

# THE INCREDIBLE SHRINKING CONTRACTING OFFICER

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#### I. INTRODUCTION AND SUMMARY

When an irresistible force such as you  
meets an old immovable object like me  
you can bet just as sure as you live  
Something’s gotta give,  
Something’s gotta give,  
Something’s gotta give.<sup>1</sup>

The erosion of the Contracting Officer’s role is not new. It has been a topic of discussion for many years. In fact, we would probably need to go back to the 1950s or even World War II to find a time when the Contracting Officer was free to act as an executive decision maker on behalf of the Government. So the question is not whether the Contracting Officer’s role is shrinking, but rather the extent and the causes of the most recent shrinkage. The following discussion will demonstrate that recent events have removed us even further from the goal in the Federal Acquisition Regulation (FAR) that “the contracting officer must have the authority to the maximum extent practicable and consistent with law, to determine the application of rules, regulations, and policies, on a specific contract.”<sup>2</sup>

A number of factors have emerged that tend to marginalize the Contracting Officer as other players occupy more of the stage and clamor for action. The process has only intensified during the past year. The “irresistible force” of the FAR, with its proclaimed authority over Contracting Officers, has met the “immovable object” of Congress, the inspectors general and the Defense

1. Lyrics by Johnny Mercer (1954).  
2. FAR 1.102-4(a).

Contract Audit Agency (DCAA). Now we know that “something’s gotta give.”<sup>3</sup> Contractors are likely to experience added frustration from new demands and choke points in the decisional apparatus.

Congress, for the last twenty-five years, has taken much more direct management responsibility in federal procurement.<sup>4</sup> Acquisition management resources have been downsized at the same time spending on government contracting has increased.<sup>5</sup> Emphasis on audit, oversight, and enforcement has shifted power away from the Contracting Officer.

For example, the National Defense Authorization Act for fiscal year 2009 (FY09 NDAA), section 871, authorizes the Government Accountability Office (GAO) to examine contractor records “and to interview any current employee regarding such transactions.”<sup>6</sup> Going a step further, the National Defense Authorization Act for FY 2010 (FY10 NDAA), section 1042, authorizes the Department of Defense (DoD) inspector general to require by subpoena the attendance and testimony of nonfederal employees.<sup>7</sup>

Moreover, Contracting Officers must confront the notion, expressed in various ways, that auditors’ advice is presumptively correct. Rather than being allowed to rely on the advice of auditors and then make a considered decision as the FAR contemplates,<sup>8</sup> Contracting Officers now have the burden of justifying their decisions when they differ from those of auditors.<sup>9</sup>

The result is pressure on Contracting Officers to acquiesce in the recommendations of auditors. That pressure has come in a variety of ways. DCAA has given notice that it may report “unsatisfactory conditions” regarding the actions of government officials, including Contracting Officers, directly to the inspector general (IG), instead of DCAA’s previous process of reporting through the official’s management chain.<sup>10</sup> This is an unobvious suggestion that Contracting Officer concurrence with auditor recommendations

3. See *supra* note 1.

4. Reacting to perceived abuses, Congress in the fiscal year 1986 Department of Defense Authorization Act (FY86 DoD Authorization Act) assumed responsibility for direct management of the defense procurement process. The FY86 DoD Authorization Act made ten costs unallowable by statute and required DoD to “clarify” regulations regarding sixteen other kinds of costs. DoD responded by limiting the ability of contractors to recover those costs. See Stephen D. Knight, *Limiting Cost Recovery: Significant Legislative and Regulatory Developments*, 20 NAT’L CONT. MGMT. J. 35, 35–36 (1986). While congressional control of defense procurement has continued unabated since then, complete discussion of that activity is beyond the scope of this article.

5. See Shelley Roberts Econom, *Confronting the Looming Crisis in the Federal Acquisition Workforce*, 35 PUB. CONT. L.J. 171, 173 (2006).

6. Duncan Hunter National Defense Authorization Act for 2009 (FY09 NDAA), Pub. L. No. 110-417, § 871, 122 Stat. 4356, 4555 (2008).

7. See National Defense Authorization Act for 2010 (FY10 NDAA), Pub. L. No. 111-84, § 1042, 123 Stat. 2190, 2455–56 (2009).

8. See FAR 1.602-2(c).

9. See DEF. CONTRACT AUDIT AGENCY (DCAA), No. 09-PAS-004(R), AUDIT GUIDANCE ON REPORTING SIGNIFICANT/SENSITIVE UNSATISFACTORY CONDITIONS RELATED TO ACTIONS OF GOVERNMENT OFFICIALS 1 (2009) [hereinafter AUDIT GUIDANCE ON UNSATISFACTORY CONDITIONS].

10. *Id.*

will help keep the IG from knocking on the door. The director of Defense Procurement and Acquisition Policy (DPAP), Shay D. Assad, recently announced new appeal rights for DCAA if it wishes to challenge a Contracting Officer's "significant disagreement" with audit recommendations. The significant disagreement arises when the Contracting Officer plans to sustain less than seventy-five percent of the total recommended questioned costs in a DCAA audit report on a contractor proposal valued at \$10 million or more.<sup>11</sup>

DCAA must make this request for higher-level review "within three business days after receiving the contracting officer's written communication."<sup>12</sup> However, there is no time limit for resolution of contested DCAA findings at higher management levels, and these officials have priorities other than sorting out issues relating to a DCAA audit report. As a result, this could turn out to be a choke point in the decision-making process, posing problems for Contracting Officers and contractors alike. Accordingly, the underlying message to Contracting Officers, again, is: "Go easy on yourself. You can avoid having to justify your decisions to higher authorities if you simply accept the auditor's recommendations in the first place."

These developments occurred against the backdrop of a blistering report by the GAO that cast doubt on the competence of the DCAA to perform its basic function of auditing.<sup>13</sup> Despite this poor showing and inadequate resources to accomplish its core tasks, DCAA has attempted far-reaching intrusion into contractor operations. For example, seeking to branch out into much broader enforcement activities, DCAA has asserted new rights regarding access to personnel and records.<sup>14</sup> In addition, DCAA has assumed vast powers for monitoring and overseeing contractors' ethics and compliance programs to determine whether contractors "conduct themselves with the highest degree of integrity and honesty."<sup>15</sup> While DCAA has done this under the guise of reviewing internal controls, DCAA has not explained how, as an audit agency—whose function is to audit costs—it may properly use internal controls as a springboard to broadly monitor contractor ethics and compliance programs. There is no little irony in DCAA assuming this expanded role at the same time that it has been criticized for a lack of professionalism and

11. Memorandum from Shay D. Assad, Dir., Def. Procurement & Acquisition Policy, to Commander, U.S. Special Operations Command et al. (Dec. 4, 2009) [hereinafter Assad Memorandum], available at <http://www.acq.osd.mil/dpap/policy/policyvault/USA006857-09-DPAP.pdf>.

12. See *id.*

13. See U.S. GOV'T ACCOUNTABILITY OFFICE, NO. 09-468, DCAA AUDITS: WIDESPREAD PROBLEMS WITH AUDIT QUALITY REQUIRE SIGNIFICANT REFORM 1 (2009) [hereinafter WIDESPREAD PROBLEMS WITH AUDIT QUALITY].

14. See DCAA, NO. 08-PAS-042(R), AUDIT GUIDANCE ON DENIAL OF ACCESS TO RECORDS DUE TO CONTRACTOR DELAYS 1 (2008) [hereinafter AUDIT GUIDANCE ON DENIAL OF ACCESS].

15. DCAA, NO. 09-PAS-014(R), AUDIT GUIDANCE ON FEDERAL ACQUISITION REGULATION (FAR) REVISIONS RELATED TO CONTRACTOR'S CODE OF BUSINESS ETHICS AND CONDUCT 2 (2009) [hereinafter AUDIT GUIDANCE ON CODE OF ETHICS AND CONDUCT].

competence. A better response would be to improve standards for recruitment, training, and supervision of auditors.

Finally, this article discusses certain decisions of the U.S. Court of Appeals for the Federal Circuit that also have marginalized the role of the Contracting Officer. The discussion will demonstrate how the court has veered from the law and from the objective of the FAR that “the contracting officer must have the authority to the maximum extent practicable and consistent with law, to determine the application of rules, regulations, and policies, on a specific contract.”<sup>16</sup> To emphasize this point, the article discusses what might occur if the court were required to append a Contracting Officer Impact Statement to its opinions involving government contracts.

## II. THE ROLE OF THE CONTRACTING OFFICER UNDER THE FEDERAL ACQUISITION REGULATION

Before examining the dilemma of the Contracting Officer today, it is useful to review the guiding principles of the FAR as rewritten in the 1990s. The “rewrite” drafters sought to liberate Contracting Officers from the caution, expressed by some agency counsel, that Contracting Officers were restrained from acting unless the FAR provided *explicit* authorization.<sup>17</sup>

Accordingly, a theme in the FAR “rewrite” is that Contracting Officers should have the liberty to exercise initiative and business judgment with maximum practicable authority to make decisions.<sup>18</sup> Also, “[p]articipants in the acquisition process should work together as a team and should be *empowered to make decisions* within their area of responsibility.”<sup>19</sup> Contracting Officers may obtain the assistance and advice of specialists in various disciplines, including “audit, law, engineering, information security, transportation, and other fields, as appropriate.”<sup>20</sup>

The FAR reinforces the Contracting Officer’s independence and discretion by stating the following:

- (e) The FAR outlines procurement policies and procedures that are used by members of the Acquisition Team. If a policy or procedure, or a particular strategy or practice, is in the best interest of the Government and *is not specifically addressed in the FAR, nor prohibited by law* (statute or case law), Executive order or other regulation, Government members of the Team *should not assume it is prohibited*. Rather, *absence of direction should be interpreted as permitting the Team to innovate and use sound business judgment* that is otherwise consistent with law and within the limits of their authority. *Contracting officers should take the lead in encouraging business process innovations and ensuring that business decisions are sound.*<sup>21</sup>

16. FAR 1.102-4(a).

17. See FAR 1.102-4(e).

18. See FAR 1.102-4(a).

19. FAR 1.102 (emphasis added).

20. FAR 1.602-2(c).

21. FAR 1.102-4(e) (emphasis added).

The FAR also states that Contracting Officers “must have the authority to the maximum extent practicable and consistent with law, to determine the application of rules, regulations, and policies, on a specific contract.”<sup>22</sup>

Under the FAR, the Contracting Officer is the key government official with “authority to enter into, administer, or terminate contracts and make related determinations and findings.”<sup>23</sup> Moreover, the FAR provides: “No contract shall be entered into unless the contracting officer ensures that all requirements of law, executive orders, regulations, and all other applicable procedures, including clearances and approvals, have been met.”<sup>24</sup> Significantly, FAR 1.602-2, entitled “Responsibilities,” states:

Contracting officers are responsible for ensuring performance of all necessary actions for effective contracting, ensuring compliance with the terms of the contract, and safeguarding the interests of the United States in its contractual relationships. In order to perform these responsibilities, *contracting officers should be allowed wide latitude to exercise business judgment.* Contracting officers shall—

- (a) Ensure that the requirements of 1.602-1(b) have been met, and that sufficient funds are available for obligation;
- (b) Ensure that contractors receive impartial, fair, and equitable treatment; and
- (c) Request and consider the advice of specialists in audit, law, engineering, information security, transportation, and other fields, as appropriate.<sup>25</sup>

Even the FAR definition of Contracting Officer emphasizes the need to lift restrictions on the Contracting Officer’s exercise of judgment:

“Contracting officer” means a person with the authority to enter into, administer, and/or terminate contracts and make related determinations and findings. The term includes certain authorized representatives of the contracting officer acting within the limits of their authority as delegated by the contracting officer. “Administrative contracting officer (ACO)” refers to a contracting officer who is administering contracts. “Termination contracting officer (TCO)” refers to a contracting officer who is settling terminated contracts. A single contracting officer may be responsible for duties in any or all of these areas. Reference in this regulation (48 CFR Chapter 1) to administrative contracting officer or termination contracting officer *does not*—

- (1) Require that a duty be performed at a particular office or activity; or
- (2) Restrict in any way a contracting officer in the performance of any duty properly assigned.<sup>26</sup>

### III. FOUNDATIONAL STATUTES

The bedrock statutory framework makes the Contracting Officer the principal government player in the award and performance of contracts, and in the resolution of contract claims and disputes.

