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A CRITICAL STUDY OF THE "TRUTH IN NEGOTIATING LAW"

Robert C. Gusman†

The Truth In Negotiating Law requires contractors under prime and subcontracts with the federal government to submit cost or pricing data prior to award of prime and subcontracts exceeding \$100,000 and prior to the pricing of any contract change exceeding \$100,000. The contractor, under these circumstances, is required to certify that, to the best of his knowledge and belief, the cost or pricing data submitted was accurate, complete and current. Prime contracts, including changes under which such a certificate is required, must contain a provision that the price shall be adjusted to exclude any significant sums found by the head of the government agency to have resulted from inaccurate, incomplete, or noncurrent data.¹

† Member of the New York, District of Columbia, and California Bars. B.A. 1953, New York University; LL.B. 1956, Cornell Law School. Assistant General Counsel, Aerojet-General Corporation. The views expressed herein are the author's and not those of any organization.

¹ 10 U.S.C.A. § 2306(f) (Supp. 1969) provides:

(f) A prime contractor or any subcontractor shall be required to submit cost or pricing data under the circumstances listed below, and shall be required to certify that, to the best of his knowledge and belief, the cost or pricing data he submitted was accurate, complete and current—

(1) Prior to the award of any negotiated prime contract under this title where the price is expected to exceed \$100,000;

(2) Prior to the pricing of any contract change or modification for which the price adjustment is expected to exceed \$100,000, or such lesser amount as may be prescribed by the head of the agency;

(3) Prior to the award of a subcontract at any tier, where the prime contractor and each higher tier subcontractor have been required to furnish such a certificate, if the price of such subcontract is expected to exceed \$100,000; or

(4) Prior to the pricing of any contract change or modification to a subcontract covered by (3) above, for which the price adjustment is expected to exceed \$100,000, or such lesser amount as may be prescribed by the head of the agency.

Any prime contract or change or modification thereto under which such certificate is required shall contain a provision that the price to the Government, including profit or fee, shall be adjusted to exclude any significant sums by which it may be determined by the head of the agency that such price was increased because the contractor or any subcontractor required to furnish such a certificate, furnished cost or pricing data which, as of a date agreed upon between the parties (which date shall be as close to the date of agreement on the negotiated price as is practicable), was inaccurate, incomplete, or noncurrent: *Provided*, That the requirements of this subsection need not be applied to contracts or subcontracts where the price negotiated is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, prices set by law or regulation or, in exceptional cases where the

Although the Act, on its surface, presents an open and deceptively simple statutory scheme, it has a surprisingly cube-like effect. Clasped within the statutory palm are the concepts of disclosure, cost and price analysis, profit limitation and misrepresentation. It is primarily directed to the problem of assuring reasonable prices for items procured where there is neither adequate price competition nor the safeguards which normally flow from economic forces at work in a truly competitive market.² It recognizes that where prices cannot be validated either by adequate price competition or by reference to established prices resulting from a competitive market, fair contract prices can nevertheless be arrived at by honest and open negotiations in which the contractor reveals his cost or pricing data to be accurate, current or complete.³ The Act assumes that cost or pricing data are not within the government's knowledge, thus placing upon the contractor the disclosure requirement.⁴ Having secured cost or pricing data, pursuant to the contractor's pricing certificate, the Act's second side implicitly commands the performance by the government of cost and price analysis and negotiation to determine a fair price.⁵ This technique involves a

head of the agency determines that the requirements of this subsection may be waived and states in writing his reasons for such determination.

For the purpose of evaluating the accuracy, completeness, and currency of cost or pricing data required to be submitted by this subsection, any authorized representative of the head of the agency who is an employee of the United States Government shall have the right, until the expiration of three years after final payment under the contract or subcontract, to examine all books, records, documents, and other data of the contractor or subcontractor related to the negotiation, pricing, or performance of the contract or subcontract.

See OFFICE OF GEN. COUNSEL OF DEP'T OF NAVY, NAVY CONTRACT LAW § 9.17A, at 183-87 (2d ed. Supp. 1965) for the legislative history of the Act. Roback, *Truth in Negotiating: The Legislative Background of P.L. 87-653*, 1 PUB. CONTRACT L.J. 3, 5 (1968), describes the pre-Act overcharge problems that led to its enactment.

² See S. REP. No. 1884, 87th Cong., 2d Sess. 3 (1962). See generally Roback, *supra* note 1, at 7, 24.

³ *Hearings Before the House Comm. on Armed Services on H.R. 5532*, 87th Cong., 1st Sess. 15-16, 57 (1962).

⁴ SUBCOMM. FOR SPECIAL INVESTIGATIONS OF THE HOUSE COMM. ON ARMED SERVICES, 90TH CONG., 2D SESS., REVIEW OF DEFENSE PROCUREMENT POLICIES, PROCEDURES, AND PRACTICES, pt. 1, at 1 (Comm. Print 1968). See generally *Hearings on Economy in Government Procurement and Property Management Before the Subcomm. on Econ. in the Govt. of the Joint Econ. Comm.*, 90th Cong., 1st Sess. (1967); *Hearings on Defense Contract Audit Agency Before a Subcomm. of the House Comm. on Government Operations*, 90th Cong., 1st Sess. (1967) [hereinafter *Defense Contract Audit Hearings*]; *Hearings on Defense Procurement Policies, Procedures and Practices Before the Subcomm. for Special Investigations of the House Comm. on Armed Services*, 90th Cong., 1st Sess., pt. 1 (1967).

⁵ See Armed Services Procurement Regulations, 32 C.F.R. § 3.807-2 (1968) [hereinafter cited as ASPR]. The regulations are issued under the authority of the Armed Services Procurement Act of 1947, 10 U.S.C. §§ 2301-2314 (1964). They govern procurement policies of the Department of Defense. See generally Nash, *Pricing Policies in Government Contracts*, 29 LAW & CONTEMP. PROB. 361 (1964).

detailed examination of the estimated cost of performance of the job, the negotiation of this estimated cost and the addition to such cost of a profit which the parties believe to be a fair reward for the work under contract. The Act, however, in practical effect, adds to the government's arsenal of remedies an effective means to recapture profits which it considers to be unearned.⁶ Significantly, the government may assert its claim during contract performance or after the work's completion. For the purposes of government contracts, it converts fixed-price type contracts into redeterminable contracts, thus permitting a downward adjustment of price, whenever the government so determines.⁷ The Act's fourth side, through its certification machinery, converts what otherwise would have been a matter of judgment into a representation. Prices of most government procurement contracts are based largely on estimated costs in proposals submitted by contractors as a basis for negotiation.⁸ Under the statutory terms the cost

⁶ Statement of Congressman F. Edw. Hebert on H.R. 5532, reprinted in *Hearings*, *supra* note 3, at 54-60. Congressman Hebert states, "This bill will prevent an unearned bonus profit from being paid, or advanced on padded estimates." *Id.* at 57. See also SENATE COMM. ON ARMED SERVICES REP. ON PROCUREMENT, S. REP. NO. 1900, 86th Cong., 2d Sess. 28 (1960). Cf. Hannah, Bond & Virden, *The Contractor Looks at the "Truth in Negotiations Act,"* 1 PUB. CONTRACT L.J. 38, 45 (1968).

⁷ A price redeterminable contract may be either prospective or retroactive. If the former, it provides "for a firm fixed price for an initial period of contract deliveries or performance and for prospective price redetermination either upward or downward at a stated time or times during the performance of the contract." ASPR, 32 C.F.R. § 3.404-5(a) (1968) (prospective price redetermination at a stated time or times during performance). This type of contract is used in procurements calling for quantity production or services; fair and reasonable prices may be negotiated for an initial period but not for later periods of performance. *Id.* § 3.404-5(b). If retroactive, there is provision "for a ceiling price and retroactive price redetermination after completion of the contract." *Id.* § 3.404-7(a) (retroactive price redetermination after completion). The retroactive contract is used when it is impossible to establish fair and reasonable prices at the time of negotiation and the amount involved is so small or the time for performance is so short that use of any other contract is impractical.

The regulations provide for three basic contracts: cost-plus, fixed-price, and incentive. The cost-plus contract is used primarily for purchasing new or untried services and for which there is little available cost data. The contractor is reimbursed for all his costs plus a fixed profit or fee. The Defense Department uses this type infrequently, as there is little incentive for contractor efficiency. *Id.* § 3.405-5. Most preferred are fixed-price contracts, particularly firm fixed-price contracts. These are negotiated at a specific price to be paid even if the contractor's costs exceed the contract price. *Id.* § 3.404-2. The incentive contract is a hybrid; it encourages efficiency in procurement situations where cost data are insufficient to arrive at a firm fixed price but sufficient to avoid the cost-plus contract. It includes a negotiated target cost and an incentive-sharing formula. The government and contractor split any difference between actual cost and target cost in proportion to an incentive-sharing ratio.

⁸ ASPR, 32 C.F.R. § 3.807 (1968). See generally Nash, *supra* note 5. It should be emphasized that a contractor is estimating what the contract will cost. The Act converts his

or pricing data supporting these estimates are represented to be accurate, current or complete. The pricing certificate thus becomes a contractual affirmation of matters that are normally judged to be opinions; breach of this certification is equivalent to misrepresenting cost or pricing data.

The Truth In Negotiating Law undoubtedly is part of a trend in which the failure to disclose matters ordinarily not regarded as fact is now classified as a breach of legal duty.⁹ Truth-telling carries a sweet lure in these days of complex and vast government transactions. The Truth In Negotiating Law is, however, an imperfect model. Despite the simplicity of its objectives and the statutory machinery for price certification and price adjustment, the Act is uneven in quality. Its lack of precision regrettably permits subjective choices as to the meaning of misrepresentation, cost or pricing data, disclosure, and overstatement. And the recognition that the government is not an unwary consumer,¹⁰ but has vast powers available to it in the procurement process,¹¹ makes the Act's credentials suspect.

estimate into actual cost or pricing data. This point is frequently overlooked in discussions of the Act. See Note, *The Truth-In-Negotiations Act—An Examination of Defective Pricing in Government Contracts*, 54 VA. L. REV. 505, 509 (1968).

⁹ See *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968); *SEC v. Texas Gulf Sulphur Co.*, 258 F. Supp. 262 (S.D.N.Y. 1966). See also 15 U.S.C. §§ 781-81n (1964) requiring those who make "take over" bids for the equity securities of a corporation to disclose the terms and underlying facts; and the Consumer Credit Protection Act, with its truth in lending provision. 82 Stat. 146, § 124 (May 29, 1968). See also *Los Angeles Times*, July 30, 1968, Part III, at 8; *N.Y. Times*, Sept. 15, 1968, § 3, at 1, col. 2; *Wall St. J.*, Oct. 8, 1968, at 3, col. 1 (Pacific Coast ed.).

¹⁰ *New York v. ITM, Inc.*, 52 Misc. 2d 39, 275 N.Y.S.2d 303 (Sup. Ct. 1966) (application of UNIFORM COMMERCIAL CODE § 2-302 to protect the gullible consumer from excessive appliance prices).

¹¹ Miller, *Government Contracts and Social Control: A Preliminary Inquiry*, 41 VA. L. REV. 27, 57 (1955) emphasizes the unequal bargaining positions of the government and contractor:

To a large extent, accordingly, the Government contract is an instrument of a power relationship, and only vaguely resembles the consensual agreement extolled by Maine and relied upon by Adam Smith. The significant decision is that of the Government in setting the terms and conditions of the proposed agreement. Little is left to the give-and-take of bargaining. The decision of the contractor is that of accepting the conditions imposed, or of not accepting them and giving up the contract entirely. Change them, bargain over them, he cannot.

