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VILLANOVA LAW REVIEW

THE TRUTH-IN-NEGOTIATIONS ACT: THE NEED FOR BOTH TRUTH AND FAIRNESS

[The Villanova Law Review, in 1968, published a Comment entitled "The 'Truth-In-Negotiating' Clause of P.L. 87-653 as Interpreted by the Armed Services Board of Contract Appeals" which explored several problem areas created by the Truth-In-Negotiations Act. The present Comment has undertaken to examine the problem areas presently underlying the Act in light of recent Court of Claims decisions which have reviewed Board doctrine concerning the disclosure of cost or pricing data.] — (Editor's Note)

I. INTRODUCTION

Almost eight years have passed since The Truth-In-Negotiations Act was enacted into law. During this period of time considerable controversy has arisen over the scope and meaning of some of the provisions of the Act. It is the purpose of this Comment to trace the legislative history of the Act, to analyze relevant court and Armed Services Board of Contract Appeals (Board) decisions and to examine in detail four of the most troublesome problems that have arisen under the Act. Considerations of fairness are interwoven into the fabric of the Act and these considerations will be explored in discussing the problems of defining the meaning of cost or pricing data, considering the scope of the causation requirement, examining the problem of offsets and finally, determining the responsibility of the prime contractor for defective data submitted by the subcontractor.

II. LEGISLATIVE HISTORY

Public Law 87-653, was, for the most part, the result of extensive overpricing by federal contractors, discovered by various audits undertaken the General Accounting Office (GAO). Between 1957 and 1962 the GAO discovered overcharges amounting to $61 million resulting from the contractors' failure to provide government negotiators with complete, accurate and current cost and pricing data. The importance of this problem was

2. P.L. 87-653 was signed into law by President Kennedy on Sept. 10, 1962.
5. Id. According to one knowledgeable official: The buyer's lack of knowledge . . . of the latest cost data available to the vendor in establishing prices is the most important weakness observed in the cases (of overpricing). This has resulted in excessive prices being paid by the Government.

reflected in prompt congressional hearings to thoroughly examine the problem\(^a\) and the revision by the Department of Defense (DOD) of its cost certification procedures. This change in the Armed Services Procurement Regulations (ASPR) required contractors to submit "current, complete, and correct cost or pricing data"\(^7\) with the purpose of prohibiting excessive profiteering by contractors. Congress, however, was not entirely satisfied with leaving matters in that posture. Accordingly, Congressman Vinson sponsored a bill\(^8\) which prohibited contractors from overcharges on incentive-type contracts.\(^9\) The Department of Defense, however, opposed this bill expressing, along with objections to specific sections of the proposed law, a general feeling that the Department’s previously enacted regulations were sufficient and that the proposed law was too inflexible. The Department also objected to limiting the statute to cover only incentive contracts.\(^10\) In spite of these objections the House endorsed the bill on June 7, 1962 and it was forwarded to the Senate Armed Services Committee for its consideration. That committee extended the bill to all types of contracts\(^11\) and agreed with Congressman Vinson that there was a need

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7. On October 1, 1959, the following provision was added to Armed Services Procurement Regulation 3-807.3 [hereinafter cited as ASPR, 32 C.F.R. § 3.807-3 (Supp. 1970)]:

Some form of price analysis should be made in every procurement, even when competitive proposals have been submitted. The presence of effective competition, however, may make it possible to limit considerably the degree of price analysis required. In the absence of effective price competition, the negotiating team must make a thorough analysis of contractors' proposals and must be in possession of current, complete and correct cost or pricing data before decisions are made on contract prices. Accordingly, the contractor should be required to furnish such data promptly as it becomes available throughout the negotiation process. To assure that the negotiating team is in possession of such data, the certificate set forth in ASPR 3-807.7 shall be obtained for each separate negotiation when the amount of the procurement action exceeds $100,000, and the price negotiated is based more on the contractor’s actual or estimated cost than on effective competition, established catalog or market prices, or prices set by law or regulation. . . . (emphasis added).