22. FAR 1.102-4(a).

23. FAR 1.602-1(a).

24. FAR 1.602-1(b).

25. FAR 1.602-2 (emphasis added).

26. FAR 2.101 (emphasis added).

### A. *The Competition in Contracting Act*

The Competition in Contracting Act and its FAR implementation make the Contracting Officer the individual responsible to provide for full and open competition. As the FAR makes clear, “10 U.S.C. § 2304 and 41 U.S.C. § 253 require, with certain limited exceptions . . . that contracting officers shall promote and provide for full and open competition in soliciting offers and awarding Government contracts.”<sup>27</sup>

The Contracting Officer also is the official who must provide written justification for awarding contracts without full and open competition:

A contracting officer shall not commence negotiations for a sole source contract, commence negotiations for a contract resulting from an unsolicited proposal, or award any other contract without providing for full and open competition unless the contracting officer—

- (1) Justifies, if required in 6.302, the use of such actions in writing;
- (2) Certifies the accuracy and completeness of the justification; and
- (3) Obtains the approval required by 6.304.<sup>28</sup>

### B. *The Contract Disputes Act*

Similarly, the Contract Disputes Act<sup>29</sup> makes the Contracting Officer responsible for issuing decisions on contractor claims.<sup>30</sup> The Contract Disputes Act defines Contracting Officer as

any person who, by appointment in accordance with applicable regulations, has the authority to enter into and administer contracts and make determinations and findings with respect thereto. The term also includes the authorized representative of the contracting officer, acting within the limits of his authority.<sup>31</sup>

The Contracting Officer must issue written decisions on contractor and government claims:

All claims by a contractor against the government relating to a contract shall be in writing and shall be submitted to the contracting officer for a decision. All claims by the government against a contractor relating to a contract *shall be the subject of a decision by the contracting officer*. The contracting officer shall issue his decision in writing.<sup>32</sup>

Although FAR 33.211(a)(2) requires Contracting Officers to “[s]ecure assistance from legal and other advisors,” each decision on a claim must result from the Contracting Officer’s independent exercise of judgment.

27. FAR 6.101(a).

28. FAR 6.303-1(a); *see also* FAR 6.303-2 (for description of the required content of each justification), 6.304 (for requirements for approval of the justification).

29. 41 U.S.C. §§ 601–613 (2006).

30. *See* FAR 33.210.

31. 41 U.S.C. § 601(3).

32. 41 U.S.C. § 605(a) (emphasis added).

For example, in *Lavezzo v. United States*, an agency supervisor tried to prevent the assigned Contracting Officer from deciding contractor claims and then referred the claims to another agency, which denied the claims.<sup>33</sup> The court remanded with instructions to the agency to have a new Contracting Officer “fairly and independently” review the claims and issue a final decision.<sup>34</sup> And in *Moreland Corp. v. United States*, Judge Wheeler stated:

Under the Contract Disputes Act, a contracting officer’s review of certified claims submitted in good faith is not intended to be a negotiating game where the agency may deny meritorious claims to gain leverage over the contractor. The law requires contractors to certify that their claims are “made in good faith,” that all “supporting data are accurate and complete to the best of [the contractor’s] knowledge and belief,” and that the amount requested “accurately reflects the contract adjustment for which the contractor believes the government is liable.” 41 U.S.C. § 605(c)(1). Certainly, a reciprocal obligation to act in good faith should apply to the Government. As the Court noted recently in *Lavezzo v. United States*, a contracting officer is obligated to “put his own mind to the problems and render his own decisions.” Such decisions must be “personal [and] independent,” and “even the appearance of coercion [must] be avoided.” 74 Fed. Cl. 502, 509 (2006). The Contracting Officer’s outright denial of meritorious contractor claims to gain some advantage over the contractor will not be condoned by this Court.<sup>35</sup>

#### IV. OVERSIGHT, ENFORCEMENT, AND COMPLIANCE: MOVING THE CONTRACTING OFFICER AWAY FROM CENTER STAGE

Recent congressional enactments have conferred new enforcement and oversight powers on the comptroller general and inspectors general. The 2009 stimulus legislation created a Recovery Accountability and Transparency Board with significant oversight powers, including the power to issue subpoenas “to compel the testimony of persons who are not Federal officers or employees.”<sup>36</sup> DCAA, seeking to expand its traditional audit advisory role into much broader enforcement activities, has asserted new rights regarding access to personnel and records.<sup>37</sup> Continuing its confrontational posture, DCAA also has assumed vast authority to monitor and oversee contractors’ ethics and compliance programs, and to determine whether contractors “conduct themselves with the highest degree of integrity and honesty.”<sup>38</sup> In these measures, DCAA has sought to create a role for itself substantially beyond the advisory role contemplated by the FAR. Finally, a recent DoD policy entitled “Resolving Contract Audit Recommendations” provides for DCAA management to request higher-level review when the Contracting Officer does not

33. 74 Fed. Cl. 502, 505 (2006).

34. *Id.* at 509.

35. 76 Fed. Cl. 268, 292 (2007).

36. American Recovery and Reinvestment Act of 2009 (Stimulus Act), Pub. L. No. 111-005, § 1524(c)(1), 123 Stat. 115, 291 (2009); see *infra* Part IV.B.

37. See AUDIT GUIDANCE ON DENIAL OF ACCESS, *supra* note 14, at 1–4.

38. AUDIT GUIDANCE ON CODE ETHICS AND CONDUCT, *supra* note 15, at 2.

include significant audit report recommendations in the Contracting Officer's pre-negotiation objective.<sup>39</sup>

All of these events further marginalize the role of the Contracting Officer. At the same time, these events mean delays in decision making as well as risk and frustration for contractors.

A. *Interviews of Company Employees: Comptroller General, Inspectors General, and DCAA*

The American Recovery and Reinvestment Act of 2009 ("Stimulus Act"), the FY09 NDAA, the FY10 NDAA, and recent DCAA audit guidance assert the Government's audit access to interview contractor employees as a matter of right.<sup>40</sup>

The FY10 NDAA expanded the authority of the Government to compel testimony in nonlitigation settings.<sup>41</sup> Section 1042 of the Act authorizes the DoD IG to require by subpoena the attendance and testimony of nonfederal employees "as necessary in the performance of functions assigned to the Inspector General" under the Inspector General Act of 1978.<sup>42</sup>

In the FY09 NDAA, Congress amended the statutes relating to the authority of the GAO to gain audit access to contractor information.<sup>43</sup> Pursuant to section 871 of that Act, the amended statutes state:

[E]ach contract awarded after using procedures other than sealed bid procedures shall provide that the *Comptroller General and his representatives are authorized to examine any records of the contractor*, or any of its subcontractors, that directly pertain to, and involve transactions relating to, the contract or subcontract, *and to interview any current employee regarding such transactions.*<sup>44</sup>

Section 1515 of the Stimulus Act grants comparable authority to the inspectors general:

- (a) Access—With respect to *each contract or grant awarded using covered funds*, any representative of an appropriate inspector general appointed under section 3 or 8G of the Inspector General Act of 1978 (5 U.S.C. App.), is authorized—
  - (1) to examine any records of the contractor or grantee, any of its subcontractors or subgrantees, or any State or local agency administering such contract, that pertain to, and involve transactions relating to, the contract, subcontract, grant, or subgrant; and

39. See Assad Memorandum, *supra* note 11.

40. See Stimulus Act § 1524(c)(1); FY10 NDAA, Pub. L. No. 111-84, § 1042, 123 Stat. 2190 (2009); FY09 NDAA, Pub. L. No. 110-417, § 871, 122 Stat. 4356, 4555 (2008); AUDIT GUIDANCE ON DENIAL OF ACCESS, *supra* note 14, at 1-4.

41. FY10 NDAA § 1042, 123 Stat. 2190.

42. *Id.*; Inspector General Act of 1978, 5 U.S.C. app. § 6. Also see the statutory authority underlying FAR 52.215-2 (Audits and Records—Negotiation). Further, 10 U.S.C. § 2313 (2006) and 41 U.S.C. § 254d (2006) only provide subpoena power over documents, records, and similar materials.

43. See FY09 NDAA § 871, 122 Stat. at 4555.

44. 41 U.S.C. § 254d(c)(1); 10 U.S.C. § 2313 (c)(1); FY09 NDAA § 871 (emphasis added).

- (2) to interview any officer or employee of the contractor, grantee, subgrantee, or agency regarding such transactions.
- (b) Relationship to Existing Authority—Nothing in this section shall be interpreted to limit or restrict in any way any existing authority of an inspector general.<sup>45</sup>

Similarly, on December 19, 2008, the DCAA, stung by an unfavorable GAO report in September 2008 on DCAA effectiveness, issued Audit Guidance 08-PAS-042(R), “Audit Guidance on Denial of Access to Records Due to Contractor Delays.”<sup>46</sup> DCAA’s guidance states in part:

When an auditor requests supporting documentation from a contractor (either verbally or in writing), the request should clearly state what support is needed and when it should be provided. The contractor should be provided a reasonable time period to provide the data given the specific circumstances. Generally, documentation supporting the contractor’s assertion (e.g., the contractor’s proposal or other submission) should be readily available. Therefore, unless the request requires analysis by the contractor or there are extenuating circumstances (e.g., the request is for a voluminous amount of data or for data stored at an off-site location), the contractor should provide the documentation upon request. For example, support for proposed labor hours should be provided the same day requested, given the information would have been generated by the contractor prior to submitting the bid proposal. If the request requires analysis or if extenuating circumstances exist, auditors should allow the contractor additional time deemed necessary to provide the requested documentation.

*Support includes access to personnel*, in addition to the documentation/data supporting the contractor’s assertion (e.g., cost records, policies and procedures, management reports). *Auditors should generally obtain supporting documentation directly from the person responsible for the information.* The contractor’s use of a liaison for requests from DCAA should not result in delays in providing requested documentation *or inhibit the auditor’s access to contractor personnel* needed to conduct the audit. Such delays and/or restrictions should be addressed in writing to senior management of the company.<sup>47</sup>

In contrast to these statutory grants of authority to GAO and the IGs, DCAA’s Audit Guidance 08-PAS-042(R) lacks the same foundation. There is no support in the law for DCAA’s claimed right to obtain supporting information directly from company employees. To the contrary, FAR 52.215-2(f) states: “The Contractor shall make available at its office *at all reasonable times* the records, materials and other evidence . . . .”<sup>48</sup> The standard for audit access is “reasonable times,”<sup>49</sup> not “provide documentation immediately upon request.”<sup>50</sup> Similarly, the definition of “full cooperation” in FAR 52.203-13, Contractor Code of Business Ethics and Conduct, provides for “timely and

45. Stimulus Act § 1515 (emphasis added).

46. AUDIT GUIDANCE ON DENIAL OF ACCESS, *supra* note 14, at 1.

47. *See id.* at 1–2 (emphasis added).