It is precisely because Government contracts do reflect a power relationship, and not a consensual agreement between equals, that mandatory conditions may be attached to them. Social control would not be possible if left to the vagaries of the bargaining table and the higgling of the marketplace. The norm (or myth) calls for an exchange of offer and acceptance, with the accepting party not expressing assent in the abstract, but indicating his willingness to be bound by the precise terms contained in the offer. The act of the business firm awarded a Government contract is, to a large extent, an act of submission. Not that the law recognizes the act as one of submission—far from it. Rather, the fiction of "assent"

I

THE DEPARTURE FROM TRADITIONAL RULES

Under ordinary contract law doctrine, nondisclosure of material information may be considered a misrepresentation.¹² If one party to a contract has superior knowledge or knowledge which is not within the reasonable reach of the other, and if such information cannot be diligently discovered, the party possessing the information is under a legal obligation to speak. His silence constitutes a misrepresentation, especially when the other party relies upon him to communicate to him the true state of facts to enable him to judge the wisdom of the bargain.¹³ So, too, there is practically universal agreement that, if the material mistake of one party was caused by the other, either purposely or innocently, or was known to him, or was of such character

is maintained, both in "compulsory" agreements and in Government contracts. The process forces obedience on all who approach its sphere of activity, but the law makes no differentiation between the offer which results in free bargaining and the offer which results in a form of economic coercion.

The contractor's system of inspection and quality control are subject to government approval, ASPR, 32 C.F.R. §§ 14.101-1 to -3 (1968); the government has the right to inspect the plant and audit the contractor's books and records, 10 U.S.C. § 2313 (1964); the government has reserved the right, in certain cases, to approve the contractor's sub-contracts, including its purchasing system and make-or-buy plan, ASPR, 32 C.F.R. §§ 3.901 to .902-5 & 23.000 to .204 (1968); the government has established the cost principles applicable to government work, *id.* §§ 15.000 to .603 (1968); the regulations are not subject to the Administrative Procedures Act, 5 U.S.C. § 1001 (1964); and profit control is limited by the Renegotiation Act of 1951, 50 U.S.C. §§ 1211-33 (1964). *See also* the Defense Production Act of 1950, 50 U.S.C. §§ 2061-2166 (1964).

¹² RESTATEMENT OF CONTRACTS § 472 (1932).

¹³ *Id.* Judge Hincks, in *Bank & Trading Corp. v. Floete*, 257 F.2d 765 (2d Cir. 1958), applied the Restatement rule in a case involving the superior knowledge of the government with respect to export regulations:

I not only concur in Judge WATERMAN'S opinion but would also base affirmance on the ground that even if a valid contract had been made the contract had been rescinded for the reasons stated in Judge Walsh's lucid opinion below. 147 F. Supp. 193, at pages 207 and 208. On February 3, 1947 when Isbrandtsen wrote its "offer" to RDC both parties were mistaken as to the state of the Netherlands export regulations. For Isbrandtsen was not informed of the "new" regulations until February 4 and RDC not until February 17. Consequently if RDC's reply of February 7th be deemed an acceptance which brought a contract into effect, there was a mutual mistake as to a fact plainly material and the contract was voidable under the Restatement of Contracts § 502. If, however, a contract be deemed to have come into effect when Isbrandtsen accepted the counteroffer contained in RDC's letter of February 7, Isbrandtsen's continued failure to disclose to RDC the new Netherlands export regulations was not privileged under § 472(1)(b) of the Restatement and consequently its non-disclosure had the effect of a material misrepresentation under § 472(2). As such it was cause for rescission under § 476(1) of the Restatement. *See Corbin on Contracts*, Vol. 3, § 610.

257 F.2d at 770-71.

that he had reason to know of it, the mistaken party has a right to rescind the contract.¹⁴

A party entering into a bargain is not bound to tell everything he knows to the other, even if he is aware that the other is ignorant of the facts; and unilateral mistake, of itself, does not make a transaction voidable. But if a fact known by one party and not the other is so vital that if the mistake were mutual the contract would be voidable, and the party knowing the facts also knows that the other does not know it, nondisclosure is not privileged.¹⁵ On the one hand the law recognizes a remedy where one of the contracting parties has superior knowledge. The possession of that information places him under a duty of disclosure. And the breach of that duty may render him liable for misrepresentation. On the other hand the law recognizes that where one of the contracting parties may have erred and this mistake was caused by the other contracting party or was known to him, the contract may be rescinded.

The Truth In Negotiating Law leaps over the possible impediments that surround common law misrepresentation and mistake by establishing, through the guise of the pricing certificate, a contract requirement that the contractor has furnished cost or pricing data that is accurate, current and complete. The failure to satisfy the certificate entitles the government to a downward price adjustment because the contractor furnished unsuitable data. So, too, the Act enlarges upon the common law by predetermining the questions of superior knowledge, mistake, and the materiality of the omitted cost or pricing data. Under common law doctrines these are matters that must be proved. But whatever cost or pricing data may actually be, the Act has been interpreted as a decree that they are facts relied upon as the basis for the establishment of the contract price.

Ironically, the best illustrations of the common law at work are found in the field of government contracts where the contractor has brought suit against the government based upon the nondisclosure of material information. These cases hold that the government is under a duty to divulge to its contractors any information of a material nature in its possession concerning a proposed project or procurement which may deter the contractor from undertaking to bid or which will alert him to circumstances which may affect the amount of his bid. They underline the notion that the Truth In Negotiating Law lacks sound

¹⁴ 3 A. CORBIN, CONTRACTS § 610 (1960).

¹⁵ *Id.*

common law roots and sharpens the discrepancies between the parties' positions.

In the leading case of *Helene Curtis Industries, Inc. v. United States*,¹⁶ plaintiff's suit was for additional costs based on its claim that the Army knew of the need for grinding powder required for the manufacture of a disinfectant. Plaintiff neither had nor had reason to have this information; the Army failed to supply the information to plaintiff in the specification or elsewhere; and this failure misled plaintiff. In the alternative, plaintiff claimed that the specification was affirmatively misleading as to the method of making the disinfectant. The court found that the Army knew that grinding powder would be necessary, since the product contracted for could not be made without it; that plaintiff, on the basis of the information available to it, reasonably expected to perform the contract by simple mixing without grinding; that the Army was aware that plaintiff expected to produce the product improperly without grinding; and that the Army did not inform the contractor of the proper method of manufacture. The specification itself was viewed by the court to be "actively misleading" in the context of the special knowledge the government possessed but did not share. As to the government's obligation, the court said:

Although it is not a fiduciary toward its contractors, the Government—where the balance of knowledge is so clearly on its side—can no more betray a contractor into a ruinous course of action by silence than by the written or spoken word.¹⁷

The Court of Claims in *J. A. Jones Construction Co. v. United States*¹⁸ allowed plaintiff-contractor to recover \$122,897.21 for premium (overtime) wages paid by it and its subcontractors. The gravamen of the complaint was that the government knew but failed to divulge that a large, high priority ICBM construction program, premised in large part on the payment of premium wages, was to be initiated in the labor area where plaintiff's contract was to be performed. The resulting labor shortage forced plaintiff to pay premium wages in order to acquire the labor necessary for contract performance, although after due inquiry it had reasonably prepared its bid on the assumption that an adequate supply of straight-time labor would be available.

In *Snyder-Lynch Motors, Inc. v. United States*,¹⁹ plaintiff brought

¹⁶ 312 F.2d 774 (Ct. Cl. 1963).

¹⁷ *Id.* at 778.

¹⁸ 390 F.2d 886 (Ct. Cl. 1968).

¹⁹ 292 F.2d 907 (Ct. Cl. 1961). To similar effect are *Blackhawk Hotels Co.*, 68-2 BCA 33,756 (1968); *Midvale-Heppenstall Co.*, 65-1 BCA 22,107 (1964); *Johnson Electronics, Inc.*, 65-1 BCA 22,099 (1964).

an action against defendant to recover damages resulting from the losses it sustained in carrying out a contract to rebuild 750 tank engines. Prior to submitting its bid, plaintiff requested a specimen engine that could be torn down and rebuilt for a practical test of the time and labor involved. The government knew from another company's experience that the cost of replacement parts was 145.5 per cent above the estimated cost, although that information was not disclosed. The court held that the government was wrong in not revealing this information and allowed the plaintiff to recover the resulting damages.

The prerequisites to liability are the government's superior knowledge and the probable consequences flowing from withholding that information, the lack of knowledge by the contractor, and the fact that the government should have been aware of the contractor's ignorance, but nevertheless failed to disclose the pertinent information. The critical fact in each of these cases is the contractor's entrapment, without warning, in a situation beyond his control.²⁰

The Truth In Negotiating Law embraces the theories of these cases, but overlooks the conditions they considered necessary to attach liability. The Act establishes the presumption that the contractor is in possession of cost or pricing data not known to the government because the data originates within his organization. It requires that this data be furnished by the contractor, even though the government may have access to this or similar data. It assumes that, when cost or pricing data is not furnished to the government, the government has established a contract price based upon a mistake. Thus the contractor, upon price adjustment, is merely giving back to the government what is due, according to the Act's theory.

The remedies for misrepresentation and mistake were not considered available to the government with respect to the overcharges reported by the General Accounting Office prior to the Act's passage. In the absence of legal remedies, the government had employed the voluntary refund device relying upon principles of fair dealing to achieve its desired adjustment.²¹ The use of the voluntary refund procedure suggests that the contractor's cost proposals were not repre-

²⁰ *Air-A-Plane Corp. v. United States*, No. 61-62 (Ct. Cl. July 24, 1968). The court's words at page 12 are instructive:

The vice of the alleged misrepresentation here is not that there were extensive changes, but that for reasons of its own the Government elected not to warn the bidders, for had it done so the bidders could not later have claimed surprise. Fundamental fairness imposes a duty on the Government to make full disclosure to bidders to give them the opportunity of refusal. Judicial rebuke of the occasional lapse provides a wholesome catharsis.

²¹ See note 13 *supra*.

sentations of facts to be relied on by the government negotiators. The strength of the government's purchasing power, its ability to audit contractor's records, and its internal estimating procedures provided reasonable safeguards against entering into contracts under a mistake of fact which was known or should have been known by the contractor.

Yet by overtaking the common law requirements to avoid or reform a contract, the Act establishes an imbalance in the law of contracts. Aside from the obvious argument relating to the stability of contract, it establishes one set of rules for the government concerning price adjustment, while contractors are left to pursue strict legal remedies before the courts with the requirement that their claims conform to standards of proof and satisfy conditions not present in the Act.²²

II

THE GOVERNMENT'S CASE

A. The Relationship Between the Pricing Certificate and the Price Reduction Clause

The crux of the Act is the pricing certificate requirement and the price adjustment provision. The regulation implementing the Act ties these clauses by establishing the condition that the price reduction is dependent upon the finding that incomplete or inaccurate cost or pricing data or data not current "as certified in the Contractor's Certificate of Current Cost or Pricing Data" has occurred.²³ At the outset, the interesting question is posed as to the appropriate standards of interpretation. If defective pricing is a matter governed by the Act, then the general rules of statutory construction should control. But in this instance there are two conflicting rules: First, that statutes in derogation of the common law should be strictly construed;²⁴ and second, that remedial statutes should be read liberally.²⁵ The Act creates a misrepresentation or a breach of contract that does not exist at common law and thus offends the basic notions about stability of contracts. Yet it is also a remedial statute, attempting to correct an imperfection in the procurement process whereby overcharging in

²² *But see* Pettit & Joseph, *Government's Obligation To Disclose Under the Truth In Negotiations Act*, 10 WM. & MARY L. REV. 18 (1968).

²³ ASPR, 32 C.F.R. § 7.104-29 (1968).

²⁴ Annot., 42 A.L.R.2d 516, 523 (1955).

²⁵ *Socony-Vacuum Oil Co. v. Smith*, 305 U.S. 424, 431 (1939); *Grand Trunk Ry. v. Richardson*, 91 U.S. 454, 472 (1875).

government contracts could result if unsuitable cost or pricing data was employed by the government negotiators.