No contracts shall be negotiated under this title containing a profit formula that would allow the contractor increased fees or profits for cost reductions or target cost underruns, unless the contractor shall have certified that the cost data be submitted in negotiations for the fixing of the target cost or price was current, accurate, and complete; and such contracts shall contain a provision that the target cost or price shall be adjusted to exclude any sums by which it may have been found after audit that the target cost or price may have been increased as a result of any inaccurate, incomplete or noncurrent data.

9. The incentive-type contract is essentially one which awards extra profit as an incentive to generate lower costs and better performance. Congressman Vinson believed that such a contract encouraged deceptive pricing since a contractor would pad the overall contract price in order to be rewarded on an incentive basis. Special Subcomm. on Procurement Practices of the Dept. of Defense, House Armed Services Comm., Report Pursuant to Section 4, Public Law 86-89, H.R. Rep. No. 1959, 86th Cong., 2d Sess. 32 (1960).


for legislation since the Department of Defense cost certification procedures were being largely ignored.\textsuperscript{12}

The Senate Committee was confronted with objections to passage of the law from the Department of Defense,\textsuperscript{13} other senators and industry spokesmen. Senator Engle was concerned with the possibility of the contractor being penalized for an honest mistake or for not being able to determine his true costs.\textsuperscript{14} Senator Symington replied that the ignorant contractor would not be injured by this law since “we are trying to get as much truth as possible into negotiations.”\textsuperscript{15} Industry spokesmen, on the other hand, were concerned that the term “data” was not defined and that actual and estimated costs were not distinguished.\textsuperscript{16} Moreover, they raised the problem of offsets and felt that the contractor should not only be penalized because of overpricing but should also benefit from their mistakes in underpricing items.\textsuperscript{17} In order to meet some of these objections further Committee studies were undertaken with the result that, after certain modifications,\textsuperscript{18} H.R. 5532 was enacted into law as Public-Law 87-653 on September 10, 1962 and became effective on December 1, 1962.\textsuperscript{19}

\textsuperscript{12} Responding to a request by a member of the House, the GAO reviewed 276 negotiated contracts entered into by the Army and Navy since January 1960 and found that 121 of these contracts involving $253 million did not include cost and pricing data certificates. See Roback, \textit{Truth in Negotiating: The Legislative Background of P.L. 87-653}, 1 PUB. CONT. L.J. 3, 19 (1968). Chairman Russell of the Senate Armed Services Committee remarked:

\textit{Hearings on H.R. 5532 Before Senate Comm. on Armed Services, 87th Cong., 2d Sess. at 46 (1962).}

13. The Department of Defense objected to the enactment of the Bill on essentially the same grounds as did the House \textit{viz}, that there was no need for such a statute because of the regulations in effect and the objection to limiting the statute to only incentive-type contracts. As previously noted, the Senate Committee was unimpressed with the former argument and complied with the latter. \textit{Hearings, supra note 12, at 26.}

14. \textit{Id.}

15. \textit{Id.}

16. \textit{Id. at 99-100.} Senator Symington expressed genuine concern with this point of view and indicated that data which was required to be certified by the contractor would only have to be certified “to the best of his knowledge and belief.” \textit{Id.}

17. \textit{Id.} Senator Symington was less impressed with this view as indicated by his remark to the spokesman: “Don’t reach out for the last cherry to the point where you break this branch.” \textit{Id. at 100.} Other general industry objections were the possibility of criminal sanction being imposed on innocent offenders, that the bill was completely one sided in favor of the government and would discourage incentive contracting. \textit{Id. at 95, 103.}