48. FAR 52.215-2(f) (emphasis added).

49. *Id.*

50. *See* AUDIT GUIDANCE ON DENIAL OF ACCESS, *supra* note 14, at 1.

complete response to Government auditors' and investigators' requests for documents and access to employees with information."<sup>51</sup>

B. *The Recovery Accountability and Transparency Board: Oversight and Enforcement Powers and Compelled Testimony—Auditors for Auditors and Overseers for Inspectors General?*

Sections 1521 to 1530 of the Stimulus Act establish the duties of a newly created Recovery Accountability and Transparency Board ("the Board"), whose purpose is to "coordinate and conduct oversight of covered funds to prevent fraud, waste, and abuse."<sup>52</sup> Sections 1541 to 1546 establish the Recovery Independent Advisory Panel ("the Panel") to "make recommendations to the Board on actions the Board could take to prevent fraud, waste, and abuse relating to covered funds."<sup>53</sup> Whatever the effects may be on other sectors of the economy, the oversight function directly benefits from the stimulus legislation in terms of added personnel and budget. A *New York Times* article reported that the Stimulus Act "directs more than \$350 million to oversight, virtually guaranteeing boom times in the field of government accountability."<sup>54</sup> The article continued: "The new stimulus package includes roughly \$253 million for inspectors general, \$84 million for the transparency board, and an additional \$25 million for the Government Accountability Office."<sup>55</sup> As a result, the writer stated, "some experts warn that the government might now need auditors for its auditors and new overseers for inspectors general, who typically answer directly to Congress."<sup>56</sup>

The Board's specific functions include reviewing contracts and grants for purpose and performance measures; reviewing satisfaction of competition requirements; auditing for "wasteful spending, poor contract or grant management, or other abuses . . . and referring matters . . . to the inspectors general"; reviewing whether sufficient qualified acquisition and grant personnel oversee covered funds; reviewing adequacy of training for acquisition personnel; and reviewing mechanisms for interagency collaboration, "including coordinating and collaborating . . . with the Inspectors General Council on Integrity and Efficiency."<sup>57</sup>

Section 1524 grants broad powers to the Board:

- (a) In General—The Board shall conduct audits and reviews of spending of covered funds and coordinate on such activities with the inspectors general of the relevant agency . . . .

51. FAR 52.203-13.

52. Stimulus Act, Pub. L. No. 111-005, § 1521, 123 Stat. 115, 289 (2009).

53. *Id.* § 1542.

54. David M. Herszenhorn, *Stimulus Plan Ensures Boom Sector: Oversight*, N.Y. TIMES, Feb. 20, 2009, at A18.

55. *Id.*

56. *Id.*

57. Stimulus Act § 1523(a)(2)(A)–(F).

- (b) Audits and Reviews. The Board may—
- (1) conduct its own independent audits and reviews relating to covered funds; and
  - (2) collaborate on audits and reviews relating to covered funds with any inspector general of an agency.
- (c) Authorities—
- (1) Audits and Reviews—In conducting audits and reviews, the Board shall have the authorities provided under section 6 of the Inspector General Act of 1978 (5 U.S.C. App.). *Additionally, the Board may issue subpoenas to compel the testimony of persons who are not Federal officers or employees and may enforce such subpoenas in the same manner as provided for inspector general subpoenas . . . .*
  - (d) Public Hearing—The Board may hold public hearings and Board personnel may conduct necessary inquiries. The head of each agency shall make all officers and employees of that agency available to provide testimony to the Board and Board personnel. *The Board may issue subpoenas to compel the testimony of persons who are not Federal officers or employees at such public hearings. . . .*<sup>58</sup>

Section 1524 appears to grant the Board subpoena power, not only for documents, but also to compel testimony of private individuals in two ways: (1) in connection with audits and reviews and (2) in connection with public hearings.<sup>59</sup> Thus, a contractor or grant recipient could face simultaneous or overlapping audits and investigations by DCAA, GAO, an IG, a “whistle-blower,” and now subpoenas from the Board.

Section 1543 authorizes the Panel to hold hearings, take testimony, and receive evidence. This provision does not give the Panel explicit subpoena power to compel document production or witness testimony.<sup>60</sup>

*C. Ethics and Compliance: DCAA's Audit Guidance on FAR 52.203-13 (July 23, 2009)*

On July 23, 2009, DCAA issued an audit guidance to its auditors on review of contractor compliance with the new FAR Subpart 3.10 and the implementing contract clause at FAR 52.203-13.<sup>61</sup> In recent letters to contractors, DCAA has articulated its formal request for information regarding Control Environment.<sup>62</sup> In this fashion, DCAA has propelled itself into the role of

58. *Id.* § 1524(a)–(d) (emphasis added).

59. *See id.*

60. *See id.* § 1543.

61. *See* AUDIT GUIDANCE CODE OF ETHICS AND CONDUCT, *supra* note 15, at 1–2.

62. *See, e.g.,* DCAA Formal Request for Information on Control Environment [hereinafter DCAA Formal Request], redacted copy available at <http://www.dii.org/resources/dcaa-form-letter-re-mandatory-disclosure.pdf>. *See generally* DCAA, AUDIT PROGRAM, ACTIVITY CODE 11070, CONTROL ENVIRONMENT AND OVERALL ACCOUNTING SYSTEM CONTROLS (Dec. 2009) [hereinafter AUDIT PROGRAM CONTROL ENVIRONMENT], available at [http://www.dcaa.mil/sap/11070\\_AP\\_NA.pdf](http://www.dcaa.mil/sap/11070_AP_NA.pdf).

monitoring whether contractors “conduct themselves with the highest degree of integrity and honesty.”<sup>63</sup> The DCAA audit guidance focuses on (1) Code of Business Ethics and Conduct, (2) Training, (3) Periodic Reviews, (4) Internal Reporting Mechanism, (5) Disciplinary Action, (6) Disclosure of Improper Conduct, (7) Full Cooperation, and (8) Display of Hotline Posters.<sup>64</sup> As a result, DCAA auditors will move far beyond their audit responsibilities and deeply into management judgment and decision making. Where DCAA will get the resources for this task, and what role will exist for the Contracting Officer, remain to be seen.

### 1. Code of Business Ethics and Conduct

The audit guidance informs DCAA auditors: “Although FAR does not detail the specific areas that should be covered, *the contractor’s written code of conduct should generally address ethical business practices and expected standards of ethical and moral behavior.*”<sup>65</sup> DCAA thus assumes the responsibility of determining the “adequacy” of a contractor’s written code of business ethics and conduct, according to DCAA’s view of “expected standards of ethical and moral behavior.”<sup>66</sup> DCAA makes clear that a code of conduct “should cover dealings with customers, suppliers, employees, and other parties,” stating “considerations” for evaluation that DCAA acknowledges are not contained in the FAR:

- Conflicts of interest, illegal or other improper payments, anticompetitive guidelines, and insider trading;
- Compliance with government contracting requirements for procurement integrity, classified information, and recruiting and employing current or former government personnel;
- Periodic acknowledgment of codes by all employees;
- Clear establishment of what behavior is acceptable or unacceptable, and what to do if employees encounter improper behavior;
- Consequences for violations.<sup>67</sup>

In staking out a wide platform to review and question contractor business practices and judgments, DCAA has assumed the role of determining “what behavior is acceptable or unacceptable” and deciding whether contractors possess sufficient ethical and moral standards.<sup>68</sup>

### 2. Ethics Awareness and Compliance Program

Here DCAA focuses on “effective training” and “disseminating information appropriate to an individual’s respective roles and responsibilities.”<sup>69</sup>

63. AUDIT GUIDANCE CODE OF ETHICS AND CONDUCT, *supra* note 15, at 2.

64. See *id.* enclosure 1.

65. See *id.* enclosure 3, at 1.

66. See *id.*

67. See *id.*

68. See *id.*

69. See *id.* enclosure 3, at 2.

DCAA advises its auditors that the FAR requires contractors to provide training to “principals and employees, as well as to the contractor’s agents and subcontractors, as appropriate.”<sup>70</sup> The audit guidance states that “auditors should evaluate the contractor’s . . . training materials to ensure it covers the contractor’s code of business ethics and conduct.”<sup>71</sup> DCAA auditors also will “test the implementation of the program by obtaining completed training documents to determine that the training was periodically provided to the appropriate individuals.”<sup>72</sup>

So, in the first instance, DCAA determines whether a contractor’s code of business ethics and conduct is “adequate” by evaluating whether the contractor has clearly established acceptable and unacceptable behavior regarding “expected standards of ethical and moral behavior.”<sup>73</sup> Then, DCAA determines whether the contractor’s training materials contain the correct content and whether the contractor communicates this training to the “appropriate” individuals.<sup>74</sup>

### 3. Business Ethics Awareness and Compliance Internal Control System

Here, DCAA zeroes in on “an effective system of internal controls and self-governance.”<sup>75</sup> DCAA states that “[m]anagement must continually communicate the importance of a strong internal control system”; and contractors “should have policies and procedures to facilitate timely discovery of improper conduct and ensure corrective measures are promptly instituted and carried out for any cases of improper conduct disclosed.”<sup>76</sup>

That DCAA claimed a right to review contractor internal controls for this purpose is interesting in light of GAO’s September 23, 2009, report to the Senate Homeland Security Committee on deficiencies in DCAA operations.<sup>77</sup> GAO reported that DCAA had rescinded eighty audit reports as a result of GAO findings.<sup>78</sup> GAO stated: “Nearly one third (24) of the 80 rescinded reports relate to unsupported opinions on contractor internal controls, which were used as the basis for risk-assessments and planning on subsequent internal control and cost-related audits.”<sup>79</sup>

DCAA’s focus on “improper conduct” is also noteworthy because FAR 52.203-13 does not define that term, but does distinguish it from “violations” of criminal law and the civil False Claims Act.<sup>80</sup> “Violations” can be measured

70. *See id.*

71. *See id.*

72. *See id.*

73. *See id.* enclosure 3, at 1.

74. *See id.* enclosure 3, at 2.

75. *See id.*

76. *See id.*

77. *See* WIDESPREAD PROBLEMS WITH AUDIT QUALITY, *supra* note 13, at 14.

78. *Id.* at 139.

79. *Id.* at 14.

80. FAR 52.203-13(b); *see* AUDIT GUIDANCE ON CODE OF ETHICS AND CONDUCT, *supra* note 15, enclosure 1, at 2.

against the requirements of law.<sup>81</sup> In contrast, “improper conduct,” like “expected standards of ethical and moral behavior,” is a vague and amorphous term.<sup>82</sup> Yet, that is the “standard” that DCAA embraces.