If, however, the question of defective pricing is a matter of contract construction, there are equally difficult standards. The imbalance here results from dealing with a contract of adhesion in which there has been no bargaining over the contract terms relating to the pricing certificate and the price reduction clause.²⁶ At the same time that the parties are caught in the white heat of a negotiation, which thrives on instinct, experience and common sense, the Act requires an almost perfect disclosure of data from what in most cases must be complex and widely scattered organizations.²⁷

Although no sure standard of interpretation can be presented at this time, proper results probably can be achieved by weighing the remedial policy of the Act against two other factors: the conduct of the parties and the contractual or commercial setting in which the parties deal. The Act should be considered subordinate to its contractual counterparts (the pricing certificate and the price reduction clause), so that the rules applicable to contractual relationships apply. This conclusion was probably intended by Congressman Vinson when he indicated that the legislative purpose underlying the inclusion of the certificate in the Act was to make the contract invalid unless the certificate was obtained, pursuant to the statutory direction.²⁸ Any other result may mean that the statute has imposed upon contractors an insurer's liability—strict liability upon finding any omitted data. This notion is buttressed by the government's establishment of a contractual relationship by the terms of the pricing certificate and the

²⁶ For discussions of contracts of adhesion and compulsory government contracts, see Isaacs, *The Standardizing of Contracts*, 27 YALE L.J. 34 (1917); Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943); Lenhoff, *The Scope of Compulsory Contracts Proper*, 43 COLUM. L. REV. 586 (1943); Patterson, *Compulsory Contracts in the Crystal Ball*, 43 COLUM. L. REV. 731 (1943); Pound, *The New Feudalism*, 16 A.B.A.J. 553 (1930); Note, 30 IND. L.J. 60 (1954).

²⁷ *Hearings*, *supra* note 3, at 43-44.

²⁸ 108 CONG. REC. 9972 (1962) (remarks of Congressman Vinson):

That requirement is set out in [ASPR] section 3-807.3 and the form of the certificate is prescribed in [ASPR] section 3-807.7.

I submit that if it is good regulation, it will be good law.

The reason for putting this provision in the law is to have the requirement followed.

When it is law, no contract will be enforceable [sic] without it. That is the point to which we have come today.

(Emphasis added.) A statutory scheme with similar effect is contained in 10 U.S.C. § 2313(b) (1964).

price reduction clause.²⁹ Accordingly, the rules applicable to contracts of adhesion should apply.³⁰

One of the basic doctrines in government contracts is that when the government enters into contracts, it is on the same footing as any other contracting party and is bound by the traditional rules governing the formation and construction of contracts—it is bound by its contracts to the same extent as a private person.³¹ A universal rule of contract construction is that other writings which are referred to in a written contract are regarded as incorporated by reference into the contract and, therefore, should be considered in the interpretation of the contract.³² The price reduction clause operates on the furnishing of incomplete pricing data and refers to the pricing certificate to determine this deficiency.³³ Thus the relationship between the pricing certificate and the price reduction clause is clear. The clause incorporates by reference the certificate as the means of establishing the data and the period to which it applies.³⁴ Stated differently, as a matter of contract, the government's right of price reduction under the price reduction clause is derived solely from and is limited by the contractor's certification of pricing data, as contained in the pricing certificate.³⁵

²⁹ ASPR, 32 C.F.R. § 7.104-29 (1968).

³⁰ Pasley, *The Interpretation of Government Contracts: A Plea for Better Understanding*, 25 *FORDHAM L. REV.* 211, 213-15 (1956).

³¹ *Lynch v. United States*, 292 U.S. 571, 579 (1934); *Hollerbach v. United States*, 233 U.S. 165, 171 (1914); *Cooke v. United States*, 91 U.S. 389, 396 (1875).

³² *Day v. United States*, 245 U.S. 159 (1917).

³³ See p. 721 & note 41 *infra*.

³⁴ Mr. Shedd, speaking for the Board in *American Bosch Arma* in outlining the significant differences between the ASPR provision before and after passage of the Truth In Negotiating Act, concluded that the price reduction clause must be read with the pricing certificate and that "the only contractual duty to furnish pricing data is such as can be implied from the contractor's obligations under the Price Reduction . . . clause in conjunction with the Certificate of Current Pricing Data." 65-2 BCA 24,838, at 24,849 (1965).

³⁵ See also 8 CCH GOV'T CONT. REP. ¶ 90,062, at 95,172 (1967). Cuneo, Ackerly & Lane, *Truth In Negotiations—Part II* (Briefing Paper No. 68-4, Aug. 1968), while agreeing with the conclusion, state:

What is your responsibility in the absence of a certificate? The current price reduction clauses are unclear. They provide for a price reduction if the price was inflated because the contractor "furnished incomplete or inaccurate cost or pricing data or data not current as certified in the Contractor's Certificate of Current Cost or Pricing Data." Technically, then, your liability for *inaccuracy* or *incompleteness* does *not* hinge on the certificate, but your liability for *noncurrency* does.

Id. at 4 (footnote omitted).

This construction is rejected by the authors and may not be accurate, since the quoted portion of the clause, as set forth in ASPR, 32 C.F.R. § 7.104-29 (1968), is bracketed by commas; hence, the "as certified" language modifies the entire expression. This result is supported by *id.* § 3.807-5(a), as amended by Defense Procurement Circ. No. 57 (Nov. 30, 1967). However, in cases dealing with the *prestatutory* clause, the Board concluded that the certificate and the price adjustment clause were independent. Lockheed

B. *The Government's Position*

The government, under the view adopted by the Board,³⁶ has the burden of proving

- (1) that the cost or pricing data furnished were inaccurate, incomplete or noncurrent;
- (2) that the price increase was caused by the defect; and
- (3) the amount of the increase.³⁷

Although there must be a cause and effect relationship between the nondisclosure of cost or pricing data and the overstated price, the Board has not bound itself to a direct causation test but has applied a "natural and probable" test or a "reasonable probability" test. The cumulative effect of this test has been to erode the causation requirement expressly stated in the Act and to limit the government's burden of proof established by previous Board opinions.

*American Bosch Arma Corp.*³⁸ established the "natural and probable" causation test. It involved a fixed-price incentive "follow-on" contract for missile guidance sets under which the government claimed that the target cost of \$14.08 million included an overstatement of \$184,831, because the contractor failed to furnish current cost or pricing data relative to seventy-five purchased parts. The contractor had accumulated and was continuing to accumulate substantial historical production data for these sets, including evidence of progressive decreases in material costs. The government's requirement was increased during various stages of negotiations from a quantity of two to sixty-four; and the contractor submitted three separate cost estimates and cost breakdowns for incremental quantities. The second of these, which constituted the principal increment of the contractor's proposal, was

Aircraft Corp., 67-1 BCA 29,439 (1967); *American Bosch Arma Corp.*, 65-2 BCA 24,838 (1965). The present clause dictates another result. One commentator has concluded that the certificate "is of minimal utility." Note, *supra* note 8, at 513. His analysis seems to be based on the prestatutory cases and overlooks Congressman Vinson's statement set forth in note 28 *supra*.

³⁶ The Board sits as the authorized representative of the Secretary of the Defense Department, pursuant to the contract's "disputes" clause. ASPR, 32 C.F.R. § 7.103-12 (1968). Its rules of procedure and charter are set forth at *id.* § 30.1 App. A (1968). Its proceedings are quasi-judicial; decisions lack finality on questions of law. 41 U.S.C. §§ 321-22 (1964). See generally Hiestand & Parler, *The Disputes Procedure Under Government Contracts: The Role of the Appeals Boards and the Courts*, 8 B.C. IND. & COMM. L. REV. (1966); Note, *Government Contracts Disputes: An Institutional Approach*, 73 YALE L.J. 1408 (1964).

³⁷ *Northrop Corp.*, 69-1 BCA 34,544, at 34,548 (1968); *Defense Electronics*, 66-1 BCA 26,191, at 26,201-02, *motion for reconsideration denied*, 66-1 BCA 26,426 (1966).

³⁸ 65-2 BCA 24,838 (1965).

for a total of forty-nine sets; and it included the contractor's "make or buy" structure and historical costs showing prices and quotations on the seventy-five purchased parts. A period of about four months elapsed from the submission of the principal increment of the contractor's proposal until conclusion of negotiations and execution of the contractor's certification of the cost or pricing data. At the time of the conference to conclude negotiation of target cost, the contractor had a breakdown of the cost elements constituting target cost, but this was not disclosed. The contractor also made a breakdown of the negotiated price which estimated the materials cost at \$73,280 less than it would have been if based on the principal increment of the contractor's proposal.

The Board found that the contractor had cost experience data as to the seventy-five purchased parts more recent than that submitted with the principal increment of its proposal, and that the data was posted in its records and otherwise "reasonably available" to it for a period of two and a half months subsequent to the pricing proposal. On the basis of the limited evidence in the record, however, the Board found that the contractor did not have more recent cost or pricing data reasonably available (considering such matters as administrative time for posting records) during the remaining six weeks immediately prior to the execution of the certificate. The Board therefore found that the contractor was required to furnish the government the additional data available to it during the two and a half months' period but not the data which did not become available until the final six weeks' period. The Board did find that additional pricing data showing reductions of \$20,746 in the prices of purchased parts (data which became available to the contractor during the government audit and during the two and a half months' period after conclusion of the audit) was not disclosed to the government. The Board found for the government using a "natural and probable" causation test.

In the absence of any more specific evidence tending to show what effect the nondisclosure of the pricing data had on the negotiated target cost, *we are of the opinion that we should adopt the natural and probable consequence of the nondisclosure [sic] as representing its effect.* Theoretically the nondisclosure of pricing data showing a price reduction of \$20,746 should have resulted in a reduction in the negotiated target cost of \$20,746 for materials cost plus a G&A allowance of 9.23% making a total of \$22,661. That is deemed to be the natural and probable consequence, and there is nothing in the record to indicate that its effect was otherwise. Accordingly, we held [sic] that the nondisclosure of significant

and reasonably available cost and pricing data caused the negotiated target price to be overstated in the sum of \$22,661.³⁹

In view of the negotiation policies and techniques followed by DOD, which were known to [the contractor] at the time the contract was negotiated, it would be a rare case indeed where there is any better proof of direct causal relationship between the nondisclosure and the overstatement of price. To hold that there is insufficient proof of the causal relationship in this case would amount to a virtual holding that there can be no entitlement to a price reduction for nondisclosure of pricing data whenever the contract price is negotiated under the policies and techniques present in this case.⁴⁰

Lockheed Aircraft Corp.,⁴¹ the second case clearly enunciating and applying the "natural and probable" test, involved pricing data furnished by a subcontractor. The subcontractor did not furnish either the prime contractor or the government the latest pricing data on over ninety per cent of the material that he had recently purchased, but he did make records of his earlier purchases available to government auditors and did make a gesture to the effect that all of his records were available for inspection if desired. The subcontractor submitted his proposal to the prime contractor in February 1962. Shortly thereafter, he began to make substantial purchases of materials. By June, when the material costs were finally negotiated, he had already purchased over ninety per cent of the materials needed. The Board found that these were excess costs, and held that the excess amount had significant effect on the process of achieving a fair and reasonable negotiated price within the intent of the price reduction clause. Consequently, causation was deemed apparent; the natural and probable effect of the failure to disclose was an increased negotiated price.⁴² The Board, in fact, had little choice but to rule this way, since there was un rebutted proof of a failure to disclose.⁴³

*Cutler-Hammer, Inc.*⁴⁴ neatly nails down the point that a reasonable probability is all that is necessary for the government to satisfy its burden of proving that defective data resulted in overstated price. *Cutler-Hammer* involved the purchase of a lens from a subcontractor. This type of lens had state-of-the-art and production difficulties which

³⁹ *Id.* at 24,853 (emphasis added). See ASPR, 32 C.F.R. § 3.807-5(a)(2) (1968).

⁴⁰ 65-2 BCA at 24,853-54.

⁴¹ 67-1 BCA 29,439 (1967).

⁴² *Id.* at 29,446.

⁴³ See Note, *supra* note 8, at 519.

⁴⁴ 67-2 BCA 29,822 (1967), *appeal docketed*, No. 364-67 Ct. Cl.

tended to restrict availability of sources for it. Prior to the contract in issue, only one company manufactured the lens. After issuing a request for quotations to five sources, Cutler-Hammer received a bid only from its prior manufacturer in the amount of \$406,445, which was included in its price proposal to the government. Some months later, but prior to negotiations, Cutler-Hammer received a price from an untried supplier in the amount of \$91,206, which was not disclosed to the government in the negotiations. After the conclusion of negotiations, a technical proposal was received and Cutler-Hammer subsequently made an award to the new supplier.