18. There was language added that certificates would be required for all contracts and most subcontracts over $100,000, and price adjustments for defective data. This requirement of certificates would not be adhered to:

\begin{itemize}
  \item where the price negotiated is based on (1) adequate price competition, (2) established catalog or market prices of commercial items sold in substantial quantities to general public, (3) law or regulation, or (4) in exceptional cases where the head of the agency determines that the requirement may be waived and states in writing his reasons for such a determination.
\end{itemize}

\textit{S. Rep. No. 1884, 87th Cong., 2d Sess. 3 (1962).}

A proposed amendment was suggested in 1963 by Representative Herbert which would, in effect, permit offsets in price adjustments, so that mistakes in both overpricing and underpricing would be taken into effect and would authorize price adjustments only when the contractor had actual knowledge that the data was defective. \textit{H.R. 7909, 88th Cong., 1st Sess. (1963).}

The statutory scheme of the Truth in Negotiations Act provides that a prime contractor or a subcontractor must submit to the government negotiators cost or pricing data prior to the award of any contract exceeding $100,000 and prior to the pricing of any contract change exceeding $100,000. The contractor must certify to the negotiators that to the best of his knowledge and belief the cost or pricing data that he is submitting is accurate, complete and current. Furthermore, each prime contract as well as supplemental changes to that contract must contain a proviso that the final price to be charged to the Government will not include any significant sums which will result in an increase in the contract price due to the failure of the prime contractor or any subcontractor to furnish accurate, complete and current cost or pricing data.20

III. THE MEANING OF COST AND PRICING DATA

An essential prerequisite for any contractor who undertakes to contract with the federal government is to know what information he must submit during negotiations. The Board has uniformly adhered to the definition given in the Armed Services Procurement Regulations21 which dis-

20. The Act states:
   (f) A Prime Contractor or any subcontractor shall be required to submit cost or pricing data under the circumstances listed below, and shall be required to certify that, to the best of his knowledge and belief, the cost or pricing data he submitted was accurate, complete and current—
   (1) Prior to the award of any negotiated prime contract under this title where the price is to exceed $100,000;
   (2) Prior to the pricing of any contract change or modification for which the price adjustment is expected to exceed $100,000 or such lesser amount as may be prescribed by the head of the agency;
   (3) Prior to the award of a subcontract at any tier, where the prime contractor and each higher tier subcontractor have been required to furnish such a certificate, if the price of such contract is expected (sic) to exceed $100,000; or
   (4) Prior to the pricing of any contract change or modification to a subcontract covered by (3) above, for which the price adjustment is expected to exceed $100,000, or such lesser amount as may be prescribed by the head of the agency.

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

21. The regulations state that:
   "Cost or pricing data" as used in this subpart refers to that portion of the contractor's submission which is factual. The requirement for "cost or pricing data" subject to certification is satisfied when all facts reasonably available to
tistinguish between verifiable facts relating to costs, and data that is essentially speculative in nature or involves an estimate or judgment on the part of the contractor. For example in Defense Electronics, Inc. the contract stipulated that Defense Electronics was to furnish telemetry systems to the Government. The contractors had received price quotations from two different subcontractors for a component of the contract item. One of the subcontractors offered a quantity discount if additional quantities were ordered from the prime contractor by the Government. However, the prime contractor failed to disclose this fact to the Government and also failed to disclose pricing data concerning the cost of certain conversion kits. In considering the contractor's failure to disclose this information the Board held that the Government was not entitled to a price reduction under the defective pricing provision of the contract. In so deciding, the Board outlined what kind of information qualifies as "cost or pricing data" and is therefore required to be submitted by the contractor:

For the purpose of the defective pricing data statute and regulations, "cost or pricing data" is defined by ASPR3–807.3(e) as "that portion of the contractor's submission which is factual." The duty to disclose is satisfied when all FACTS reasonably available to the contractor which might reasonably be expected to affect the negotiated price are accurately disclosed. ASPR3–807.1(e), cost or pricing data includes such factual matters as vendor quotations and "all facts which can reasonably be expected to contribute to sound estimates of future costs." Being factual, it is the type of information that can be verified. It does not apply to or make representations as to the ac-