In the guidance, DCAA states that internal controls must provide for, at a minimum:

- (1) Assignment of responsibility at a sufficiently high level to ensure the effectiveness of the business ethics awareness and compliance program and internal control system.<sup>83</sup>

According to DCAA, “the manager responsible for the ethics program should report to a high level official such as the vice president or CFO.”<sup>84</sup>

- (2) Procedures to ensure individuals that previously engaged in conduct that conflicts with the contractor’s code of conduct are not appointed as a principal of the company (e.g., officer, director, partner).<sup>85</sup>

DCAA instructs its auditors to review contractor policies and procedures “and test the procedures to verify that they include steps for exercising due diligence in identifying such conduct (e.g., require background checks before appointing principals of the company) and that the steps have been taken when applicable.”<sup>86</sup> As with other provisions of the audit guidance, DCAA has now inserted itself into evaluating contractor employment practices.

- (3) Periodic evaluations (i.e., at least annually) of the effectiveness of the business ethics and awareness compliance program and internal control system.<sup>87</sup>

DCAA directs its auditors to “review the results of these evaluations and determine the impact on any audits,” and to ascertain that the contractor “has taken the necessary corrective actions to address” weaknesses.<sup>88</sup> Implicit here is the assertion of a broad power to second-guess (“review the results of these evaluations”) contractor compliance programs and internal control systems, and determine whether “weaknesses” exist, as well as to second-guess whether corrective actions are necessary and sufficient to address the “weakness.”<sup>89</sup>

A recent DCAA letter to contractors adds a disclosure element. The letter states that DCAA must verify that the contractor (1) performs “periodic reviews of the company business practices, procedures, and internal controls for compliance with standards of conduct as stated in FAR 52.203-13(c)(2)(ii)(C)” and (2) “provides appropriate disclosure to the government of information needed to fulfill its responsibilities.”<sup>90</sup> The cited paragraph from FAR 52.203-13 contains

81. FAR 52.203-13(b)(3).

82. See AUDIT GUIDANCE CODE OF ETHICS AND CONDUCT, *supra* note 15, enclosure 3, at 1–2.

83. *Id.* enclosure 3, at 2.

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.*

89. *See id.*

90. DCAA Formal Request, *supra* note 62, at 2 (emphasis added).

no disclosure requirement.<sup>91</sup> Moreover, DCAA's letter states: "*We define adequate disclosure as disclosure to DCAA and the ACO of all findings that significantly impact government contracts within 5–10 days of identification; disclosure of the corrective actions in process or planned by the company; and disclosure of adjustments to government contract costs and improvements to underlying business systems.*"<sup>92</sup> The DCAA letter then requests "a list of violations to the code of conduct/ethics which occurred in the past 12 months."<sup>93</sup> These are also requirements of DCAA's invention.

- (4) Disciplinary action for improper conduct, or failing to take reasonable steps to detect improper conduct.<sup>94</sup>

According to the July 23, 2009, guidance, DCAA auditors will seek "evidence of the assessment performed to determine if disciplinary action taken was needed, and evidence of the disciplinary action taken."<sup>95</sup> If the contractor states no disciplinary action was needed, "the auditor should take steps to ensure that there were no reports of improper conduct by the contractor (such as those reported under the requirements [of mandatory disclosure to the Inspector General])."<sup>96</sup> If the auditor finds that "there is a report of improper conduct and the contractor failed to take disciplinary action when it should have been taken, the auditor should cite the contractor for an internal control deficiency."<sup>97</sup>

This part of the audit guidance is particularly disturbing. First, it sets up DCAA auditors to second-guess employee disciplinary actions, both in terms of whether "improper conduct"—as previously noted, an undefined term—occurred, and whether the disciplinary action, if any, was appropriate to the "improper conduct."<sup>98</sup> Second, the guidance is clear that DCAA auditors will seek documents relating to employee disciplinary actions.<sup>99</sup> This will place DCAA squarely within a company's human resources function (in addition to its ethics and compliance function), reviewing documents and making judgments about labor issues that could be complicated by union agreements and employment contracts, along with confidentiality and privacy issues.

Third, the audit guidance poses a danger that DCAA could overreach in asserting that "reports" of improper conduct should result in disciplinary action, and that the absence of a disciplinary action would result in a DCAA citation for an internal control deficiency.<sup>100</sup> Thus, a disagreement with DCAA over a human resources function—such as appropriate discipline to

91. See FAR 52.203-13(c)(2)(ii)(C).

92. DCAA Formal Request, *supra* note 62, at 2 (emphasis added).

93. *Id.*

94. AUDIT GUIDANCE ON CODE OF ETHICS AND CONDUCT, *supra* note 15, enclosure 3, at 2.

95. *Id.*

96. *Id.* enclosure 3, at 2–3.

97. *Id.* enclosure 3, at 3.

98. See *id.* enclosure 3, at 2–3.

99. See *id.* enclosure 3, at 2.

100. See *id.* enclosure 3, at 3.

be imposed on an employee for “improper conduct”—may lead to a DCAA determination of an inadequate internal control system for government contract purposes.<sup>101</sup> Additionally, the audit guidance appears expansive in its use of the term “report.”<sup>102</sup> It cites a mandatory disclosure to the IG under FAR 52.203-13 as one example of a “report.”<sup>103</sup> The implication is that a “report” of improper conduct could come in any number of forms, written or oral. This DCAA intrusion into traditional human resources activities is also unprecedented and without support.

- (5) An internal reporting mechanism, such as a hotline, by which employees may anonymously or confidentially report suspected instances of improper conduct, and instructions that encourage employees to make such reports.<sup>104</sup>

Although the audit guidance does not discuss this requirement in detail, the requirement is logically related to the one preceding it. That is, the hotline is a source of “reports” of improper conduct.<sup>105</sup> Thus, DCAA may seek access to the hotline information as part of the “evidence” described above.<sup>106</sup>

- (6) Timely disclosure in writing to the agency Office of Inspector General (OIG), with a copy to the contracting officer, when there is credible evidence of violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations, or a violation of the civil False Claims Act in connection with Government contracts.<sup>107</sup>

The audit guidance instructs DCAA auditors to “ensure that the contractor’s policies and procedures include a reasonable definition of credible evidence and a reasonable timeframe for disclosure once credible evidence is obtained.”<sup>108</sup> This is a particularly troubling statement. While FAR 52.203-13 requires disclosure of “credible evidence” of certain violations, the regulation does not define the meaning of that term.<sup>109</sup> Thus, DCAA is posturing itself to enforce the definition it favors on contractors by disapproving any contractor definition with which it disagrees (and determining the contractor’s internal control system “inadequate” at the same time), in the absence of a regulatory definition.

Significantly, DCAA’s letter to contractors uses the wrong standard for disclosures to the agency IG. In its letter, DCAA stated: “We will review policies and procedures and determine if they provide for timely reporting to appropriate Government officials *of any suspected violation of law* in connection with Government contracts *or any other irregularities* in connection with such contracts in accordance with FAR 52.203-13(b)(3) and FAR 52.203-13(c)

101. *See id.*

102. *See id.*

103. *See id.* (citing FAR 52.203-13).

104. *Id.* enclosure 3, at 3.

105. *See id.*

106. *See id.* enclosure 3, at 2.

107. *Id.* enclosure 3, at 3.

108. *Id.*

109. FAR 52.203-13(c)(2)(ii)(F).

(2)(ii)(F).”<sup>110</sup> A “suspected violation of law . . . or any other regularities” is broader than “credible evidence” of a violation of specified federal criminal statutes or the civil False Claims Act.<sup>111</sup>

Moreover, contractors may expect that DCAA’s view of a “reasonable time-frame for disclosure” will be unrealistically short, given the five-to-ten-day reporting requirement in DCAA’s letter to contractors.<sup>112</sup> In its Memorandum for Regional Directors dated December 19, 2008, DCAA asserted entitlement to virtually same-day audit access in certain situations.<sup>113</sup> That approach will likely apply here as well.

- (7) Full cooperation with any government agencies responsible for audits, investigations, or corrective actions.<sup>114</sup>

The audit guidance instructs DCAA auditors to cite contractors for deficiencies relating to their control environment “[i]f there are known cases where the contractor has not cooperated with audits or investigations.”<sup>115</sup> DCAA auditors “should confirm that there are no outstanding access to records issues or subpoenas that would indicate the contractor’s lack of cooperation.”<sup>116</sup> DCAA’s position is that if a contractor has not complied with DCAA’s assumption of authority to demand access to records,<sup>117</sup> the contractor necessarily did not fulfill its “full cooperation” obligation.<sup>118</sup> DCAA fails to recognize that the “full cooperation” obligation in FAR 52.203-13 relates to instances of mandatory disclosure of “credible evidence” of certain violations *to the agency IG*.<sup>119</sup> The definition of “full cooperation” makes that point: “disclosure to the Government of the information *sufficient for law enforcement to identify the nature and extent of the offense and the individuals responsible for the conduct*.”<sup>120</sup> Yet DCAA has inserted itself into the process that requires reporting only to the IG.

#### 4. DCAA Audit Control Environment Program

The DCAA audit program (distinct from the audit guidance) relating to FAR 52.203-13 contains a disturbing section on “Board of Directors/Audit Committee.”<sup>121</sup> That section focuses on the independence and the “active

110. DCAA Formal Request, *supra* note 62, at 3 (emphasis added).

111. *See id.*; FAR 52.203-13(c)(2)(ii)(F).

112. *See* DCAA Formal Request, *supra* note 62, at 2.

113. DCAA, No. 08-PAS-043(R), AUDIT GUIDANCE ON SIGNIFICANT DEFICIENCIES/MATERIAL WEAKNESSES AND AUDIT OPINIONS ON INTERNAL CONTROL SYSTEMS 2 (2008) [hereinafter AUDIT GUIDANCE ON SIGNIFICANT DEFICIENCIES], available at <http://www.dii.org/resources/2008-dcaa-audit-internal-control.pdf>.

114. AUDIT GUIDANCE ON CODE OF ETHICS AND CONDUCT, *supra* note 15, enclosure 3, at 3.

115. *Id.*

116. *Id.*

117. *See* AUDIT GUIDANCE ON SIGNIFICANT DEFICIENCIES, *supra* note 113, at 1.

118. *See* AUDIT GUIDANCE ON CODE OF ETHICS AND CONDUCT, *supra* note 15, enclosure 3, at 3.

119. FAR 52.203-13(a) (emphasis added).

120. *Id.* (emphasis added).

121. *See* AUDIT PROGRAM CONTROL ENVIRONMENT, *supra* note 62, at 9–10.

role” that DCAA believes the Board of Directors and Audit Committee should play in management of a company.<sup>122</sup> Specifically, the audit program instructs DCAA auditors to obtain a list of members of the Board of Directors and Audit Committee “and assess their independence.”<sup>123</sup> It further states:

- (b) Evaluate the minutes of the Board of Directors’ meeting and all communications with the Audit Committee, or body of similar authority *to determine if the Board is taking an active role in significant management decisions.*
- (c) Evaluate the minutes of the Audit Committee meetings to determine if the committee (and/or Board of Directors) is acting effectively on all audit matters, including internal and external audit recommendations.
- (d) Verify that the internal audit department is functionally and organizationally independent to achieve objectivity in the conduct of its audits.<sup>124</sup>

Again, DCAA would insert itself directly into the management of the company. First, DCAA considers itself qualified to evaluate and judge the independence of the Board of Directors and Audit Committee.<sup>125</sup> Second, DCAA will demand access to Board of Directors and Audit Committee meeting minutes and all communications between those two entities.<sup>126</sup> Third, DCAA will determine whether the Board of Directors “is taking an active role in significant management decisions” and whether the Board and Committee are “acting effectively on all audit matters, including internal and external audit recommendations.”<sup>127</sup> This expansive assertion of power to review and evaluate the communications, decisions, and actions of the Board of Directors and Audit Committee is unprecedented and unwise. DCAA has neither the expertise nor the experience to undertake these actions.

