (or higher tier subcontractor) is also responsible for performing cost or price analysis on the data it receives from its subcontractors. (Remember that the prime also has to award its subcontracts at fair and reasonable prices.) That analysis becomes cost or pricing data and may have to be submitted to the government (and updated!) as part of compliance. (See 15.404-3(b) and (c).)

The prime contractor is responsible for flowing the cost or pricing data requirements down to its subcontractors if the subcontract value exceeds the 15.403-4 threshold, and each tier must also flow the requirements down to the next tier, until nobody has a contract action that exceeds the threshold.

The continuing requirement regarding subcontractors (at any tier) is why defective pricing risk actually *increases* once the proposal has been submitted. The risk increases because after proposal submission the proposal teams breathe a sigh of relief, get some sleep, and then are assigned to new projects. It is rare to see the proposal team kept intact throughout negotiations. Thus, the lines of communication between prime and subcontractor, and between subcontractor and lower-tier subcontractor, degrade. The data flow slows or even stops. Meanwhile, the requirements are still in place and contractors still have the duty to update their cost or pricing data to keep it accurate, complete, and current until completion of price negotiations.

Looking at the provisions/clauses that apply to post-award modifications, we see that the requirements are much the same. Any post-award pricing action that exceeds the 15.403-4 threshold and it not exempted by 15.403-1 requires submission of certified cost or pricing data, with the same administrative remedies for defective pricing as would apply to a pre-award defective certification. However, FAR 15.403-2 does exempt certain contract modifications from the requirement. The exemptions include: (1) the exercise of an option at the price established at contract award or initial negotiation, and (2) proposals used solely for overrun funding or interim billing price adjustments.

There's more to write concerning information other than certified cost or pricing data but, as we noted in Part 1, we want to focus on the classic requirements pertaining to certified cost or pricing data. So let's move on to a business case where we can apply what we've learned: the defective pricing allegations made against BAE Tactical Vehicle Systems (BAE) (formerly Stewart & Stevenson) as initially discussed in **this article**, which addressed this **ASBCA decision** .

Allegations of Defective Pricing Regarding BAE's Proposal to Definitize a UCA

Here is a chronology of events as we gleaned them from the decision:

-

April 2008 – BAE submits its initial proposal

-

30 May 2008 -- Contract award via UCA (undefinitized contract action), price negotiations commenced

-

May - September 2008 – negotiations ongoing; multiple iterations of Bills of Material (BOMs) including one generated on 11 September 2008

-

22 September 2008 - Negotiations concluded, price agreement reached, "handshake date"

-

24 September 2008 -- BAE Systems executes Certificate of Current Cost or Pricing Data (CCCPD), with an "effective certification date" of 04 September 2008

-

24 September 2008 -- Contractor "sweep" date, final BOM created and uploaded

Looking at the chronology above, the first thing we see is that BAE conducted its "sweep" *after* the price agreement "handshake date," concurrent with execution of the CCCPD but well *after*
the CCCPD's effective date—nearly three weeks after the effective date the parties had agreed upon. We have seen many contractors do the same thing: they run their sweeps after the price agreement has already been reached. That has always confused us.

As we have discussed throughout this two-part article, defective pricing risk exists up to—*but not after*
—the "handshake date" when price agreement has been reached. By definition, any changes to cost or pricing data that occur after than date cannot be said to have significantly impacted the contract price.

So what purpose does conducting a sweep after that date serve?

Suppose the sweep uncovers some cost or pricing data that was not accurate, complete, and current. The contractor can notify the contracting officer and offer to reopen negotiations. If the offer is not accepted, then the contractor has some measure of defense against downstream allegations of defective pricing. But if the offer *is* accepted, then negotiations are reopened—and that moves the "handshake date" to whenever the new final price agreement date is. That means that another sweep will have to be performed, to identify any new changes to cost or pricing data. And if that new sweep uncovers more changes, then the process will have to repeat … potentially forever. That doesn't make much sense to us.

In our view, it makes much more sense to perform sweeps just before the price agreement date. Do one complete sweep, identify any changed cost or pricing data, and disclose the changes as the final part of negotiations. Then execute the CCCPD right away. Risk is minimized and no further sweeps are necessary.

Another thing that confuses us about the BAE situation is that the effective date of the CCCPD

(04 September) was well before the actual price agreement date (20 September). If the parties agreed on that effective date, that's fine. But then any changes to cost or pricing data that occurred after the effective date are irrelevant to price negotiations—by mutual agreement of the parties. Specifically, there was no need for BAE to generate additional BOMs after 4 September; the BOMs generated on 11 September and 24 September were irrelevant to the price negotiations. Similarly, the sweep on 28 September was nice, but unless it uncovered cost or pricing data that were defective as of 04 September, who cares?

Seen in this light, let's look at some of the government's allegations and BAE's defenses, as described by Judge O'Sullivan in her decision (link above). Our commentary is in italics. We should note that we are not attorneys and our thoughts and opinions are simply those of a layperson. Do *not* rely on us for legal advice.

1.

DCAA determined that BAE received updated quotations for 40 different part numbers up to and including 4 September 2008 but failed to disclose these updated quotations to the government. Further, DCAA determined that, prior to 4 September, BAE issued purchase orders to vendors for 11 parts at lower prices than disclosed to the government. BAE argued that the government relied on vendor quotations and purchase order prices that were the same as, or higher than, the prices in the 24 September sweep BOM; the government relied on quotations from unqualified vendors; and the government relied on quotations received after the 04 September certification date.