22. The Armed Services Board of Contract Appeals cases which have undertaken to define what is cost or pricing data include: Defense Electronics, Inc., ASBCA No. 11127, 66–1 BCA 26,191 (1966) (Cancellation Clauses); FMC Corp., ASBCA Nos. 10095, 11113, 66–1 BCA 25,696 (1966) (scrap prices) (information on experiments in process is not cost data in a fixed price contract); Radio Engineering Labs., ASBCA No. 11052, 67–2 BCA 20,071 (1967) (costs of tests); Lockheed Aircraft Corp., ASBCA No. 10453, 67–1 BCA 29,439 (1967) (subcontractor's labor estimates are not cost data). For an earlier view on the scope of the cost and price certification requirement, see Cuneo & Crowell, Negotiated Contracts — Two-Step Procurement, Cost and Pricing Data Requirements and Protests to the Comptroller General, 5 B.C. IND. & COMM. L. REV. 43, 53 (1964).

uracy of the contractor's judgment in estimating future costs. A clear distinction is drawn between "facts" and "judgment". 24

Although the definition on its face appears easy to cope with, its application to particular factual situations is not at all certain. In *Sparton Corp.*, 25 the Government had contracted to purchase sonobuoys from Sparton after Sparton had submitted a materials list containing price quotations which were in excess of prices offered by an untried subcontractor. For various reasons Sparton subsequently awarded the subcontract to the previously untried subcontractor and the Government contended that since the contractor did not submit these quotations it had therefore failed to submit accurate, current and complete data. The Board rejected this argument by stating:

In the definition of cost and pricing data which was set out (earlier) it is stated that vendor's quotations are considered to be cost and pricing data which should be disclosed, but this is qualified by the caveat that such data should "reasonably be expected to have a significant bearing on costs . . . [T]he Government does not prove its case unless it shows that the contractor, at the time the data is submitted, did not intend to deal with the vendor listed, but did intend to do business with the lower cost vendor. 26

Since *Sparton*, however, the Board has apparently retreated to a more flexible and encompassing position. In *Bell & Howell Co.*, 27 for example, the Government entered into a contract for the purchase of ammunition in which Bell & Howell failed to disclose to the Government the lowest available quotations from an untried supplier. The Board curiously agreed with the *Sparton* test that the quotes must be data which "might reasonably be expected to affect the price negotiations" 28 but felt that a key distinction in this case was that Bell & Howell, at the time of contracting, was actively and vigorously conducting negotiations with the low bidder. In support of its decision the Board referred to its decision in *Cutler-Hammer, Inc.* 29 which also involved the status of a vendor's quotations. In *Cutler-Hammer* the contractor failed to disclose to the Government that he was considering a bid from an antenna lens supplier to be used in a complex reconnaissance system. While the quotation received from the untried vendor was considerably lower than the quotations submitted to the Government the contractor thought the bid was meritorious enough to request a further technical proposal. However it was not until after negotiations with the Government had been completed that Cutler-Hammer

24. *Id.* at 26,203-04 (emphasis added).
26. *Id.* at 30,381 (emphasis added).
27. ASBCA No. 11999, 68-1 BCA 32,335 (1968).
28. *Id.* at 32,347.
awarded the contract to the untried vendor. On these facts the Board held that the Government was entitled to a price reduction since the low quotations were "significant from the stand-point of over-all contract negotiation." 30 Quite remarkably, in view of this holding, the Board also commented that the vendor's quotation "was far from being data upon which a firm price reduction could have been reached." 31 On appeal, the Court of Claims upheld the Board on this issue. 32 The court rejected the contractor's argument that the only data that need be submitted is that data upon which a reasonable businessman would rely in negotiating a contract. Rather, the court found it significant that the contractor had gone beyond merely accepting the quotation and had followed it up by requesting a technical proposal thereby indicating that the contractor was "actively negotiating" with the vendor. Judge Nichols dissented on this issue stating that the contractor was being unjustly penalized for merely following up on the bid by requesting a technical proposal to confirm its initial belief that the vendor could not possibly perform at such a low figure. 33