D. *DCAA to Report “Unsatisfactory Conditions” Relating to Actions of Government Officials Directly to the DoD Inspector General (Mar. 13, 2009)*

On March 13, 2009, DCAA issued Audit Guidance 09-PAS-004(R), “Audit Guidance on Reporting Significant/Sensitive Unsatisfactory Conditions Related to Actions of Government Officials,” which contained revised procedures for reporting “unsatisfactory conditions” relating to actions of government officials, including Contracting Officers.<sup>128</sup> DCAA will now report these actions directly to the DoD IG, as opposed to DCAA’s previous process of reporting through the official’s management chain.<sup>129</sup> Reportable actions include those that “appear to reflect mismanagement, a failure to comply with specific requirements or gross negligence in fulfilling his or her responsibility

122. *See id.* at 9.

123. *Id.*

124. *Id.* at 9–10 (emphasis added).

125. *See id.* at 9.

126. *See id.* at 9–10.

127. *See id.*

128. *See* AUDIT GUIDANCE ON UNSATISFACTORY CONDITIONS, *supra* note 9, at 1.

129. *Id.*

that result in substantial harm to the Government or taxpayers, or that frustrate public policy.”<sup>130</sup>

DCAA acknowledged that “contracting officers have wide authority to make decisions regarding contract matters” and that “DCAA auditors act as advisors to contracting officers.”<sup>131</sup> Nevertheless, the subjective standard in the new DCAA procedure brings new pressure on Contracting Officers to acquiesce in DCAA’s “advice” to avoid a referral by DCAA to the IG.<sup>132</sup>

On April 8, 2009, the DoD IG issued Report D-2009-6-004, which it described as the “first in a series of reports we plan to issue on the actions that contracting officers took in response to audit reports of DoD contractors involved in Iraq reconstruction efforts.”<sup>133</sup> The report took issue with Contracting Officer decisions that disregarded DCAA recommendations.<sup>134</sup>

Thus, while paying lip service to the independence and authority of Contracting Officers, these changes signal a shift in power from the Contracting Officer to the auditor. Given GAO’s conclusions about the lack of professionalism and competence in DCAA,<sup>135</sup> this shift does not bode well for contractors seeking certainty and continuity in government decision making.

E. *DCAA Audits: “Widespread Problems with Audit Quality Require Significant Reform” (GAO Report to the Senate Committee on Homeland Security and Governmental Affairs, Sept. 2009)*

In September 2009, GAO issued report GAO-09-468 entitled “DCAA Audits: Widespread Problems with Audit Quality Require Significant Reform” to the Senate Committee on Homeland Security and Governmental Affairs.<sup>136</sup> The problems described in that report reflect a serious lack of competence at DCAA and call into question the wisdom of any expansion of DCAA authority.

As background, GAO testified a year earlier before the Committee that DCAA failed to meet professional audit standards at three locations in California.<sup>137</sup> Specifically, GAO found

that the audit documentation for 14 selected audits at two locations did not support reported opinions, that DCAA supervisors dropped findings and changed

130. *Id.*

131. *Id.* enclosure 1, at 2.

132. *See id.* at 1.

133. INSPECTOR GEN., U.S. DEP’T OF DEF., REPORT NO. D-2009-6-004, DEFENSE CONTRACT MANAGEMENT AGENCY ACTIONS ON AUDITS OF COST ACCOUNTING STANDARDS AND INTERNAL CONTROL SYSTEMS AT DoD CONTRACTORS INVOLVED IN IRAQ RECONSTRUCTION ACTIVITIES I (2009).

134. *See id.*

135. *See* WIDESPREAD PROBLEMS WITH AUDIT QUALITY, *supra* note 13, at 69–70; *infra* Part III.E.

136. *Id.* at 1.

137. *See id.*

audit opinions without adequate audit evidence for their changes, and that sufficient audit work was not performed to support audit opinions and conclusions. Further, we found that contractor officials and the Department of Defense (DOD) contracting community improperly influenced the audit scope, conclusions, and opinions of several audits, including forward pricing audits at a third location—a serious independence issue. During our investigation, DCAA managers took actions against their staff at two locations that served to intimidate auditors and create an abusive work environment. For example, we learned of verbal admonishments, reassignments, and threats of disciplinary action against auditors who spoke with or contacted our investigators, DOD investigators, or DOD contracting officials.<sup>138</sup>

The Committee requested that GAO broaden its ongoing assessment of DCAA's management environment and audit quality assurance structure at DCAA offices nationwide.<sup>139</sup> GAO then reviewed audit documentation for selected audits at field audit offices in each of DCAA's five regions for compliance with generally accepted government auditing standards (GAGAS) and other applicable standards.<sup>140</sup>

GAO selected thirty-seven audits of contractor internal control systems performed by seven geographically dispersed DCAA field offices within the five DCAA regions during fiscal years 2004 through 2006, the most recently completed fiscal years.<sup>141</sup> GAO selected an additional thirty-two paid voucher, overpayment, request for equitable adjustment, and incurred cost assignments that were completed during fiscal years 2004 through 2006 to review supporting documentation to determine whether DCAA auditors were identifying and reporting contractor overpayments and billing errors.<sup>142</sup> In total, GAO reviewed sixty-nine DCAA audits and cost-related assignments.<sup>143</sup>

GAO found audit quality problems at DCAA offices nationwide, including compromise of auditor independence, insufficient audit testing, and inadequate planning and supervision.<sup>144</sup> GAO concluded that nationwide audit quality problems were rooted in DCAA's "poor management environment."<sup>145</sup> GAO found "serious quality problems in the 69 audits and cost-related assignments [GAO] reviewed," and characterized DCAA's audit quality assurance program as "ineffective."<sup>146</sup> Of the 69 audits and cost-related assignments reviewed, "65 exhibited serious GAGAS or other deficiencies similar to those found in our prior investigation, including compromise of auditor independence, insufficient audit testing, and inadequate planning and supervision."<sup>147</sup> In ad-

138. *Id.*

139. *Id.* at 2.

140. *Id.*

141. *Id.*

142. *Id.* at 3–4.

143. *Id.* at 4.

144. *See id.* at 14.

145. *Id.*

146. *Id.*

147. *Id.*

dition, “the remaining four audits also had GAGAS compliance problems.”<sup>148</sup> DCAA stated that it “rescinded the 80 audit reports because the audit evidence was outdated, insufficient, or inconsistent with reported conclusions and opinions and reliance on the reports for contracting decisions could pose a problem.”<sup>149</sup> GAO continued:

Nearly one third (24) of the 80 rescinded reports relate to unsupported opinions on contractor internal controls, which were used as the basis for risk-assessments and planning on subsequent internal control and cost-related audits. Other rescinded reports relate to CAS compliance and contract pricing decisions. Because the conclusions and opinions in the rescinded reports were used to assess risk in planning subsequent audits, they impact the reliability of hundreds of other audits and contracting decisions covering billions of dollars in DOD expenditures. We found that DCAA’s focus on a production-oriented mission led DCAA management to establish policies, procedures, and training that emphasized performing a large quantity of audits to support contracting decisions over audit quality. An ineffective quality assurance structure compounded this problem.<sup>150</sup>

In its published highlights of the report, GAO reported the following significant issues, among others:

- DCAA auditors spent 530 hours to support an audit of a nonexistent billing system and reported adequate system controls.
- Supervisory auditors directed audit staff to delete some audit documents, generate others, and, in one case, copy the signature of a prior supervisor onto new documents, making it appear that the prior supervisor had approved a revised risk assessment.
- Supervisory auditor who approved altered documents was later promoted to western region quality assurance manager, where he served as quality control check over thousands of audits.<sup>151</sup>

GAO recommended far-reaching changes to DCAA’s procedures, and faulted the DoD IG for mistakenly concluding that DCAA’s system of quality control was adequate.<sup>152</sup> GAO also recommended strengthening the protection of DCAA auditors and suggested that Congress consider creating “an independent, government-wide contract audit agency”:

In the short term, as DCAA makes progress in correcting fundamental weaknesses that have impacted audit quality, Congress could consider enhancing DCAA reform efforts by enacting legislation to grant it protections and authorities similar to those embodied in the Inspector General Act . . . .

In the longer term, depending on the outcome of acquisition management reform initiatives under way and the success of DCAA management reforms, Congress could consider creating an independent, government-wide contract audit agency. Legislation to move DCAA should incorporate the protections and authorities

148. *Id.*

149. *Id.*

150. *Id.*

151. *See id.* at 20.

152. *Id.*

similar to those embodied in the Inspector General Act, if these have not already been granted to DCAA.<sup>153</sup>

Following the release of the GAO report, a Senate Homeland Security and Governmental Affairs Committee press release, dated September 23, 2009, reported the frustration of Committee Chairman Joe Lieberman (I-CT) and Ranking Member Susan Collins (R-ME).<sup>154</sup> The senators commented that “continued systemic weaknesses at the Defense Contract Audit Agency (DCAA), three years after they were first brought to light, were unacceptable” and “suggested that the DCAA might need to be separated from the Department of Defense (DOD) to ensure its independence.”<sup>155</sup> The press release continued:

“The Committee has run out of patience,” said Lieberman. “Too much is on the line and the time for incremental changes is over. Each and every audit that GAO reviewed failed to meet auditing standards. That is not an aberration or a case of a few employees not knowing what to do. That indicates systemic issues within the agency. I expect strong leadership from the DOD so that our Committee will not be sitting here a year from now discussing the same old problems. We need to identify the root causes and get on to the solutions that the taxpayers demand and certainly deserve.”

Collins said: “The Department of Defense and other federal agencies rely on DCAA to detect waste, fraud, and abuse. It is, therefore, unacceptable for this federal policing agency to continue to have significant performance failures. With more than a little frustration, I note that we are here almost one year to the day since the Committee’s last hearing on this very same topic—DCAA’s poor performance. I think it’s important for the witnesses to know why we feel so strongly and why there’s such a sense of outrage among all of us” on the Committee. She said the auditors’ job is to provide critical oversight on contracts worth billions of dollars, “an enormous investment” of taxpayer dollars, and that the goods and services involved go to support American troops in harm’s way. “We have to get this right,” Collins said. “We cannot be back here again next September,” asking the same questions about the same structural flaws.<sup>156</sup>

Senator Collins was mistaken in asserting that “[t]he Department of Defense and other federal agencies rely on DCAA to detect waste, fraud, and abuse.”<sup>157</sup> She has attributed the powers of the IG to DCAA. The Inspector General Act of 1978 states that its purpose in creating the Offices of the IG was, among other things, “to *prevent and detect fraud and abuse . . .*”<sup>158</sup> Nevertheless, Senator Collins’s statement aligns with DCAA’s attempted ex-

153. *Id.* at 72–73.