In sustaining the government's claim, the Board held that any doubt over whether disclosure of the untried and unproved quote would have had any effect on the contract price would be resolved in favor of the government. The reasoning was that indefinite consequences fall on the one who did not disclose. The government argued that, had it been fully advised of the facts, it would have either delayed the execution of the contract until more data relative to the supplier's competency became available or excluded the lens cost from the contract pricing structure and reserved it for further negotiation. Although the Board recognized that it could never be sure just what the parties would have done if the lower price had been disclosed, it was convinced that something contractually different would have been developed to cover this situation. Thus the Board, after rejecting the government's argument that it would have delayed the execution of the contract until more data was available, concluded:

[T]he Government has established the *reasonable probability* that with a disclosure of the . . . quotation, the parties would have agreed that the cost of the [lens] would be excluded from the contract price, and reserved for further negotiations an addition to the contract price at a later date.⁴⁵

It can be argued that in *Cutler-Hammer* the government did not prove that the nondisclosure data *caused* an overstated price. All the government directly proved is that it would have acted differently. It is just as likely, however, that the contractor would not have agreed with the government in the exercise of these alternatives. Using hindsight testimony as to what the parties would have done had the government known of the undisclosed cost or pricing data, the Board is able to speculate after the fact as to cause and effect between nondisclosed data and the contract price. This is precisely what happened in *Bell & Howell Co.*⁴⁶ That case involved the nondisclosure of lower vendor

⁴⁵ *Id.* at 29,829 (emphasis added).

⁴⁶ 68-1 BCA 32,335 (1968).

quotes while Bell & Howell was actively negotiating with those vendors. The Board noted Bell & Howell's contention "that the disclosure of the low quotes would not have resulted in any reduction of the price below what was agreed to . . .,"⁴⁷ and also considered that the government negotiator had "conceded at the hearing that if he had known about the low quotes, he would not have refused to consider the explanation given by the contractor for not basing its price on the low quotes and demanded a further price reduction . . ."⁴⁸ The Board concluded that although disclosure would not have enabled the government to negotiate a price reduction,⁴⁹ the government nevertheless "would not have entered into the firm fixed price specified [in the contract modification] or any comparable figure."⁵⁰ The Board found that the government had moved toward a firm fixed-price contract because its evaluation of the contractor's proposal indicated that the contractor had realistic firm prices on the purchase parts. The disclosure of the low quotes, in the Board's opinion, and the probable discussion of the risks attending such quotes would have persuaded the government to conclude that there were still too many risks and contingencies to shift to a firm fixed-price basis. Accordingly, the contractor was held liable.

In these cases the Board's reasoning on the burden of proving causation is subject to three criticisms: It relies upon testimony that deals directly with a conclusion of law; it uses conjecture which does not sustain the government's burden of proof; and it applies a subjective test that pursued to its logical conclusion could raise the "natural and probable" test to a rule of per se liability.⁵¹ If less than per se liability is intended, then this test offers little or no guidance in future cases.

The use of the "natural and probable" test and its extension, the "reasonable probability test," permits the government to succeed by testifying, "I probably would have insisted upon a lower price." This type of testimony, though successfully used in *Cutler-Hammer* and *Bell & Howell*, begs the very question of causation. Traditionally, a witness' testimony as to a legal conclusion, since it usurps the fact-finder's function, will be excluded.⁵² Yet this type of testimony forms the foundation for the government's case under the Board's test.

⁴⁷ *Id.* at 32,348.

⁴⁸ *Id.*

⁴⁹ *Id.* at 32,349.

⁵⁰ *Id.*

⁵¹ ASPR, 32 C.F.R. § 3.807-5(a)(2) (1968), as amended, Defense Procurement Circ. No. 66 (Jan. 2, 1969), 8 CCH GOV'T CONT. REP. ¶ 79,115 at 75,165-66 (1969), rejects the idea that the government need prove that it would have acted differently. Rather the regulation attempts to create an unwarranted form of per se liability.

⁵² 7 J. WIGMORE, EVIDENCE §§ 1918, 1952 (2d ed. 1940).

Arguably, such self-serving testimony is not sufficient to support the government's burden of proof under the Act. *International Harvester Co. v. United States*⁵³ dealt squarely with the question of the government's right to obtain a price reduction under a contract clause authorizing a price adjustment and treated the sufficiency of such testimony to support the government's burden of proof. International Harvester sued to recover \$1.7 million from the United States. One of the questions before the Court of Claims was whether the government, if it had known certain facts, would have instituted price redetermination proceedings, pursuant to the contract terms. The government in July 1953 asked International Harvester and other competitors to bid on a forthcoming contract award for trucks. It was understood that the winner of the contract award would be the government's sole manufacturer. Price was the most important consideration in awarding the contract. International Harvester was willing, if necessary, to assume a loss if it was the successful bidder. Accordingly, it prepared its bid on a "specific cost basis," reducing in its bid certain indirect costs, but not disclosing the manner of cost computation to the government at the time of the award, although it was requested to do so. The United States contended on this issue that, had International Harvester set forth the components of its price in its bid proposals or had it made such data available to the government's price analyst, downward and forward price redetermination would have occurred, resulting in a contract price reduction of \$490,533.08.

In words that are directly applicable to our discussion, the Court of Claims held:

The crux of the matter is that defendant is required to prove that it would have requested or required negotiations for price redetermination had the actual basis upon which the bid was first computed been known. This requirement is not met by the testimony of defendant's price analyst that had he known the actual facts, he would have recommended price redetermination proceedings. Defendant's failure to meet this burden of proof leaves us to mere speculation as to whether or how much defendant was damaged by plaintiff's withholding information from defendant, and by its misrepresentations in the cost data submitted with its bid.⁵⁴

Looking at the Board decisions on causation on a case by case basis, a rationale can be supplied to mute some of this criticism. *American Bosch Arma* should be accepted as a proper application of the "natural and probable" consequences test. *Cutler-Hammer, Lock-*

⁵³ 169 Ct. Cl. 821 (1965).

⁵⁴ *Id.* at 847.

heed Aircraft, and Bell & Howell should be limited to the proposition that the government's burden of proof will be lightened where there is un rebutted proof of a failure to disclose facts which are peculiarly in the possession of the contractor, and the contractor affirmatively acts upon those facts after the negotiations.⁵⁵ This is the factual pattern common to these three decisions. In each case vendor material prices, albeit speculative, were actively considered by the contractor, but not disclosed during negotiations.

If, however, the Board intends to create a standard of "liability per se" upon proof of a failure to disclose, it clearly has exceeded that point in time and space where legal causation does occur. Causation is an explicit requirement of the Act. A rule is needed that meshes with the objectives of the Act and, at the same time, provides predictable results, by establishing a consistent burden of proof. If the government does indeed bear the burden of proof as to causation, a failure to disclose is not some evidence of an overstated price. The specific factors to be examined are whether there was a natural and continuous sequence between cause and effect. Was one a substantial factor in producing the other?⁵⁶ Testimony as to what might have happened or testimony about modifying a method of negotiation should be immaterial. This test would not place an unfair burden on the government because the Board could look to two pivotal events: Whether an unearned profit exists; and whether data exists that would have a meaningful relationship to cost or price analysis. If the Act was passed because alleged overpricing led to windfall profits, there should be no objection to the cause and effect being established in this manner.⁵⁷

⁵⁵ But *Cutler-Hammer*, unless reversed, should probably be confined to its special facts because factual cost or pricing data was not present in that case, and direct causation was not proved.

⁵⁶ A generally accepted rule for determining legal cause is as follows:

The proximate cause, involved as it may be with many other causes, must be at the least, something without which the event would not happen. The court must ask itself *whether there was a natural and continuous sequence between cause and effect. Was the one a substantial factor in producing the other? Was there a direct connection between them, without too many intervening causes? Is the effect of cause on result not too attenuated? [sic] Is the cause likely, in the usual judgment of mankind, to produce the result? Or by the exercise of prudent foresight could the result be foreseen? Is the result too remote from the cause, and here we consider remoteness in time and space. . . .*

Palsgraf v. Long Is. R.R., 248 N.Y. 339, 354, 162 N.E. 99, 104 (1928) (dissenting opinion) (emphasis added).

⁵⁷ The government has assumed that if an agreed price includes amounts which can conceivably be attributed to erroneous or incomplete cost or pricing data, it is not a fair price and the resultant profits are not earned profits. Yet former Secretary of Defense Clifford in his letter of June 13, 1968, to Senator Russell, Congressmen Rivers and Mahon, offers data that casts doubt upon the assumption that windfall profits exist, thus providing

So, too, emphasis should be placed upon the ability of a reasonable and prudent person to employ the data alleged not to have been disclosed for the purposes of cost or price analysis. To the extent the data is not suitable for this purpose and its use is solely a matter of opinion, it should be given little weight.

III

THE CONTRACTOR'S CASE

The Act's varied conditions bestow upon contractors several arguments that may rightfully defeat the government's claim. Although some support for the suggestion that the government should be required to prove direct causation. He states:

A misunderstood and misinterpreted profit statistic which has been discussed recently is the negotiated "going-in" profit on noncompetitive contracts. Some people apparently assume that this profit is a guarantee of what the contractor will actually earn when the contract is completed. This is not the case. . . . [T]he contractor's profit percentage can be expected to decrease to the extent that his actual costs are higher than negotiated at the outset—a very frequent occurrence on development and initial production of complex military items.

Furthermore, by law and regulation there are many contractor costs which are not allowed on Government work and which thus must be paid by the contractor out of his profits. These unallowable costs include interest on borrowed capital, donations and contributions, advertising, and others; in the aggregate such unallowables average in excess of 1.5% of the contractor's actual costs.

The statement has been made that since 1964 "going-in" negotiated profits have increased 25% over the 1959-1963 period. The actual increase from January 1, 1964 through December 31, 1967 has been 22%. A principal reason for this increase in "going-in" profit rates is the fact that we have consistently increased the use of firm-fixed-price and incentive type contracts, while reducing the use of cost-plus-fixed-fee (CPFF) contracts. This shifts responsibility and risk from the Government to the contractor, and provides an incentive for better management. Our experience shows that the *total cost* to the Government is thereby reduced. Hence, it is sound practice to share the cost savings with the contractor.

Since 1961 the percent of awards based on firm-fixed-price contracts has increased from 31.5% to 56.3% of all awards; incentive contracts have increased from 14.4% to 26.1%; while the percent of CPFF awards has dropped from 36.6% to 10.4%. We would indeed be exacting unreasonable penalties if such dramatic shifts in risk were not accompanied by improved profit *opportunities*. As a consequence, the average negotiated "going-in" profit has increased from 7.7%, on estimated cost, to 9.4% since January 1964—a 22% increase.

Despite this apparent improvement in profit opportunities, the limited data available to us thus far on completed contracts show no improvement in realized profits—that is, they are remaining at the 1959-1963 level. We are currently examining why the anticipated improvement has not occurred, because we cannot properly expect industry to accept greater risks, and to apply an ever larger share of their own financial resources to the performance of complex military undertakings, without a valid opportunity to obtain profit results commensurate with the lower cost to the Government. Unless such improvements do occur in the future, we can only expect strong pressures to revert to much greater use of CPFF type contracts. I am sure that you will agree, as I find industry leaders do, that this would be a retrogressive step.

the discussion may not be inclusive of all possible positions, there are several important contentions that should be considered.⁵⁸ First, the contractor may have disclosed to the government the cost or pricing data that is the subject of the dispute. Second, the nondisclosed information may be lacking the characteristics of cost or pricing data, and thus be properly classified as judgmental or speculative in nature. Third, the government may have elected that only pricing data or only cost data would be furnished to it in the negotiations and should not be able to retreat to a position it rejected earlier. Fourth, the contractor's nondisclosure may not have caused an overstatement in contract price because the government did not rely upon the contractor's cost or pricing data. Fifth, the contractor should be able to offset asserted understatements of costs against alleged overstatements. Finally, the contractor's omission may be the result of an honest mistake.

A. *The Contractor's Disclosure of Cost or Pricing Data*

A determination that cost or pricing data was furnished to the government by the contractor will, obviously, satisfy the Act's requirements and defeat the government's complaint. The disclosure may be a disclosure of a body of information to a government representative or it may take the form of a "constructive" disclosure; that is, the government should have known that cost or pricing data existed. The principle supporting the "constructive" disclosure of cost or pricing data is that both sides have obligations under the Act.