It seems clear that the Board and courts have confused the determination as to when a vendor's quotations constitute cost or pricing data. This confusion has been primarily caused by three factors. First, Sparton clearly expressed the view that the Government must prove that at the time the data was submitted the contractor had no intention of dealing with the vendor whose quotations were submitted to the Government. 34 However the Board in Bell & Howell and the court in Cutler-Hammer clearly impose much less of a burden on the Government. In both of these cases the contractors were dealing with untried vendors who had submitted quotations considerably lower than those received from other proven vendors. It seems quite possible that many contractors in similar circumstances would have no intention whatsoever of dealing with such an untried vendor at the time of contracting. If the Board wishes to impose on a contractor the duty to submit all quotations which he receives, or in the alternative, all quotations on which the contractor takes some "follow-up" action; it should be more explicit. Secondly, it is evident that the Board and the court have retreated from the test enunciated in Sparton — that the data should be of such a nature that it would "reasonably be expected to have a significant bearing on costs." 35 As previously noted, the Board in Cutler-Hammer conceded that the untried vendor's quotation could not have been relied on in reaching a price reduction in the contract. It therefore seems doubtful that quotations which were so uncertain as to their validity that

30. ASBCA No. 10900, 67-2 BCA 29,822, 28 (1967).
31. Id.
33. Judge Nichols also felt that the contractor should not be penalized since there had been virtually no way for the contractor to have known that such a low quotation would qualify as "cost or pricing data" because of the lack of Board decisions on this issue and also because the government had failed to notify the contractor that such information should be submitted. Id. at 1319.
34. See text accompanying note 25 supra.
35. See text accompanying note 26 supra.
they would not effect a price reduction should be reasonably expected to affect price negotiations. The suggestion has been made that the Board is seeking to establish the rule that if the undisclosed data might affect the contract price, such data would be within the ambit of the Act. However, at no time has the Board explicitly stated this to be the proper test. If this can be considered to be the appropriate test then contractors would be well-advised to submit all price quotations which they are “considering” to the Government during negotiations. This is the course of action suggested by the language of the court in Cutler-Hammer.

Thirdly, the Board and the courts have not yet addressed themselves to the problem of what result should be reached when the contractor considers only one cost quotation prior to completion of its negotiations with the Government and then, after the certificate is filed, takes advantage of a lower cost proposal. The court in Cutler-Hammer opined that no reduction in the contract price could be imposed on the contractor under the Act since the “costs were accurate, complete and current as of the filing of the certificate.” Such a result would be anomalous since contractors could argue that they neglected to reveal a quotation because they did not consider it “cost or pricing data.” Furthermore, if the pivotal determinations are to be whether the contractor “vigorously negotiated” with the untried vendor or whether the contractor “considered” using a lower bidder, the result may well be an emasculation of the Act since contractors may refuse to accept quotations from those bidders expected to submit low bids, thus increasing the contract price to the Government. After filing the pricing certificate the contractor might then “discover” that a lower cost was available and no price reduction would apparently be available to the Government.

It is suggested that either legislative or judicial action is needed to correct the confusion concerning vendor’s quotations. While a rigid arbitrary rule would appear to be inappropriate it is felt that a workable and fair test could be enunciated by the Board to alleviate the presently-existing confusion. The proper standard to be applied should indicate that in the absence of special circumstances all vendor’s quotations which have not been discarded by the contractor as clearly unreasonable prior to the completion of negotiations should be submitted to the Government. Moreover, the Act should be amended to allow a downward revision of the contract