154. Press Release, S. Comm. on Homeland Sec. & Governmental Affairs, Troubles Persist at Defense Contract Audit Agency (Sept. 23, 2009), available at [http://hsgac.senate.gov/public/index.cfm?FuseAction=Press.MajorityNews&ContentRecord\\_id=e830b286-5056-8059-7644-7f0c74bea8b1](http://hsgac.senate.gov/public/index.cfm?FuseAction=Press.MajorityNews&ContentRecord_id=e830b286-5056-8059-7644-7f0c74bea8b1).

155. *Id.*

156. *Id.*

157. *Id.*

158. Inspector General Act of 1978, Pub. L. No. 95-452, § 2, 92 Stat. 1101, 1101 (emphasis added).

pansion of its own powers, and could reflect DCAA's success in convincing elected officials of the validity of its position.

F. "Resolving Contract Audit Recommendations": Memorandum from Director, Defense Procurement and Acquisition Policy (Dec. 2009)

In a December 4, 2009, memorandum entitled "Resolving Contract Audit Recommendations" ("Assad Memorandum"), Shay D. Assad, Director of the Defense Procurement and Acquisition Policy (DPAP), set forth "DoD's policy for resolving disagreements when the contracting officer does not include significant audit report recommendations (excluding unsupported costs) from the Defense Contract Audit Agency (DCAA) in establishing his/her pre-negotiation objective."<sup>159</sup> The Assad Memorandum states that "significant disagreement" exists when the contracting officer's pre-negotiation objective plans to "sustain less than 75 percent of the total recommended questioned costs in a DCAA audit report on a contractor proposal valued at \$10 million or more."<sup>160</sup>

The Assad Memorandum requires the following steps:

- (1) Contracting Officers first should "attempt to resolve significant issues brought to their attention by DCAA audit reports."
- (2) "When significant disagreements occur, the contracting officer shall discuss the basis of the disagreement with the auditor prior to negotiations. The contracting officer shall document that discussion, and the basis for disagreement in the pre-negotiation objective (or pre-business clearance) and in a written communication to the auditor prior to commencing negotiations . . . ."
- (3) "If after the discussion between the contracting officer and the auditor, the auditor does not agree with the contracting officer, DCAA's management may request that the DoD Component's management review the contracting officer's decision." DCAA must make this request for higher-level review "within three business days after receiving the contracting officer's written communication."
- (4) If the differences are not resolved at the component's highest management level, the director of DCAA may contact the DPAP director "to discuss the disagreement."
- (5) If the DCAA director believes the DPAP director has not adequately addressed the matter, "the disagreement may finally be elevated to the Under Secretaries for Defense, Acquisition, Technology, Logistics and Comptroller."
- (6) In addition, the DCAA director may contact the DPAP director "on any disagreement with audit recommendations which he believes re-

159. See Assad Memorandum, *supra* note 11.

160. *Id.*

quires my attention (e.g., precedent setting or of high interest to the Department).”<sup>161</sup>

The Assad Memorandum states that implementing procedures will be provided to DCAA within sixty days of the memorandum.<sup>162</sup>

The Assad Memorandum also recognizes the authority and discretion of the Contracting Officer.<sup>163</sup> It begins by stating that DoD “fully supports contracting officers making informed decisions within the scope of their authority utilizing the advice of specialists in audit, law, engineering, etc.,” and closes by stating the auditor and Contracting Officer should “work together, recognizing that it is the contracting officer’s ultimate responsibility to determine fair and reasonable contract values.”<sup>164</sup>

Thus, the Assad Memorandum reinforces the Contracting Officer’s status under the FAR as the person responsible for making informed decisions after considering the advice of specialists.<sup>165</sup> It also provides a process for resolving differences between Contracting Officers and DCAA that, if adhered to, is preferable to DCAA taking other steps, such as referring the matter to the DoD IG rather than higher management.<sup>166</sup>

On the other hand, that process can be seen as another example of the erosion of the Contracting Officer’s authority to make independent business judgments. In addition, while DCAA must make its request for higher-level review “within three business days after receiving the contracting officer’s written communication,” there is no time limit on resolution of the issues at the higher levels of management.<sup>167</sup> This could mean paralysis of the decision-making process, as these officials are faced with many priorities other than resolving differences over a DoD audit report.

It remains to be seen whether Contracting Officers will choose the easier route of concurring with DCAA to avoid the need to defend their decisions in the appeal process.

#### G. Proposed Rule on Contractor Business Systems

On January 15, 2010, DoD issued a proposed rule to amend the Defense Federal Acquisition Regulation Supplement (“DFARS”) regarding contractor business systems.<sup>168</sup> The proposed rule defines contractor business systems as accounting systems, estimating systems, purchasing systems, earned value management systems (“EVMS”), material management and

161. *See id.*

162. *Id.*

163. *Id.*

164. *Id.*

165. *See id.*

166. *See id.*

167. *Id.*

168. DFARS Case 2009-D03875, Defense Federal Acquisition Regulation Supplement; Business Systems—Definition and Administration, 75 Fed. Reg. 2457, 2457 (proposed Jan. 15, 2010) (interim rule) (to be codified at DFARS pts. 215, 234, 242, 244, 252).

accounting systems (“MMAS”), and property management systems.<sup>169</sup> The rule would require Administrative Contracting Officers (“ACOs”) to withhold payment when contractor business systems contain deficiencies, further limiting the Contracting Officer’s discretion to administer the contract.<sup>170</sup>

For each covered business system, the proposed rule would add or amend a DFARS contract clause that lists the attributes of an acceptable system.<sup>171</sup> New DFARS contract clauses would prescribe requirements for an accounting system and purchasing system.<sup>172</sup> The rule would require a contractor to “establish and maintain acceptable business systems in accordance with the terms and conditions of the contract.”<sup>173</sup> If the DCAA identified system deficiencies, the auditor would report the deficiencies to the ACO.<sup>174</sup> The ACO would then notify the contractor and request a response.<sup>175</sup> If the ACO then concluded there was a business system deficiency, the ACO would implement a ten percent withhold on the contractor’s payments for each system deficiency.<sup>176</sup> While there is a nominal fifty percent cap, the proposed rule states that the ACO may withhold 100% of the contractor’s payments under certain circumstances.<sup>177</sup> The ACO would remove the withholds only after the contractor successfully implemented a corrective action plan and “substantially corrected” the system deficiencies.<sup>178</sup>

Commentators, including the American Bar Association Section of Public Contract Law, pointed out, among other things, the lack of any requirement for the ACO to demonstrate causation between an alleged deficiency and any potential risk or harm to the Government.<sup>179</sup> Instead, the proposed rule assumes that any deficiency in a business system will automatically cause the Government to be overcharged.<sup>180</sup> The proposed rule thus treats all alleged business system deficiencies alike, except for deficiencies that “are highly likely to lead to improper contract payments being made, or represent an unacceptable risk of loss to the government.”<sup>181</sup> Commentators also observed (a) the punitive nature of the rule, in allowing up to 100% of a contractor’s

169. *See id.*

170. *See id.*

171. *Id.* at 2458.

172. *Id.*

173. *Id.* at 2461.

174. *See id.*

175. *See id.*

176. *See id.* at 2462.

177. *See id.*

178. *Id.* at 2458.

179. Letter from Karen L. Manos, Chair, Section of Pub. Cont. Law, Am. Bar Ass’n, to Mark Gomersall, at 10 (Mar. 16, 2010) [hereinafter Manos Letter], available at [http://www.abanet.org/contract/federal/regscomm/costs\\_032.pdf](http://www.abanet.org/contract/federal/regscomm/costs_032.pdf).

180. *See* DFARS Case 2009-D03875, Defense Federal Acquisition Regulation Supplement; Business Systems—Definition and Administration, 75 Fed. Reg. 2457, 2462 (proposed Jan. 15, 2010).

181. *See id.*

billings to be withheld; (b) the availability of other remedies to address unallowable costs and adverse consequences of business system deficiencies; (c) the absence of any guidelines on the coordination of proposed withholding with the other remedies; and (d) the lack of any definition of acceptable business systems.<sup>182</sup>

The requirement that ACOs withhold ten percent across the board, without any finding of potential risk or harm to the Government, deprives the ACOs of the discretion granted to them by the FAR, as discussed above.<sup>183</sup> For the reasons discussed above, ACOs also would be under pressure to agree with any DCAA findings, further diminishing the exercise of discretion.<sup>184</sup>

## V. DECISIONS OF THE FEDERAL CIRCUIT

The Federal Circuit has issued a number of opinions that deviate from established principles and limit the Contracting Officer's sound exercise of discretion otherwise provided in the FAR. Professor Ralph Nash has observed that the Federal Circuit has departed from the legacy of the former Court of Claims as the "conscience of the government."<sup>185</sup>

Let us suppose that Congress enacted a statute called "The Court of Appeals for the Federal Circuit Accountability and Transparency Act of 2010." This statute would require the court to append to each decision involving government contracts a "Contracting Officer Impact Statement," after reviewing proposed impact statements from the parties. This could force the court to view its decisions through a different prism, and to confront the potential adverse consequences of its decisions.

Set forth below is a summary of some of the Federal Circuit's decisions, together with a suggested Contracting Officer Impact Statement. Although these decisions have been commented on previously, they deserve reexamination through the prism of their impact on the Contracting Officer's ability to accomplish essential tasks under established precedent and under the objective in the FAR that "the contracting officer must have the authority to the maximum extent practicable and consistent with law, to determine the application of rules, regulations, and policies, on a specific contract."<sup>186</sup>

### A. The "Plain Meaning" Rule

The Federal Circuit has held that the trial forum must determine whether contractual language is clear and unambiguous without the aid of extrin-

182. See Manos Letter, *supra* note 179, at 3-7, 9.

183. DFARS Case 2009-D03875, 75 Fed. Reg. at 2462.

184. *Id.* at 2457.

185. See Ralph C. Nash Jr., *The Government Contract Decisions of the Federal Circuit*, NASH & CIBINIC REP. ROUNDTABLE, Dec. 2009, at 6-8 to 6-17; Stephen D. Knight, *Federal Circuit Cost Decisions Bode Ill for Contractors*, PROCUREMENT LAW., Winter 2004, at 1.

186. FAR 1.102-4(a).

sic evidence such as the parties' negotiating history or their conduct during performance.<sup>187</sup> Frequently, however, the intent of the parties cannot be ascertained without resort to extrinsic evidence. In fact, parties may intend that words have the opposite of their customarily accepted meaning.<sup>188</sup> Judge Frank stated:

Even if a word in a written agreement is not ambiguous on its face, the better authorities hold that its context, its "environment," must be taken into account in deciding what the parties mutually had in mind when they used that verbal symbol.<sup>189</sup>

Similarly, as Judge Learned Hand cautioned: "There is no more likely way to misapprehend the meaning of language—be it in a constitution, a statute, a will or a contract—than to read the words literally, forgetting the object which the document as a whole is meant to secure."<sup>190</sup>

*Contracting Officer Impact Statement:* The "plain meaning" rule minimizes the significance of negotiation memoranda and records of the parties' communications during performance. Hence, it sends a message that it may be unnecessary (even disadvantageous) for the Contracting Officer to keep such records. If language is "clear and unambiguous," there would be no need for explanatory memoranda. The existence of such records could undermine an argument based on "plain meaning." The absence of contemporaneous records would leave the Contracting Officer more flexibility in crafting an argument later based on "plain meaning." The point is that any rule that discourages full documentation of significant contractual events undermines the integrity of the contracting process. It encourages the Contracting Officer to adopt unsound management practices.