In *American Bosch Arma* a disclosure of cost or pricing data occurred when the contractor made available to the government auditor all make-or-buy records used in the preparation of its proposal. The auditor furnished an audit report of his findings to the government negotiating team. The Board concluded that "anything that could be found from examination of appellant's records up to [the audit's completion date] was disclosed to the Government."⁵⁹ The Board reached the same conclusion in *Defense Electronics*.⁶⁰

When the contractor made data available to the Government auditor for his use in auditing the contractor's change order price proposal, that was a sufficient furnishing of such data for the purposes of the Price Reduction clause, and the contractor was under no obligation to furnish to the contracting officer personally data

⁵⁸ The Act calls for a reduction in price when the price has been increased by "any significant sums." This problem is not considered here because the Board has tended to consider the amounts in the cases before it as significant. A good discussion is found in Comment, *The "Truth-in-Negotiating" Clause of P.L. 87-653 as Interpreted by the Armed Services Board of Contract Appeals*, 13 VILL. L. REV. 604, 616 (1968).

⁵⁹ 65-2 BCA 24,838, at 24,851 (1965).

⁶⁰ 66-1 BCA 26,191, *motion for reconsideration denied*, 66-1 BCA 26,426 (1966).

not requested by the contracting officer which the contractor had already made available to the Government auditor and which the auditor had used and referred to in the audit report which was furnished to the contracting officer.⁶¹

In *Lockheed Aircraft Corp.*,⁶² however, the Board rejected the contractor's contention that its responsibilities under the price reduction clause were satisfied because its pertinent records were available to the government. The Board explained that a meaningful disclosure required the contractor to place before the government the actual body of data used to support its proposal:

We do not have before us a situation where a subcontractor during negotiations actually disclose [sic] for *examination and review* to the prime contractor (or the respondent) the numerous purchase orders for material already purchased.⁶³

The Board in *Lockheed Aircraft* distinguished *American Bosch Arma* and *Defense Electronics* on the ground that the data involved in those cases was physically examined by the government. The holding of *Lockheed Aircraft* is that the contractor must be sure the government is aware of the existence of any significant information.⁶⁴ There is, however, no language in the Act which indicates that the contractor should be held responsible for the government's analysis of the data presented to it.

None of the cases has considered the question of whether the government *should* have known of the existence of cost or pricing data and had an affirmative duty to seek out such data from the contractor

⁶¹ *Id.* at 26,202. FMC Corp., 66-1 BCA 25,696 (1966), contains language to the effect that pertinent data need only be made *available* to the government. The contractor fulfilled the requirements of the clause on the basis of a stipulation between the parties that:

All pertinent FMC books and records relating to the pricing of the changes imposed by Modifications No. 2 and No. 6 were made available to these Government personnel in connection with the negotiation of Modifications No. 137 and No. 138.

Id. at 25,710.

⁶² 67-1 BCA 29,439 (1967).

⁶³ *Id.* at 29,446 (emphasis added).

⁶⁴ The gesture allegedly made to Lockheed or to the Air Force that all records were available was practically meaningless *absent any inkling that such specific, significant data was in reality present and available.*

Id. (emphasis added). Compare this statement with the argument that the only thing necessary, both before and after enactment of the bill, is for GAO to discharge its statutory duty to inspect the books and records of contractors and subcontractors under negotiated procurements with limited or no competition. McClelland, *Negotiated Procurement and the Rule of Law: The Fiasco of Public Law 87-653*, 32 *FORDHAM L. REV.* 411, 412-13, 441 (1964).

based upon such notice.⁶⁵ Nevertheless, government's accepting such a duty in prior contracts, or government's stationing personnel at the contractor's plant may give rise to this circumstance. The Board gave little weight to the latter position in *FMC Corp.*,⁶⁶ where it said that the mere presence at the contractor's plant of a staff of fifty government personnel did not mean they were aware of every transaction in which the contractor was involved.⁶⁷ Although this is an accurate conclusion, knowledge may be imputed to the government where it has had sufficient control of prior transactions and enough contact with the contractor to inquire into the existence of data.⁶⁸ Although it may be urged that this places a difficult burden on the government, it would appear to be no less than the burden already borne by the contractor who, to protect himself, must make available for "examination and review" the required information. Indeed, we may inquire whether the Act's intent would be negated if the disclosure obligation rested solely with the contractor and the government had no burden of inquiry based upon imputed knowledge in situations involving a prior course of conduct.

B. *The Limits on the Contractor's Disclosure Obligation*

The Board has uniformly held that the definition of cost or pricing data set forth in ASPR is, in defective pricing appeals, the governing definition of that phrase. The emphasis in the ASPR definition is upon verifiable facts relating to the validity of costs. Not embraced by the definition, however, is data that is speculative in nature or is an estimate or judgment. The distinction between facts and judgment was neatly summarized by the Board in *Defense Electronics*:

For the purpose of the defective pricing data statute and regulations, "cost or pricing data" is defined by ASPR 3-807.3(e) as "that portion of the contractor's submission which is factual". [sic] The duty to disclose is satisfied *when all FACTS reasonably available to the contractor* which might reasonably be expected to affect the negotiated price are accurately disclosed. ASPR 3-807.1

⁶⁵ The government has interpreted the Act as requiring on its part greater emphasis in the area of cost and price analysis. See ASPR, 32 C.F.R. § 3.807-2 (1968). 47 COMP. GEN. 336,344 (1967) notes that:

The legislative history of Public Law 87-653 discloses that one of its primary purposes was to require full, complete and accurate data and disclosure by both parties.

⁶⁶ 66-1 BCA 25,696 (1966).

⁶⁷ *Id.* at 25,704.

⁶⁸ 39 AM. JUR. *Notice and Notices* § 12 (1942) states:

[W]hatever fairly puts a person on inquiry is sufficient notice where the means of knowledge are at hand; and if he omits to inquire, he is then chargeable with all the facts which, by a proper inquiry, he might have ascertained.

[sic] (e). Cost or pricing data includes such factual matters as vendor quotations and "all facts which can reasonably be expected to contribute to sound estimates of future costs". [sic] *Being factual, it is the type of information that can be verified. It does not apply to or make representations as to the accuracy of the contractor's judgment in estimating future costs. A clear distinction is drawn between "facts" and "judgment".*[sic]⁶⁹

Even though the Board's decisions are not uniform, the rule to be derived is that data, to fall within the embrace of the pricing certificate, means cost or pricing data which constitute a meaningful component of the contractor's proposed costs and which may be objectively checked for their accuracy. This definition is in accord with the ASPR requirements which hold that cost or pricing data include more than historical accounting data. Falling within the scope of the definition are vendor quotations, non-recurring costs, changes in production methods and production or procurement volume, unit cost trends such as those associated with labor efficiency, and make-or-buy decisions or any other management decisions which could reasonably be expected to have significant bearing on costs under the proposed contract. The definition has limitations in that cost or pricing data, being factual, is that type of information which can be verified. It does not include representations of the contractor's judgment as to the estimated portion of future costs or projections.⁷⁰

That vendor quotations are cost or pricing data is no longer open to question; ASPR and five Board cases have accepted this result. Yet a firm conclusion cannot be drawn that would permit the statement of an inflexible rule. In *Sparton Corp.*⁷¹ the Board considered the question of a materials list that contained quoted prices in excess of prices offered to the contractor by a supplier who was untried, but who later received the subcontract work. The Board found that the intention to switch to the new supplier was not made until after award. Under these circumstances the Board concluded that to hold the contractor liable the omitted data must "reasonably be expected to have a significant bearing" on contract costs.⁷² The Board added that "the Government does not prove its case unless it shows that the contractor, at the time the data is submitted, did not intend to deal with the vendor listed, but did intend to do business with the lower cost vendor."⁷³ In *Bell &*

⁶⁹ 66-1 BCA at 26,203-04 (emphasis added).

⁷⁰ ASPR, 32 C.F.R. § 3.807-3(e) (1968).

⁷¹ 67-2 BCA 30,373 (1967), *aff'd on motion for reconsideration*, 68-1 BCA 31,167 (1967).

⁷² *Id.* at 30,381.

⁷³ *Id.*

Howell Co.,⁷⁴ however, the government succeeded in its argument that vendor quotes to untried vendors were cost or pricing data which should have been furnished. The point of distinction, as in *Cutler-Hammer, Inc.*,⁷⁵ is that Bell & Howell was actively and vigorously engaged in negotiating with and making plant surveys of the vendors who had submitted the low quotes, and that it was probable that the contractor would place orders for the parts with those vendors.

The government enlarges the definition of cost or pricing data while the contractor attempts to restrict it. Thus the cases recognize that cancellation clauses,⁷⁶ scrap prices,⁷⁷ and the cost of tests⁷⁸ are cost or pricing data. Moreover, the Board's holding in *Cutler-Hammer* can be interpreted to mean that any time a contractor has any data which *might* be significant from the standpoint of overall contract negotiations, he must disclose this data to the government.⁷⁹ This result, however, when subjected to analysis does not seem to follow from the words of the Act.⁸⁰ In *Cutler-Hammer* the contractor failed to disclose a quotation for components of a highly complex airborne reconnaissance system. The quotation was significantly lower than that used in negotiations, and the contractor admitted that the lower quotation was purposely withheld from the government. The contractor contended, however, that disclosure would have had no effect on the negotiated price since the quotation was from an untried vendor and since production difficulties were to be anticipated because of industry unfamiliarity with the particular components.

Cutler-Hammer presented two special facts to the Board. First, the data was purposely withheld by the contractor. Second, the con-

⁷⁴ 68-1 BCA 32,335 (1968).

⁷⁵ 67-2 BCA 29,822 (1967).

⁷⁶ Defense Electronics Inc., 66-1 BCA 26,191 (1966).

⁷⁷ FMC Corp., 66-1 BCA 25,696 (1966).

⁷⁸ Radio Eng'r. Labs., 67-2 BCA 20,071 (1967).

⁷⁹ Defense Procurement Circ. No. 66 (Jan. 2, 1969), 8 CCH GOV'T CONTR. REP. ¶ 79,115, at 75,064 (1969), amending ASPR, 32 C.F.R. § 3.807-3(e) (1968), adopts this test.

⁸⁰ If our analysis is correct the Board or a court would not be bound by the ASPR definition:

The general proposition is that regulations promulgated pursuant to statutory authority which are consistent with the statutory purposes and intent have the force and effect of law, *Standard Oil Co. v. Johnson*, 316 U.S. 481 (1942); *Leslie Miller, Inc. v. Arkansas*, 352 U.S. 187 (1956); *California Comm'n v. United States*, 355 U.S. 534, 542 (1958); *Cafeteria Workers v. McElroy*, 367 U.S. 886, 890 (1961); *Paul v. United States*, 371 U.S. 245, 250-55 (1963); and *United States v. Georgia Pub. Serv. Comm'n*, 371 U.S. 285, 288-293 (1963). If the definition were regarded as instructional rather than an implementation of law it would not be binding. Cf. *G. L. Christian and Associates v. United States*, 312 F.2d 418; *reconsidered* July 12, 1963, 320 F.2d 345, *cert. den.* 375 U.S. 954.

ASPR, 32 C.F.R. § 3.807-3(e) (1968).

tractor intended to pursue negotiations with the untried supplier. It is clear the lower-cost supplier's original price quotation did not constitute cost or pricing data upon which a price reduction could have been negotiated. Even at the completion of the negotiations there was no way to measure the supplier's competence. Thus the supplier's quotation in *Cutler-Hammer* should not have been considered cost or pricing data.⁸¹

The Board's definition of cost or pricing data when combined with its interpretation of the natural and probable causation test creates an unwarranted form of strict liability. The Board should find whether the nondisclosed data is factual cost or pricing data and then should determine if the nondisclosure directly caused an overstatement in price. The Board in *Cutler-Hammer* seems to rule that if the nondisclosed data *might* cause an increase in price, such data must be cost or pricing data.⁸² It is doubtful that this was the result intended by the Act.

The Board has not articulated any sure guide for the future; and it probably cannot do so because each set of facts will have its own nuances to shift the scales one way or another. But the Board has held that information on experiments in process is not cost or pricing data in a fixed-price contract,⁸³ that a subcontractor's labor estimates are not considered factual data,⁸⁴ and that vendor quotes from untried suppliers are not cost or pricing data if the contractor does not intend to do business with that supplier.⁸⁵

A possible way to handle this dilemma is to recognize that, while the word "data" has a very broad meaning, it is nevertheless modified by the phrase "cost or pricing." Under the well-known rule of construction, *expressio unius est exclusio alterius*, the word data should be limited by the phrase "cost or pricing."⁸⁶ Thus it is possible to suggest

⁸¹ In *Cutler-Hammer*, the Board commented:

[A]t the time of contract negotiations (13-19 Feb. 64), and again on the date of execution of the . . . Certificate (26 Feb. 64), the Transco quotation was far from being data upon which a firm price reduction could be reached, . . . [but] the information was significant from the standpoint of over-all contract negotiation.