We suspect the prices in the 24 September sweep BOM are irrelevant to the dispute. What matters (or what should matter) are the quotes and prices disclosed to the government up to (but not past) the 04 September CCCPD effective date.

1.

DCAA determined that BAE did not use the most current exchange rate (USD to Euro) in the costs proposed with respect to two part numbers. BAE used a rate of 1.5846 in its costs proposed in April of 2008. In August 2008 it had checked exchange rates online, at which time the rate was 1.467220, but it did not update the proposed costs for the two parts. BAE argued that the government had as much access to the publicly available foreign exchange rates as BAE did, and a contractor is not required to use any particular data in its proposal.

*We agree that TINA is a disclosure requirement and not a use requirement. (See our article on that point, **here** .) However, we aren't so sure about BAE's argument that the government should have checked the exchange rates before finalizing the contract price. Remember, one of the prohibited defective pricing defenses is "the Contracting Officer should have known that the certified cost or pricing data in issue were defective even though the Contractor or subcontractor took no affirmative action to bring the character of the data to the attention of the Contracting Officer."*

1.

DCAA found that BAE had not updated its proposed prices for 215 parts that BAE planned to manufacture in house to reflect the labor rates agreed on in a recently finalized forward pricing rate agreement. BAE argued that the Army was not only aware of the updated rates, but (a) used them prior to the 4 September certification date in negotiating prices for engineering change proposals and individual parts on other contracts; and (b) proposed price reductions to FAB SHOP parts after receiving the new rates, which reductions were accepted by BAE.

This is one that's a bit confusing to us. If BAE disclosed the new part pricing and agreed to associated price reductions, then it's hard to see how the contract price would have been significantly inflated from a lack of disclosure. On the other hand, if BAE disclosed the new part pricing after the price agreement date, and the associated price reductions were reflected in a contract modification subsequent to UCA definitization, then perhaps the government has room to argue that the CCCPD was defectively executed on the certification date, even though the government ended up not being harmed. (If that's correct, then this is yet another reason that post-certification sweeps are not particularly useful.)This is probably an issue that would have been developed at trial, had one been permitted to take place.

1.

DCAA found that BAE did not disclose the most "relevant" historical data with respect to one part called a thrust washer, namely a purchase order issued before the certification date at a unit price considerably below BAE's proposed unit prices for the part. BAE argued that the lower purchase order price for the thrust washer that DCAA relies on for its "historical data" defective pricing allegation was incorporated into the 24 September sweep BOM.

As we have repeatedly asserted, we believe that the 24 September "sweep" BOM is irrelevant to the question as to whether or not the contract price was significantly impacted by defective certified cost or pricing data as of the mutually agreed-to effective date of 04 September. Thus, the question at trial should have been whether the lower purchase order price was (or was not) disclosed as of 04 September.

1.

DCAA reviewed engineering drawings that called out quantities of parts needed for the contract and determined that some of the parts proposed by BAE were not required and others were required in a quantity less than that proposed. BAE argued that the Army controlled the FMTV configuration and had actual knowledge of required quantities, that quantity errors in any event may not qualify as defective pricing, and that the government has not identified with any specificity what cost or pricing data was "defective" or cited to any errors in quantities in the underlying engineering drawings or other cost or pricing data.

DCAA likes to look at engineering drawings in a number of its audits. The problem is, while engineering drawings call out parts and quantities of parts, the quantities shown on drawings do not always translate into purchase order quantities. Suppliers often specify minimum buy quantities, such that the contractor might need 10 but the minimum buy is 100—so you would price 100 not 10. In addition, Manufacturing often increases needed quantities to account for scrappage (low yields) and other factors. The process of converting a drawing to an Engineering BOM to a Manufacturing BOM is a complex one. That's why when one is negotiating the contract price, one looks at the Consolidated BOM and not at engineering drawings when seeking to determine the quantities of parts actually required for the contract. More fundamentally, we need to ask whether the average DCAA auditor has the training and experience to actually understand how to read a drawing and how to walk the process from drawing to CBOM. (Isn't that a GAGAS requirement in order to be able to express an opinion?) Thus, while BAE's argument that the Army controlled the configuration and had as much insight into the necessary parts and quantities of parts as BAE had is probably not a strong one (see our commentary on issue #2, above), BAE probably had a number of other strong arguments to be made at trial, had one taken place.

BAE also advanced other arguments in its submissions to the ASBCA. They included the position that DCAA used the wrong BOM as the baseline for defective pricing. DCAA used the 11 September BOM but it should have used the 28 September "sweep" BOM. Our opinion is that neither of those two BOMs is relevant. The only BOM that should have mattered was the one closest to, but not after, the 04 September CCCPD effective date.

We have spent a lot of time (and words) discussing the requirements associated with certified cost or pricing data and how a contractor should interpret those requirements when implementing controls and processes to militate the risk of defective pricing. Even so, these two articles, taken together, are really a high-level summary of the risks. We could have written an entire book on the topic (as other have). However, the next question is: what are you going to do now? How are you going to use this information to enhance your compliance program?

UPDATE: *After this article was drafted but before publication, Law360 carried a very brief notice that BAE and the US Government settled their False Claims Act lawsuit over the alleged defective pricing of BAE's FMTV contract. As part of the settlement, BAE agreed to "pay the U.S. government $3 million, and return 'unallowable costs,' to resolve a Michigan federal court False Claims Act suit claiming it inflated parts and labor costs on a $3.6 billion U.S. Army truck contract." Considering that the original COFD (which was subsequently rescinded by the contracting officer) demanded $56 million, this has to be considered to be a victory for BAE and its attorneys.*