#### B. Definition of "Costs" and a New Prerequisite for Contractor Assertions of Equitable Estoppel

In *Rumsfeld v. United Technologies Corp.*, the question before the Armed Services Board of Contract Appeals (ASBCA) was the definition of "costs" for allocability purposes.<sup>191</sup> The Cost Accounting Standards ("CAS") govern the issue of allocability but contain no definition of "costs."<sup>192</sup> The ASBCA looked to generally accepted accounting principles ("GAAP") and heard testimony from six accounting and economics experts on CAS and GAAP.<sup>193</sup>

187. See *Coast Fed. Bank, FSB v. United States*, 323 F.3d 1035, 1040–41 (Fed. Cir. 2003) ("When the contractual language is unambiguous on its face, our inquiry ends and the plain meaning of the Agreement controls."); see also *Bell BCI Co. v. United States*, 570 F.3d 1337, 1341 (Fed. Cir. 2009).

188. See *United States v. Lennox Metal Mfg. Co.*, 225 F.2d 302, 309–16 (2d Cir. 1955) (Frank, J., concurring) (stating that "may" in the context of the parties' intentions is construed to mean "shall").

189. See *id.* at 310.

190. *Cent. Hanover Bank & Trust Co. v. Comm'r*, 159 F.2d 167, 169 (2d Cir. 1947).

191. 315 F.3d 1361, 1369 (Fed. Cir. 2003), *cert. denied*, 540 U.S. 1012 (2003).

192. See *id.* at 1367.

193. See *id.*

On appeal, the Federal Circuit held that while the ASBCA could properly consider expert testimony on GAAP, the ASBCA should not have received expert testimony on CAS.<sup>194</sup> The court stated:

The views of the self-proclaimed CAS experts, including professors of economics and accounting, a former employee of the CAS Board, and a government contracts accounting consultant, as to the proper interpretation of those regulations is simply irrelevant to our interpretive task; *such evidence should not be received, much less considered*, by the Board on the interpretive issue. That interpretive issue is to be approached like other legal issues—based on briefing and argument by the affected parties.<sup>195</sup>

The court then, on its own, resorted to several standard dictionaries and the FAR to find a definition of “costs.”<sup>196</sup>

In *Cabell v. Markham*, Judge Learned Hand stated, “it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning.”<sup>197</sup>

Moreover, the taking of expert testimony is within the sound discretion of the trial judge, and the test is a broad one: whether the testimony will assist the judge in understanding the evidence.<sup>198</sup> Rule 702 of the Federal Rules of Evidence states the court may receive opinion testimony if it “will assist the trier of fact to understand the evidence or to determine a fact in issue.”<sup>199</sup>

The court in *United Technologies* also noted that the ASBCA, because of its interpretation of “cost,” never reached the contractor’s estoppel argument—i.e., that the Government should be estopped from contesting a treatment of costs that it previously had approved.<sup>200</sup> Yet, even though the estoppel argument was not at issue in the appeal, the court nevertheless prescribed a new standard for the ASBCA to apply on remand:

Adjudication of the estoppel issue must proceed under the “well settled [rule] that the Government may not be estopped on the same terms as any other litigant.” *Heckler v. Cmty. Health Servs. of Crawford County, Inc.*, 467 U.S. 51, 60, 104 S. Ct. 2218 (1984). Beyond a mere showing of acts giving rise to an estoppel, Pratt must show “*affirmative misconduct* [as] a prerequisite for invoking equitable estop-

194. *See id.* at 1369.

195. *Id.* (emphasis added).

196. *See id.* at 1370–71.

197. 148 F.2d 737, 739 (2d Cir.), *aff’d*, 326 U.S. 404 (1945); *see also* *United States v. Lennox Metal Mfg. Co.*, 225 F.2d 302, 311 (2d Cir. 1955) (stating that “Corbin, in 1951 said, ‘There is no dictionary on earth that can record all the usages of words or other symbols.’”); *Hurst v. W.J. Lake & Co.*, 16 P.2d 627, 629 (Or. 1932) (stating that “the language of the dictionaries is not the only language spoken in America”); JOHN CIBINIC JR. ET AL., *ADMINISTRATION OF GOVERNMENT CONTRACTS* 210 (4th ed. 2006).

198. FED. R. EVID. 702.

199. *Id.*

200. *Rumsfeld v. United Techs. Corp.*, 315 F.3d 1361, 1377 (Fed. Cir. 2003), *cert. denied*, 540 U.S. 1012 (2003).

pel against the government.” *Zacharin v. United States*, 213 F.3d 1366, 1371, 55 USPQ2d 1047, 1051 (Fed. Cir. 2000).<sup>201</sup>

In fact, under applicable precedent, affirmative misconduct is not a condition prerequisite for applying estoppel against the Government where government agents were acting within the scope of their authority.<sup>202</sup>

*Contracting Officer Impact Statement:* The *United Technologies* decision disregards the discretion of the trial forum to decide what opinion testimony “will assist the trier of fact.” In addition, this decision overlooks and undermines the latitude the FAR gives to the Contracting Officer to obtain the advice of experts in reaching a decision. So now let us imagine a conference in which the Contracting Officer has assembled her team. The Contracting Officer says:

OK, this is a complex case involving CAS and GAAP issues and there are serious definitional problems. I’m going to divide you into two groups to make recommendations and report to me. The GAAP group should consult with experts in GAAP and see where their guidance takes you. For the CAS group, I’m sorry, folks, but the court says we can’t pay attention to any “self-proclaimed CAS experts” so you are going to be limited to this stack of standard dictionaries.

Moreover, the court’s imposition of an “affirmative misconduct” prerequisite for equitable estoppel claims where government agents act within the scope of their authority undermines trust between the Government and the contractor, and creates another incentive for unsound management practices.<sup>203</sup> Contractors have a right to expect that Contracting Officers will be bound by acts within the scope of their authority without having to prove “affirmative misconduct.”<sup>204</sup> *United Technologies* encourages Contracting Officers to believe that words and acts do not count because, absent “affirmative misconduct,” they will not be held responsible.<sup>205</sup>

### C. Authority of Contracting Officials

In a case where the Contracting Officer permitted the Contracting Officer’s Representative (“COR”) to assume control of contract administration, including handling all requests for equitable adjustment, the Federal Circuit held the contractor was nevertheless strictly bound by the contractual limitations on the COR’s authority.<sup>206</sup> The court, however, remanded the case to the ASBCA to determine whether the Contracting Officer had ratified the COR’s actions.<sup>207</sup>

201. *Id.*

202. See Karen L. Manos, *Estoppel Against the Government: What Does “Affirmative Misconduct” Have to Do with It?* GOV’T CONT. COSTS, PRICING & ACCOUNTING REP., June 2006, ¶ 1, at 3–4.

203. See *United Techs.*, 315 F.3d at 1377.

204. See *id.*

205. See *id.*

206. See *Winter v. Cath-dr/Balti Joint Venture*, 497 F.3d 1339, 1344–46 (Fed. Cir. 2007).

207. See *id.* at 1348.

*Contracting Officer Impact Statement:* This decision overlooks the practical difficulty for contractors when the Contracting Officer delegates authority and takes a back seat to subordinates. On a day-to-day basis, contractors have no practical alternative except to adjust to the situation and do their best in dealing with the subordinate. The decision frustrates sound contract administration by encouraging contractors to flood Contracting Officers with requests for decisions, either bypassing designated representatives or asking for ratification of decisions of those representatives. This will be particularly burdensome as most Contracting Officers are remote from the site of the work and depend on their on-site representatives to solve problems at the local level.

#### D. Unabsorbed Overhead

In *Wickham Contracting Co. v. Fischer*, while not required to, the Federal Circuit held that the *Eichleay* formula for calculating unabsorbed overhead is “the exclusive means for compensating a contractor for unabsorbed overhead.”<sup>208</sup> The court was not confronted with the question “whether the *Eichleay* formula is superior to other competing means for calculating unabsorbed overhead, such as the burden fluctuation method.”<sup>209</sup>

*Contracting Officer Impact Statement:* There is usually no single measure of damages that applies regardless of the circumstances. When the court *sua sponte* proclaims one measure of damages as the exclusive measure, the court abandons its adjudicative role and acts in a legislative capacity. The result is that the Contracting Officer’s hands are tied in negotiating a fair settlement and, failing that, issuing a reasoned final decision.

#### E. Costs of Settling Third-Party Suits

##### 1. *Boeing North American v. Roche*

The decision in *Boeing North American, Inc. v. Roche* involved costs and fees associated with settlement of a shareholder derivative suit.<sup>210</sup> The Federal Circuit borrowed from the legal cost principle’s treatment of civil False Claims Act (FCA) cases where the Government does not intervene, which permits Contracting Officers to disallow costs on finding the underlying suit had “very little likelihood” of success on the merits.<sup>211</sup> There was no indication that this civil FCA standard had any application to other private suits. Yet the Federal Circuit in *Boeing* applied the standard to settlement of a shareholder derivative suit, on the notion that those costs were “similar” to costs that were expressly unallowable by the legal costs principle.<sup>212</sup>

208. 12 F.3d 1574, 1580–81 (Fed. Cir. 1994).

209. See John S. Pachter & Carl T. Hahn, *Jumping On (or Off) the Eichleay Bandwagon: Do We Have a Sticky Wickham?* PROCUREMENT LAW, Summer 1996, at 3.

210. 298 F.3d 1274, 1276 (Fed. Cir. 2002).

211. FAR 31.205-47(c)(2); see *Boeing*, 298 F.3d at 1288.

212. *Boeing*, 298 F.3d at 1288–89.

*Contracting Officer Impact Statement*: Nothing in the FAR supports the court's decision to apply the cost principle applicable to settlement of FCA cases in a situation involving settlement of a private third-party lawsuit. The court also placed the burden on the contractor to prove the suit had "very little likelihood of success on the merits." Traditionally the Government has had the burden of proving cost disallowances. The decision frustrates the long-established policy that encourages parties to settle lawsuits by forcing examination of the merits of the suit: the very activity settlement is designed to avoid. The result is that Contracting Officers will face a burdensome and unwelcome exercise in reviewing settlements of third-party lawsuits.