67-2 BCA 29,822, at 29,828. The Board appears to equate defective cost or pricing data with the nondisclosure of *any* data.

⁸² *Id.* at 29,829.

⁸³ *FMC Corp.*, 66-1 BCA 25,696 (1966).

⁸⁴ *Lockheed Aircraft Corp.*, 67-1 BCA 29,439 (1967).

⁸⁵ *Sparton Corp.*, 67-2 BCA 30,373, *aff'd on motion for reconsideration*, 68-1 BCA 31,167 (1967).

⁸⁶ "Cost or pricing data" is the enumeration of a particular kind of data, thus excluding other data. See *Manners v. Morosco*, 258 F. 557, 560 (2d Cir. 1919), *rev'd on other grounds*, 252 U.S. 317 (1920).

In *FMC Corp.*, the Board said it was an "all inclusive concept," but only to "future production capacity, estimates of future production capacity, future efficiency as affected

two rules to handle this problem of definition. The first rule would recognize that a particular kind of data is involved, namely, that which involves only cost or pricing information. The second rule would be that, as the ASPR suggests, the data be verifiable and factual, that is, measurable in the arena of cost or price analysis and fact rather than opinion. At this point, if the data involved meets these tests, a separate requirement from the limitation on data, the causation test, should be applied.

C. *The Effect of Election by the Contracting Officer*

"Cost or pricing data" as set forth in the Act is in the disjunctive, thus indicating that either cost or pricing data, or both, may be furnished.⁸⁷ The consequence of this construction is that the contractor is free to bargain only for the submission of one kind of data, or the government, exercising its judgment, may require the submission of only one kind of data. After the furnishing of cost or pricing data, but not both, the government should be bound by its election as to the kind of data to be furnished and should not be able to claim, after the fact, that defective data was furnished to it in the negotiations. Suppose the government and the contractor agree either for reasons of practicality or the reliability of data that in their negotiations they will use historical pricing data as to the cost of an item of material. Later, of course, it is found that the contractor had received and did not furnish a lower price quotation concerning this material. The contractor's defense would be that since an election had been made as to which data will be furnished, the government should be bound by its election, with the result that the contractor is discharged from furnishing cost data. With this lesson in mind, it would be prudent to expect the government in its negotiations to call for both cost and pricing data.

When this question is presented to the Board, however, a ruling may be made that the word "or" should be read as "and." The text of the Act, as well as its legislative history, as a whole, makes it clear that the reference to "cost" was not intended to exclude pricing factors other than cost. The Senate Report stated:

In determining the price under many types of negotiated contracts the Government must rely, at least in part, *on cost and pricing data* submitted by the contractor or his subcontractor.⁸⁸

by learning curves . . . if they affect the work." 66-1 BCA 25,696, at 25,700. They concluded, however, experiments in process were not cost or pricing data.

⁸⁷ See *Hearings Before the Subcomm. of the Comm. on Gov't Oper.*, 90th Cong., 1st Sess., at 91 (1968).

⁸⁸ S. REP. NO. 1884, 87th Cong., 2d Sess. 3 (1962).

But the draftsmen were well aware of the existing pricing procedures established by ASPR setting forth the methods to be used by the government in negotiating prices. The regulations explained that:

The extent to which any particular method, or *combination of methods* [cost or price analysis], should be used will depend upon the judgment of the contracting officer.⁸⁹

It would follow that the flexibility accorded the government prior to the Act's enactment in negotiating contract prices by calling for either cost or pricing data was not intended to be affected by the Act merely because cost or pricing data is phrased in the disjunctive. Even if the word "or" in the Act should be read as "and," the inescapable conclusion is that the contractor did not *cause* an overstatement in price, since agreement had been reached that only one kind of data would be furnished.

D. *The Effect of Lack of Reliance*

To establish causation the government must prove that it relied on the action of the contractor with regard to the defective data. In this instance the contractor has available to him several important arguments. Since the government, in the normal course of preparing for the price negotiations, conducts its own investigations into the validity of the contractor's proposals, it should be held to all the consequences flowing from it including any overstatement in price. Second, the manner in which the negotiations were conducted may indicate that the government did not rely on the contractor's cost or pricing data. When the parties deal on a lump sum basis it would appear that the contract price is the result of bargaining, obtained without regard to the components of cost (cost or pricing data). This would mean that the contractor's nondisclosure did not cause a price overstatement.

It is established legal doctrine that where a party makes his own independent investigation and then relies on his own knowledge or judgment, he cannot fault the representation of the other party, even if those representations are inaccurate.⁹⁰ If there is sufficient opportunity for examining the real facts when his attention is directed to the sources of information, and he commences, or purports to commence, an investigation, simple notions of expediency and of justice require that he be charged with all the knowledge which he might have

⁸⁹ ASPR, 32 C.F.R. § 3.807-1 (1961) (*emphasis added*).

⁹⁰ *Sacramento Suburban Fruit Lands Co. v. Klaffenbach*, 40 F.2d 899, 903 (9th Cir. 1930); *In re Bowen*, 58 F. Supp. 286, 297 (E.D. Pa. 1944); *Mahaffey v. Ferguson*, 156 Pa. 156, 168, 27 A. 21, 22 (1893).

obtained had he pursued the inquiry with diligence and completeness. Yet this argument has not been adequately analyzed by the Board. Where the Board has considered the effect of the government's investigation, the Board has often found that the government has not relied exclusively on its own investigations⁹¹—a finding that conflicts with general legal principles.⁹² Although this principle seemingly places the government in the quandary of choosing between conducting an independent analysis and losing its claim,⁹³ as a practical matter, the government must conduct its own analysis of the contractor's proposals. And the effective use of the Act requires both that this be done vigorously and that the government assume responsibility for its conduct.⁹⁴

Where the data is not reasonably available to it, then the government did rely on the contractor's representation. Thus, owing to the sequence of events in *Cutler-Hammer*, the government should probably not be held to any investigation it may have conducted, since it could not reasonably have learned of the quotation from an untried supplier. And the lower quotations from the untried supplier in *Bell & Howell* may merit the same conclusion. Suppose, however, that the government in *Bell & Howell*, despite its ignorance of the lower quotation, could analyze Bell & Howell's proposal and determine that it should be able to procure the items at a lower price. The government, then, enters the negotiations on this assumption. In the absence of any decisions on this situation, we could only guess at the result. But a strong argument could be made for the government's lack of reliance.

Moreover, lack of reliance is almost inherent in the negotiation process.⁹⁵ In negotiating the price for its contracts, the government ordinarily is concerned with the reasonableness of the overall contract

⁹¹ See *American Bosch Arma Corp.*, 65-2 BCA 24,838 (1965).

⁹² *Hackleman v. Lyman*, 50 Cal. App. 323, 326, 195 P. 263, 264 (1920):

If a purchaser of real estate visits the property prior to the sale and makes a personal examination of it, touching representations made as to its quality, character, or condition, he will be presumed to rely, not upon the representations, but upon his own judgment in making the purchase, provided the vendor does nothing to prevent his investigation being as full as he chooses.

Shappirio v. Goldberg, 192 U.S. 232, 241-42 (1904):

When the means of knowledge are open and at hand, or furnished to the purchaser or his agent and no effort is made to prevent the party from using them, and especially where the purchaser undertakes examination for himself, he will not be heard to say that he has been deceived to his injury by the misrepresentations of the vendor.

The same rule is also applied in the law of sales. 46 AM. JUR. *Sales* § 105 (1943).

⁹³ Braemer, *Recent Developments in Government Contract Law*, 22 BUS. LAW. 1057, 1069 (1967).

⁹⁴ See Comment, *supra* note 58, at 613.

⁹⁵ See 3 A. CORBIN, *CONTRACTS* § 579, at 413 (1960).

price rather than reaching agreement on each individual cost element that may be involved.⁹⁶ These negotiations, like most business transactions, thrive on give and take, perception and judgment. Yet the total price negotiated is only as sound and equitable as the individual cost elements that make up the total price. Nevertheless, the government generally deals on a total cost basis, trading offers and counter-offers until a price is hammered out. The difficulty of this approach in relation to price adjustments under the Act was discussed by the Board in *American Bosch Arma*:

This case illustrates the difficulty of establishing that nondisclosure of pricing data concerning a specific cost element caused an increase in the negotiated total price when there was no agreement or understanding with respect to specific cost elements.⁹⁷

Accordingly, under the government's negotiation technique, a price concluded on a lump sum basis leaves significant elements of cost unresolved. The government may believe that the reduction negotiated from the contractor's proposed price pertained to specific individual cost elements which it had questioned. However, the contractor may have understood that the negotiations were concluded on an entirely different basis. Later, when the government claims defective pricing, the contractor should be able to prevail since there was no reliance on his proposal—the contract price was not based on any specific agreement on cost elements.⁹⁸ Although the Board noted this position in *FMC Corp.*,⁹⁹ the cases at this time suggest that the use of the total cost method, by itself, may not defeat the government's claim. The Board has been torn between the circumstances presented to it for decision, and the recognition that treating lump sum negotiations as an intervening cause will defeat the legislative purpose. Conversely, it may be urged that the total cost method of negotiation does break the chain of causation. The government is free to negotiate price agreements on the components of cost. Having selected the method of negotiation, it should not be free to insist upon a price reduction if

⁹⁶ *American Bosch Arma Corp.*, 65-2 BCA 24,838, at 24,847 (1965). See also Defense Procurement Circ. No. 22 (Jan. 29, 1965).

⁹⁷ 65-2 BCA 24,838, at 24,852-53 (1965).

⁹⁸ *Id.* at 24,847.

⁹⁹ Thus, the method of negotiation is immaterial, as long as the evidence shows that the Government relied upon data furnished to it, or negotiated a price in the absence of data which should have been furnished to it within the context of the applicable clause. *However, method of negotiation may become significant in determining whether the Government did in fact rely upon the data furnished or would have relied upon absent data in reaching agreement on price.*

FMC Corp., 66-1 BCA 25,696, at 25,699 (1966) (emphasis added).

hindsight shows a basis for price reduction. All that can be said at the moment, however, is that total cost or lump sum negotiations increases the government's burden of proof. In combination with other facts showing nonreliance, the contractor can use total cost negotiations in support of the theory that the government's position is inequitable since its lump sum bargaining technique compensated for an overstatement in price.

E. *The Offset Problem*

A strict reading of the Act suggests that the price adjustment provisions provide for only price *reductions*. If the government insists on a price reduction because the contractor has overstated cost figures, the government should agree to a price increase where the contractor has understated cost figures. That is, the contractor's losses from cost underestimation would first be offset against its gains from cost overestimation. Offsets in this case may be used in either or both of two senses: offsets within the same item of cost or offsets for any item of cost which was understated.