## 2. *Geren v. Tecom*

In *Geren v. Tecom, Inc.*, the Federal Circuit held that costs of defending and settling third-party litigation alleging conduct that, if proven, would violate a contract clause are unallowable unless the contractor obtains a determination from the Contracting Officer that litigation had "very little likelihood of success."<sup>213</sup> Because *Tecom* involved settlement of a Title VII sexual harassment suit, there was no basis to extend the *Boeing* ruling by suggesting that the costs were "similar" to costs made expressly unallowable.<sup>214</sup> The ASBCA so held, concluding that "similarity" would have to involve "charges of criminal conduct, fraud or similar misconduct, or violations of the Major Fraud Act."<sup>215</sup> Thus the ASBCA held it was unnecessary for the Contracting Officer to inquire whether there was "very little likelihood of success on the merits" of the Title VII claims before allowing defense and settlement costs.<sup>216</sup>

The Federal Circuit, however, held that *Boeing* is applicable in *all* instances where the claimed costs are associated with a settlement.<sup>217</sup> Thus in *Tecom*, the Federal Circuit found it unnecessary to invoke the similar or related analysis.<sup>218</sup> Instead, the court said that if the plaintiff had prevailed in the underlying litigation, it would have demonstrated that the contractor *breached the contract*.<sup>219</sup> And the costs would be unallowable because the FAR makes unallowable costs that are not in compliance with contract terms.<sup>220</sup> So now the Contracting Officer must determine whether the underlying Title VII suit had "very little likelihood of success."<sup>221</sup>

The Federal Circuit in *Tecom* mistakenly relied on the 1963 decision of the Court of Claims in *Dade Bros. v. United States*<sup>222</sup> for the proposition that costs

213. 566 F.3d 1037, 1039, 1041–44 (Fed. Cir. 2009) (emphasis added).

214. *See id.* at 1039, 1041–45.

215. *Id.* at 1040.

216. *Id.*

217. *See Boeing N. Am., Inc. v. Roche*, 298 F.3d 1274, 1288–89 (Fed. Cir. 2002).

218. *See Tecom*, 566 F.3d at 1043.

219. *See id.*

220. *See id.*

221. *Id.* at 1046.

222. 325 F.2d 239 (Ct. Cl. 1963).

resulting from settlement of breach of a contractual obligation are unallowable.<sup>223</sup> In fact, legal and settlement costs involving *violation of a contract term* were *reimbursed in Dade without controversy*.<sup>224</sup> The *disallowed* costs involved proven serious misconduct leading to punitive damages.<sup>225</sup> In *Dade*, the Court of Claims did *not* hold that costs of third-party suits are unallowable if the suit alleges violation of a contract clause.<sup>226</sup>

The Federal Circuit also erred in its analysis of the regulatory history of the FAR cost principles.<sup>227</sup> The phrase “terms of the contract” in FAR 31.201-2 does not state or support a rule that costs of third-party suits involving violation of contract clauses are unallowable.<sup>228</sup>

The ASBCA had long held that a contractor’s decision to settle rather than litigate third-party claims, including Title VII employment discrimination claims, was within the normal course of doing business and was therefore an exercise of prudent business judgment.<sup>229</sup> The previous settled law encouraged settlement of third-party litigation as being in the interest of both the Government and contractors.<sup>230</sup>

*Contracting Officer Impact Statement:* The *Tecom* decision, like the *Boeing* decision, represents an attempt by the court to legislate in the area of cost principles, rather than adjudicate the case based on established principles.<sup>231</sup> Following are some of the serious issues created by these decisions:

- One reason to settle is to avoid the time and expense of fully threshing out the merits of private suits. Likelihood of success is a factor but not the only factor. As Judge Lourie said in his dissent in *Tecom*, “[T]he whole point of a settlement generally is that neither party is assured of success and the law favors settlement of such disputes.”<sup>232</sup> Now, however, when a case is settled, the Contracting Officer will be required to assess the merits of the settled litigation, again, the very activity the settlement was designed to avoid.
- “Very little likelihood of success” is a high standard.<sup>233</sup> It is higher, for example, than the threshold test that governs preliminary injunctive relief, and it may be an impossibly high standard. What Contracting Officer will venture to find that a suit had “very little likelihood of suc-

223. *Geren v. Tecom, Inc.*, 566 F.3d 1037, 1043–44 (Fed. Cir. 2009).

224. *See* 325 F.2d at 240.

225. *See id.* at 239.

226. *See id.* at 240.

227. *See* Richard C. Johnson et al., *Geren v. Tecom, Inc.: The Federal Circuit Creates a New FAR Cost Principle*, GOV’T CONT. COSTS, PRICING & ACCOUNTING REP., July 2009, ¶ 27, at 6.

228. *See id.* at 6, 8–9.

229. *See id.* at 8.

230. *See id.*

231. *See generally* *Geren v. Tecom, Inc.*, 566 F.3d 1037 (Fed. Cir. 2009); *Boeing N. Am., Inc. v. Roche*, 298 F.3d 1274 (Fed. Cir. 2002).

232. *Tecom*, 566 F.3d at 1048.

233. *See id.* at 1046.

cess” and agree to reimburse settlement costs and expenses on that basis? In that light, the *Tecom* ruling could prove to be tantamount to a blanket denial of reimbursement for costs of settling or defending all third-party litigation that remotely alleges a violation of the government contract.

- Contracting Officers are not equipped by experience or training to conduct this type of inquiry. It will become a battle of counsel, engaging in wasteful expense that, again, settlement is supposed to avoid.
- Catch 22: Can we expect Contracting Officers to find that the standard “very little likelihood of success on the merits” means the suit was frivolous and any settlement of a frivolous suit for more than a token payment is per se unreasonable and therefore unallowable?
- What about a suit that is pressed to conclusion and the defendant contractor prevails on the merits? Doesn’t that prove “there was very little likelihood that the third party would have been successful on the merits”?<sup>234</sup> Not automatically, it would appear. Suppose the Contracting Officer says, “No, I think the plaintiff had *good* likelihood of success. You and your expensive lawyer just found a clever way to defeat a meritorious claim.” In a fully litigated case, the issue would be legal costs but not settlement costs.
- What about suits that involve multiple counts, alleging violation of contract and other claims as well? Must the contractor *segregate* the costs of defending against the various claims and obtain agreement on elements of the settlement or face an automatic and blanket disallowance of all settlement and defense costs?
- How does all this square with mandatory alternative dispute resolution (“ADR”) imposed by many courts?
- If the contractor appeals a disallowance of costs, does it have to prove the merits of the settled case, in a trial within a trial?

In short, the *Boeing* and *Tecom* decisions frustrate the discretion of the Contracting Officer to approve costs of settlement of third-party litigation.<sup>235</sup>

#### F. *Void versus Voidable Contracts*

In *Long Island Savings Bank, FSB v. United States*, the Federal Circuit, *sua sponte* and in an unprecedented decision, declared void a fully performed contract from which the Government had obtained substantial benefit as a result of unrelated contractor fraud.<sup>236</sup> However, (a) the fraud was committed by the bank’s CEO without the knowledge or consent of the contractor, (b) the Government’s material breach of contract preceded the contractor’s discovery

234. See generally *id.*

235. See *id.*; *Boeing*, 298 F.3d 1274.

236. 503 F.3d 1234, 1237, 1251 (Fed. Cir. 2007), *reh’g and reh’g en banc denied*, 2007 U.S. App. LEXIS 30345 (2007), *cert. denied*, 129 S. Ct. 38, 38 (2008).

of the fraudulent activity, (c) the contractor acted in good faith to rectify the fraud once it was discovered, and (d) the fraud resulted in no harm to the Government.<sup>237</sup>

In connection with the “Assistance Agreement,” Long Island Savings Bank warranted that it was not in violation of any statutes or regulations.<sup>238</sup> Only the CEO knew the statement was false.<sup>239</sup> The Federal Circuit held that the contract was tainted by fraud from its inception and was therefore void *ab initio*.<sup>240</sup> In *United States v. Jamieson Science & Engineering, Inc.*, the D.C. Circuit correctly noted that a void contract is one under which the promisor has no duty of performance.<sup>241</sup> This category, the court observed, is reserved for a minute group of contracts in fundamental violation of public policy (e.g., an agreement to commit a felony or a wagering agreement in a jurisdiction where gambling is illegal).<sup>242</sup> Conversely, a voidable contract is one under which an injured party (here, the Government) may elect to avoid legal obligations or to continue with the contract.<sup>243</sup>

*Contracting Officer Impact Statement:* The reasoning of the Federal Circuit is seriously flawed and interferes with the Contracting Officer’s discretion to elect whether to void a contract under traditional principles. In *Long Island Savings Bank* the fraud did not go to the essence of the contract, preventing it from coming into being; as distinguished, for example, from a case involving a false certification of small business status.<sup>244</sup>

- There are many opportunities in government contracts for a contractor’s agents or employees to make false statements without the contractor’s knowledge (e.g., certificate of independent price determination, affirmative action compliance, gratuities, covenant against contingent fees). Does this mean the government must, after the fact, treat the contract as void *ab initio*?
- The opinion severely restricts the Contracting Officer’s ability to function by undercutting the Government’s policy of encouraging voluntary compliance and disclosure by contractors.<sup>245</sup> The bank made disclosure when it learned of the facts but was punished for doing so—the opposite of what voluntary disclosure is intended to accomplish.<sup>246</sup>
- On the question of remedy, the court said that a contractor may pursue other theories of recovery where a contract is tainted by fraud and there-

237. John S. Pachter, *The Strange Case of Long Island Savings Bank—Or How a Contract Self-Destructed into Voidness*, PROCUREMENT LAW., Fall 2008, at 1.

238. See *Long Island Sav. Bank*, 503 F.3d at 1246.

239. See *id.* at 1247–48.

240. See *id.* at 1251.

241. See 214 F.3d 1372, 1376 (D.C. Cir. 2000).

242. See *id.* at 1377.

243. See *id.* at 1376.

244. See *Long Island Sav. Bank, FSB v. United States*, 503 F.3d 1234, 1250 (Fed. Cir. 2007).

245. See *id.* at 1241–42, 1254.

246. See *id.* at 1254.

fore void *ab initio*.<sup>247</sup> In support of this proposition, the court pointed to *Mississippi Valley*, in which the Supreme Court discussed the possibility of recovery based on *quantum valebat*.<sup>248</sup> But how would *quantum valebat* work here, where there are no goods delivered that could be subject to valuation? More significantly, given (a) the Federal Circuit's holding that the contract was void *ab initio*<sup>249</sup> and (b) Court of Federal Claims (COFC) contract jurisdiction is limited to implied-in-fact or express contracts,<sup>250</sup> how could the contractor recover anything in the COFC? In any case, a contractor that fraudulently induces the Government to contract with it may not recover upon *quantum meruit* or *quantum valebat*. Moreover, a contractor could not expect a different result by filing an administrative claim, which would be referred to the contracting agency for resolution.

There is no basis to know whether any of these decisions might have been decided differently had the court been required to accompany each opinion with a Contracting Officer Impact Statement. Such a requirement would nevertheless give the parties an opportunity to address the issue in a formal way, and it would require the court to confront it head-on.

## VI. CONCLUSION

The cumulative result of the Federal Circuit's decisions, combined with the statutory, regulatory, and policy changes discussed above, has further marginalized the Contracting Officer. These events have continued the drive away from the FAR's goal that "the contracting officer must have the authority to the maximum extent practicable and consistent with law, to determine the application of rules, regulations, and policies, on a specific contract."<sup>251</sup> This diminution of authority of the Contracting Officer also creates headaches for contractors as the decision-making apparatus becomes slower and less predictable.

It is time to return to first principles, and revisit the worthwhile goals of the FAR rewrite for Contracting Officer discretionary decision making. That review should consider the proper roles of the Contracting Officer and the enforcement community and their relationships with each other.

247. *See id.*

248. *See id.* (citing *United States v. Miss. Valley Generating Co.*, 364 U.S. 520, 566 n.22 (1961)).

249. *See id.* at 1254.

250. *See* 28 U.S.C. § 1491(a)(1) (2006).

251. FAR 1.102-4(a).