The question of offsets was presented to the Board in *Cutler-Hammer*. The omitted costs were related to the overstated costs, in that both were concerned with the same general cost area of purchases from third parties. The omitted costs would have increased the target cost. The Board rejected the proposition that the Act contemplated offsetting one cost with another, indicating that other remedies were available to contractors for the correction of mistakes:

In this regard we have not overlooked the fact that these remedies may be more restrictive than the corresponding remedy of the Government under the Defective Pricing procedure. The simple answer to this is that both the statute and the contractual provision which it implements, literally limit the adjustment to pricing deficiencies which tend to overstate the contract price.¹⁰⁰

The Board's explanation is not, however, entirely convincing. There is no reason to conclude that the Act was intended to distinguish between favorable and unfavorable mistakes, with the contractor being confined to a previously established remedy. But the Board held that the Act, on this point, must be strictly construed:

As such we would need to be shown a clear Congressional intent that all cost and pricing deficiencies, regardless of their nature or direction, were correctable under the statute before we could grant that relief here. On this point we must, of course, recognize that

¹⁰⁰ *Cutler-Hammer Inc.*, 67-2 BCA 29,822, at 29,826 (1967).

there is some indication in the legislative history that the result which we here reach may not have been intended. By the same token there is just as much, if not more, evidence that such was the Congressional purpose. As a consequence we cannot say that the Congressional purpose in this regard is conclusively evident one way or the other. We are therefore constrained to adopt a literal interpretation of the statute, and, if we err, it is for others, be it the Congress or the courts, to set the matter right.¹⁰¹

We may indeed fault the Board for its attempt at statutory analysis. The better approach would have been to examine the words of the Act. It speaks only of price adjustments "to exclude any *significant sum* by which . . . the price was increased." The Board should have considered the problem of offsets on the basis of the inclusion in the negotiated price of "a *significant sum*." It is suggested that the word "significant" in the Act permits consideration of the degree of the price overstatement. If so, then the Board should allow such offsets because the Act should permit an analysis of the significance of the price increase.¹⁰²

The use of offsets is at least supported by the argument of fairness. Assuming that a contractor makes two honest errors, is there a valid reason why the government should take advantage of one and ignore the other? The government's rebuttal to this is that it should not be expected to act as an insurer of the contractor against his own mistakes in furnishing data concerning his own costs.¹⁰³ Yet, the Board's holding in *Cutler-Hammer* does not eliminate the possible exception that arises when the overstated cost or pricing data is so closely connected with the understated data that it would be impractical to consider the one without the other.¹⁰⁴

Recently the Defense Department agreed to limited offsets in two situations: (1) When the accuracy of an item, which is an average rate, is questioned, overstatements in making up the rate may be set off by

¹⁰¹ *Id.* at 29,826-27. One note writer suggests that the Board was wrong in its reading of the legislative history. See Comment, *supra* note 58, at 618-19.

¹⁰² Roback, *supra* note 1, at 26-27, noted the Department of Defense and General Accounting Office objections to offsets. Their theory is that, by not permitting offsets, the Act encourages contractors to use extra care in submitting proper information, while an offset privilege would have the reverse effect. He noted that offsets could have the effect of encouraging contractors to deliberately understate costs hoping to reprice them during contract performance. This position assumes that a contractor will defectively price a contract in two ways: first, by overstating costs in violation of the pricing certificate; and second, by understating costs to diminish a government defective pricing claim. This seems unlikely.

¹⁰³ *Id.* at 26.

¹⁰⁴ Defense Procurement Circ. No. 57 (Nov. 30, 1967).

the understatements; and (2) overstatements and understatements relating to the same item can be offset against each other. However, offsets are allowed only if the net adjustment is downward.

The Department should also permit offsets where the contractor demonstrates that some items have been unintentionally overstated, while closely related items have been inadvertently understated.

F. *Overstatements in Price and Honest Mistakes*

Under the Act the contractor certifies the suitability of the cost or pricing data to the best of his knowledge or belief. This limitation was introduced by industry representatives who questioned the practical enforcement of a statute which was unqualified in its terms.¹⁰⁵ The cost or pricing data that may exist in a large industrial organization for the purpose of pricing a government contract may be difficult to assemble.¹⁰⁶ It is practically impossible, in large contracts, to foresee all the costs that may be incurred; therefore, cost information is not always complete and a large portion of it must necessarily be estimated.¹⁰⁷ Thus an unqualified certification is simply unrealistic.

Senator Symington was sensitive to this problem and noted Mr. Vinson's suggestion that liability would not arise if the contractor had made an honest mistake. The colloquy is instructive:

Senator SYMINGTON. You had better read the testimony of Mr. Vinson given this committee. His suggestion does not say you are guilty of anything if you make an honest mistake. It simply says, as I understand it, that you give the best estimate you have of what your costs will be before the incentive contract is set.

Mr. OLVERSON. I am not sure that the provision in the bill says that; it says "cost data," and it doesn't use the word "estimate."

And in developing the testimony here that is one of the things—

Senator SYMINGTON. Then would you be satisfied if it said, "To the best of the knowledge of the company"?

Mr. OLVERSON. Estimated costs to the best of the knowledge of the company would certainly make it a much better provision.

Senator SYMINGTON. If you gave cost data you would give the best cost data you had at the time. A statement was wanted that this was the best knowledge available. And they shouldn't be punished if they made an honest mistake, only if they deliberately set a high figure.

Would you furnish some language along those lines you think would be applicable?

¹⁰⁵ *Hearings, supra* note 3, at 95.

¹⁰⁶ *Id.* at 43.

¹⁰⁷ *Id.* at 95.

Mr. OLVERSON. Certainly. We would be glad to try, sir.

And that is the basis of our position, that the language of the present bill would almost make a contractor certify concerning facts which he just wouldn't know about. Cost is something tangible, and it is difficult for a contractor to predict what his costs are going to be.

Senator SYMINGTON. All right.¹⁰⁸

Although this discussion would support the view that, under the pricing certificate, the contractor would not be liable for an honest mistake, representatives of the Department of Defense took the position that a statutory right existed to reduce the price because the price adjustment provisions of the Act did not hinge on the qualification of "knowledge and belief" set forth in the pricing certificate. The liability imposed on a contractor was said not to pivot on intent or knowledge.¹⁰⁹

Even though this interpretation is supported by the notion that a contractor should not receive a profit based on defective cost or pricing data where he had the responsibility of submitting correct data at the time the price was negotiated, the harshness of this view compels closer examination. We have postulated elsewhere in this article that the pricing certificate and price reduction clause are tied together to form a single document.¹¹⁰ Liability under the price reduction clause should turn on the pricing certificate. On this basis, then, it would be fair to say that the legislative history of the Act planned for an exemption for an honest mistake to be accepted in a proper case. This view is reinforced by the provision of the Act which establishes the disclosure requirement as an affirmative obligation of the contractor. This requirement is cast in terms of duty and the corollary of a duty is not liability for an "honest mistake" but liability resulting from fault or negligence. The qualification of "knowledge and belief" is a tacit recognition that a standard of commercial reasonableness would be observed in enforcing the statutory mandate.

IV

THE SUBCONTRACT DILEMMA

The Act confronts the prime contractor with the problem whether he will be liable for the defective pricing of his subcontractor.¹¹¹ The

¹⁰⁸ *Id.* at 99.

¹⁰⁹ *Id.* at 62. See also *Defense Contract Audit Hearings*, *supra* note 4, at 24-25.

¹¹⁰ See pp. 716-18 *supra*.

¹¹¹ Pettit, *The Defective Pricing Law and Implementing Regulations—A Year and a Half Late*, 29 *LAW & CONTEMP. PROB.* 552, 559 (1964).

government has interpreted the Act to mean that it has a right to reduce the contractor's price when a subcontractor furnished defective cost or pricing data in connection with a subcontract where a certificate of cost or pricing data was or should have been furnished. The focus of the government's interpretation is that a subcontractor's cost or pricing data forms part of the contractor's cost or pricing data and is, therefore, covered by the contractor's certificate.¹¹²

Traditionally, our law has been premised upon establishing liability because of the actor's fault or negligence. The burgeoning areas of strict liability have, in the personal injury field, constituted a recognized exception resulting from social forces at play in the community. In subcontract relationships the parties deal at arms length. The basis for prices is normally considered to be a competitive advantage, which most businessmen would not want to disclose to those with whom they intend to contract. Access by a contractor to a subcontractor's books and records is an unusual procedure.¹¹³ Thus the government's basis for holding the contractor liable for omissions on the part of his subcontractor is unclear, if not erroneous.

So, too, government definitions of "cost or pricing data" relating to the Act's legislative history stressed the reasonable availability of data before assessing liability against the contractor. The critical fact is that the contractor does not have a basis to know the subcontractor's cost or pricing data. Congressman Hebert, a principal sponsor of the Act, has stated that it was in part intended to enable the government during negotiations to obtain the contractor's information, but not data the contractor did not know:

Truth will work wonders. All this section requires is that the truth be made known at the time of the bargaining. Who can object to telling the truth? The argument about persons being penalized for what they do not know is plain nonsense. The truth is nothing more or less than what a contractor knows when he opens his mouth. What he does not know, he does not speak. No semantical exercise can change those values.¹¹⁴

Since the price reduction clause is intended to be used in conjunction with the pricing certificate, it would follow that the "knowledge and belief" portions of the certificate confirm this analysis.

The Act undoubtedly intended to preserve the privity of contract arrangement that is said to exist in government contracts; the prime

¹¹² See ASPR, 32 C.F.R. § 7.104-29 (1968).

¹¹³ See Fromson, *Government Subcontractor*, 159 N.Y.L.J., Jan. 5, 1968, at 1 & 4; Kurth, *Selling to a Government Prime Contractor—The Contract Provisions Clause by Clause*, 23 BUS. LAW. 423, 438 (1968).

¹¹⁴ *Hearings*, *supra* note 3, at 57.

contractor was to be a conduit for the recapture of amounts due subcontractors with a companion obligation to hold such amounts in trust until payment was made to the government.¹¹⁵

The extremeness of this interpretation is brought home with the recognition that it could be applied against a prime contractor because his subcontractor had been adjudicated a bankrupt or was insolvent.¹¹⁶ Until this question is resolved, the contractor must be prepared to balance on a tightrope—at one end the government holds him responsible for the omissions of his subcontractor; at the other end the subcontractor is unwilling or unable to assume the burden of the government's claim.

A possible solution to the problem, and one indirectly suggested by the government, is to permit the subcontractor to appeal any adverse defective pricing decision to the Board of Contract Appeals.¹¹⁷

The subcontractor's dilemma, however, is one of forum-selection; an appeal to the Board of Contract Appeals or a contractor's suit against him in a state or federal court having jurisdiction of the subject matter. The balance of the present factors might tip the scales in the direction of accepting a court's determination. A Board decision may favor *per se* liability against the subcontractor. Moreover, it may dismiss the subcontractor's appeal because there is no evidence of a dispute under the prime contract or because of the absence of a contracting officer's decision.¹¹⁸ Similarly, the Board may hold there is actually no dispute between the prime contractor and the government, thereby defeating the subcontractor's right of appeal. This decision may result from an agreement by a prime contractor and contracting officer on the interpretation of contract clauses, and the subcontractor would be precluded from challenging this interpretation.¹¹⁹

However, once the subcontractor elects a court proceeding, a multiplicity of proceedings may occur; the contractor, to preserve his rights, will be forced to appeal to the Board while pursuing his defense before the court.¹²⁰ Unless the Board is recognized as the ex-

¹¹⁵ *International Harvester Co. v. United States*, 342 F.2d 432, 437 (Ct. Cl. 1965). *But see Collins Radio Co.*, 67-2 BCA 29,976 (1967).

¹¹⁶ *Pettit*, *supra* note 111, at 559. Of course, under these circumstances the contractor may be excused from any responsibility by operation of law.

¹¹⁷ ASPR, 32 C.F.R. § 23-203(b) (1968).

¹¹⁸ *Howry-Berg Steel & Iron Wks.*, Navy BCA 4 CCH Cont. Cas. F. 50,571 (1947).

¹¹⁹ *Florida Builders, Inc.*, 63 BCA 19,289 (1963).

¹²⁰ Mr. Cuneo, in a speech before the Southwestern Legal Foundation Institute on Government Contracts in Dallas on September 12, 1968, described this problem as follows:

The material facts begin with the General Accounting Office issuing a report that the sub's data was defective. The subcontract had been executed prior to agreement on the prime contract price.

clusive forum for defective pricing appeals, contractors and the government may be faced with forum shopping and multiple proceedings.¹²¹ Regardless of other defects in the Act, the possibility of holding the contractor liable for the acts of his subcontractor is one which leads to results not fully appreciated or understood at this time.

V

OTHER GOVERNMENTAL APPROACHES TO DEFECTIVE PRICING

A. *Withholding of Money by the Government Because of Defective Pricing Allegations*

Suppose the government under the "Disputes" clause of a contract made a final decision to the effect that incomplete pricing data was furnished in negotiations, and that under the contract's price reduction clause the contractor was indebted to the government. A Change Order which accompanied the Contracting Officer's final decision purported to reduce the contract amount. Thereafter, on appeal a complaint is filed with the Board, disputing the Contracting Officer's final decision and rejecting the Change Order. However, after the appeal is filed the government demands a refund, based upon the Contracting Officer's decision and the Change Order. The government states that this amount should be set off against amounts due under or from payments due under other government contracts. The government may attempt to fashion a remedy of this nature, but the legality of this maneuver is questionable.

Pursuant to ASPR 3-807.5(e) the Contracting Office notified the prime of contemplated price reduction action because of the defective sub data. Thereupon, the prime withheld under the subcontract a sufficient sum to cover the possible price reduction. The sub protested the withholding.

The prime offered to process an administrative appeal under its Disputes article in its name on behalf of the sub to settle the defective data issue. However, the sub rejected the offer for the reason, among others, that the sub did not wish to have the issue determined by the Armed Services Board of Contract Appeals in light of its recent pro-Government defective decisions. The sub then sued the prime in a state court for breach of contract.

The prime will have to defend on the basis that it was using self-help to protect itself against the charge of defective sub data. It is expected the sub will defend against the defective data claim that it is entitled to off-sets.

The prime has also taken an administrative appeal under its Disputes article from a final Contracting Officer's decision alleging the Government's right to a price reduction because of the defective sub data. The prime fears that it is in danger of being whipsawed by contrary administrative and judicial decisions.

BNA FED. CONTR. REP. No. 239, at A-14 (Sept. 16, 1968).

¹²¹ The Board, however, appears to have rejected this argument in *Honeywell, Inc.*, 68-1 BCA 31,171 (1967).

It has become a cliché to say that the United States has the inherent right to set off amounts due to it against claims of contractors.¹²² Like most generalities the statement is too broad to be accurate. The fundamental rule governing the right of setoff is that it only extends to set-offs arising out of the same transaction.¹²³ In *Burroughs Corp.*,¹²⁴ the government asserted the right to withhold and apply monies from payments due the contractor under other government contracts. Moreover, the government insisted on the right even though the claim was disputed by means of an appeal to the Board. Professor Williston, for one, has emphatically concluded that the governing legal principle is to the contrary:

Where an absolute debt has arisen as the price or exchange for some performance received by the debtor, no breach of duty by the creditor will excuse the debtor from liability. This is true even though there are mutual obligations which are both liquidated debts. Under the common law, such debts do not extinguish one another *pro tanto*, either automatically or by manifestation of election by one party. Either agreement of the parties or judicial action is necessary.¹²⁵

It is equally true that the government may not unilaterally set off an unliquidated claim against the contractor without its consent. In *Comp. Gen. Decision B23802*,¹²⁶ the Comptroller General stated the principle in these terms:

It is well established that as a general rule the courts will not allow unliquidated claims to be set off and of course where the claim is not only unliquidated at the inception of a legal action but is not susceptible of exact determination by the court any setoff would not be allowed.¹²⁷

¹²² See ASPR, 32 C.F.R. § 163.106-1 (1968).

¹²³ *Ozanic v. United States*, 188 F.2d 228, 231 (2d Cir. 1951); *Castner, Curran & Bullitt, Inc. v. United States*, 5 F.2d 214, 216 (2d Cir. 1925). See also Lane, *Administrative Resolution of Government Breaches*, 28 FED. B.J. 199, 226-28 n.107 (1968).

¹²⁴ 65-2 BCA 23,970 (1965).

¹²⁵ 6 S. WILLISTON, CONTRACTS § 887E (3d ed. 1962).

¹²⁶ 21 COMP. GEN. 894 (1942).

¹²⁷ *Id.* at 896. See also *Climatic Rainwear Co. v. United States*, 88 F. Supp. 415 (Ct. Cl. 1950), where suit was brought to recover a balance of money under a contract for raincoats, and the government had set off an equivalent sum representing excess costs and liquidated damages claimed by the United States under a prior contract:

A disputed claim for damages, for breach of contract, cannot in any sense of the word be considered a stated account and such claim is not subject to the control and decision of the accounting officers of the United States. As stated in *Standard Dredging Co. v. United States*, 71 Ct. Cl. 218, 240-41 (1930): " * * * The reason is plain. Such claims must be sustained by extraneous proof and often involve a broad field of investigation requiring the determination of difficult legal questions and the application of judgment and discretion upon the measure-

Thus, although the court decisions are to the contrary, *Burroughs Corp.* suggests that the government might assert its possible right to a price reduction by setoff of an unliquidated amount after a dispute has been filed with the Board.¹²⁸ The government, however, should not be allowed to complicate the difficult problem of equitable administration of the Act with an objectionable remedy.

B. *Attacking Defective Pricing through the False Claims Act*

Under the False Claims Act,¹²⁹ any person who makes a claim for payment or approval upon or against the government knowing such claim to be false, fictitious, or fraudulent is required to pay the sum of \$2,000 for each false invoice submitted, plus double the amount of damages. Although the government may attempt to cure defective pricing by prosecuting under this Act for the submission of a false certificate, *i.e.*, one not reflecting changes in current pricing data occurring before the completion of negotiations, it surely should not be allowed to prevail.

The chief purpose of the False Claims Act was to provide restitution to the government of money taken from it by fraud.¹³⁰ In the normal defective pricing situation, the Act is not violated by a contractor's submission of an erroneous certificate because the certificate is not a demand for money.¹³¹ The certificate rests on an offer by the

ment of damages and the weight of conflicting evidence. * * *

. . . This account was in dispute between the parties and being thus unsettled, it could not equitably be used to apply against a sum due and owing to the plaintiff under the terms of Contract 14952 and the reservations made under the termination settlement agreement.

The Government's defense of release is, therefore, overruled.

Id. at 418.

As noted by Judge Medina in the *Grace Line* case, the unilateral withholding and applying of money allegedly due the United States on a disputed claim against a creditor does not constitute payment of that creditor's claim against the United States.

Grace Line, Inc. v. United States, 255 F.2d 810, 814 (2d Cir. 1958). To a similar effect are: 7 COMP. GEN. 186 (1927); 19 COMP. GEN. 785 (1940); and 21 COMP. GEN. 894 (1942).

¹²⁸ Where it is clear, however, that the government *must eventually* recover, there is authority to the effect that a setoff of monies under other contracts may not be objectionable. *Barry v. United States*, 259 U.S. 47, 52-53 (1913). See also *Gratiot v. United States*, 40 U.S. (15 Pet.) 336, 370 (1841). Statutory right for setoff does exist after judgment against the government. 31 U.S.C. § 227 (1964). A thoughtful comment discussing the government's setoff rights may be found in Cuneo, *Some Footings in a Quagmire: Stabilization of Obligations and Party Positions Under Government Contracts*, 37 GEO. WASH. L. REV. 1, 50-54 (1968).

¹²⁹ 31 U.S.C. § 231 (1964).

¹³⁰ *United States ex rel. Marcus v. Hess*, 317 U.S. 537, 551-52, *rehearing denied*, 318 U.S. 799 (1943); *United States v. Brethauer*, 222 F. Supp. 500, 502 (W.D. Mo. 1963).

¹³¹ See *United States v. Farina*, 153 F. Supp. 819 (D.N.J. 1957).

contractor to perform a service or furnish supplies at a certain price, and since an offer alone cannot violate the Act,¹³² basing liability on the certificate is clearly erroneous. Moreover, the cost figures are only estimates, and in *Maxwell v. United States*,¹³³ it was recognized that estimates prepared for the purpose of submitting a claim under a terminated defense contract did not provide the basis for finding a violation of the Criminal False Claims Act, found in 18 U.S.C. § 1001.

Even if a contractor demands payment under a false certificate, the False Claims Act should not be used to correct defective pricing for three reasons: First, the parties have contractually provided for an administrative determination for factual disputes by the Board, and a civil fraud suit deprives the contractor of his contractual right to have facts determined by the Board; second, the parties have contractually agreed that damages for defective data will be at most a dollar-for-dollar reduction of the contract price, whereas civil fraud damages are double this amount, plus perhaps as much as \$2,000 per invoice; and third, since the Truth in Negotiating Law contemplates both resolution of defective cost or pricing data issues pursuant to the usual contractual remedies and a price reduction only in the amount of the defect, it is more specific and therefore should be controlling. If the government can proceed under the False Claims Act, it can then treat the disputes procedure as elective in defective pricing cases, whereas the contractor must follow this procedure under pain of losing all rights under the contract.

Nevertheless, the court in *United States v. Honeywell, Inc.*¹³⁴ rejected the contractor's assertion that the Truth in Negotiating Law was the exclusive government remedy in defective pricing cases,¹³⁵ and subsequently, in the contractor's separate appeal to the Board, the Board declined jurisdiction.¹³⁶ Thus the government is free to pursue either remedy and is able to pyramid its remedies in an unhealthy manner. Since the purpose of the Truth in Negotiating Law was to enable the government to achieve lower prices through increased accuracy of cost and pricing data, while the False Claims Act was intended "to reach any person who knowingly assisted in causing the government to pay claims grounded in fraud . . .,"¹³⁷ applying the latter act to defective pricing disregards the scope and function of the pricing certificate.¹³⁸

¹³² *Id.* at 821-22.

¹³³ 277 F.2d 481, 502 (6th Cir. 1960).

¹³⁴ Civil No. 67-181 (M.D. Fla., filed May 1, 1967).

¹³⁵ Defendant's motion for summary judgment was denied on Jan. 29, 1968.

¹³⁶ Note 121 *supra*.

¹³⁷ *United States ex rel. Marcus v. Hess*, 317 U.S. 537, 544 (1943).

¹³⁸ *See* Note, *supra* note 8, at 515-16.

CONCLUSION

The Act is an uncontrolled arrow in the government's quiver. Proceeding from a misconception, fed by unreality, "Truth in Negotiating" emerges as a slogan without substance. Confusion arises from the uncertain meanings growing out of the phrase "cost or pricing data," and the Act's relationship with other laws. Hindsight and subjectivity surround the tests for causation. The lines surrounding the burden of proof waver. The light that supposedly emanates from the distinction between the availability of data and the disclosure of data is not constant. Experience under the Act teaches us that it is uneven in quality. Imperfect laws are a basis for injustice.

Proper analysis of a defective pricing case proceeds from the premise that the price reduction clause and pricing certificate are a single document. Contractual rather than statutory rules of interpretation must be applied. At the outset a determination must be made whether the nondisclosed information is cost or pricing data. The administration of the Act would be improved if "cost or pricing data" was not considered an all-embracing phrase. The term should not be defined by what its significance may have been during negotiations. Instead, "cost or pricing data" should be considered as an arithmetical fact capable of being subject to cost or price analysis. By its very nature cost or pricing data should be subject to the rule of reason. The negative aspect of certain information should be used as a test to place such data beyond the disclosure requirements.

Having determined that cost or pricing data is present, the Board or court should insist that causation be proved. Causation should be viewed as a continuous flow of events in which certainties, not probabilities, are relevant. The government, too, must be held to have responsibilities under the Act. It should be held to a duty of inquiry to seek out data suggested by the facts and circumstances of a particular negotiation. In this way, there is assurance that the Act will have a vigorous application.

Under this analysis, the government's burden of proof does not become the subject of fluctuating interpretations. And the basic concept of equity and fair dealing should be employed to sanction offsets of inadvertently understated and overstated cost or pricing data. Liability by the prime contractor for a subcontractor's cost or pricing data is clearly beyond the terms of the pricing certificate where the prime contractor does not know of the existence of such data. Furthermore, it is harsh and mistaken to use the Act as a basis for the offsetting of accounts on other contracts after a dispute has arisen. To avoid con-

fusion in procurement law, "Truth in Negotiating" must be confined to its own sphere. The pricing certificate is not the knowing submission of a claim against the government for payment or approval of money, and hence should not be the basis for an alleged violation of the Civil False Claims Act.

Legislative reconsideration of the Act could take many forms. Many of the matters previously discussed could be incorporated into a revised statute, including a reciprocal obligation on the government's part to disclose equivalent data. Other options, however, are available to the Congress. The entire subject could be considered as part of the proceedings under the Renegotiation Act. Alternatively, separate profit limitations could be passed for fixed price type contracts, although such restrictions would be inconsistent with the incentive features of such contracts. What the passage of the Act discloses, however, is an implicit criticism of the manner in which industry and government prepare proposals and positions to negotiate contract prices. Further study, objectively pursued, may point the way to improved negotiating practices so that the Act's requirements could be dispensed with or considered hortatory.