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37. Our decision as to this facet of the case should not be construed as indicating that Cutler-Hammer had planned to include the higher quotation in its proposal only until the certificate was filed, and then intended to use the lower bid. All we are saying is that when a contractor goes beyond merely receiving a quotation, and considers using a lower bidder, that possibility should be reported to the Government.
38. Id.
39. Id.
40. Bell & Howell Co., ASBCA No. 11999, 68-1 BCA 32,335 (1968).
price when the contractor takes advantage of a lower-cost quotation after the certificate has been filed. This standard would not infringe on the benefits conferred by the Act upon the contractor who by his own efficiency and ingenuity lowers the overall cost of the contract since the lower quotation has been received from a third person and is independent of the contractor's own efforts.\textsuperscript{42}

Of course, it may be contended that a more thorough re-appraisal of the entire concept of what type of data falls within the ambit of the cost and pricing requirement is needed in view of industry-wide criticism that present definitions provide relatively little guidance.\textsuperscript{43} One commentator has suggested that the Act be amended so as to require the contractor to submit all information developed by the contractor's estimating and pricing personnel whether or not it was used in the ultimate price proposal. Such information would be limited to the first and second levels of backup data used in support of the cost breakdown. Moreover, the contractor would be required to make available for Government inspection all directly perti-

\textsuperscript{42} There had been some dispute in the past as to the meaning of the requirement that the cost or pricing data be “current.” A contractor was required to certify his cost or pricing data at various stages of his negotiations, as, for example, when he submitted his initial proposal, later while negotiations are being conducted and still later when the negotiations are completed and before the contract is signed. However, ASPR, 32 C.F.R. § 3,807-3(e) (Supp. 1970), has appeared to reach a reasonable solution. That regulation provides that the data is considered to be current “when all facts reasonably available to the contractor up to the time of agreement on price” (emphasis added) is submitted. Therefore, the data is considered current when agreement on price was reached rather than perhaps some months later when the formal contract is reached. See Bannerman, Comments on P.L. 87-653 and Changes in the ASPR Implementation, 1 PUB. CONT. L.J. 30, 34 (July 1968).

\textsuperscript{43} See Hannah, Bond & Virden, The Contractor Looks At The “Truth In Negotiations” Act, 1 PUB. CONT. L.J. 38 (1968), where the authors interpret the legislative history of the Act to only require the contractor to submit facts derived from generally accepted estimating procedures as well as other data specifically considered by him in his price proposal. The authors reject the onerous burden allegedly imposed on contractors because of ASPR, 32 C.F.R. § 3,807-3(e) (Supp. 1970), and the decisions of the Board which have further defined the concept. See note 22 supra. The authors level further criticism at the present concept of cost or pricing data by stating:

In view of the ever broadening definition of “data,” some contractors have come to suspect that some Government negotiators sometimes learn from audit reports or otherwise of the possible existence of data that have not been disclosed, but which may be insufficiently significant or too speculative to be used to effect a reduction of price at the negotiation stage. Therefore, instead of requiring the data to be submitted at that point, the information is used as the basis for a later request for price reduction. To avoid the adverse publicity which might result from institution of formal proceedings involving charges of nondisclosure, the contractor is pressured into agreeing to a price reduction he would not have accepted before the contract was executed. Even if these suspicions are not so far justified, certainly the possibilities of this kind of action exist.

It should be obvious that no contractor with a complex organization can search out, identify or submit all data available to him which a tribunal might later say “could reasonably be expected to contribute to sound estimates” of costs or prices. Contractors recognize that (and we quote from contractor responses) “it is impossible to disclose all facts which may be relevant to prices”; “cost or pricing data are never absolutely accurate, complete and current, but only reasonably so. Consequently, hypercritical Government representatives can always find areas of disagreement.”

Hannah, supra at 40.
It is posited that such an amendment should be adopted by Congress. It has already been suggested in this Comment that, with regard to vendor’s quotes, some uniform criteria should be established to provide sufficient guidance for contractors. It would appear that an amendment to the Act, similar to that proposed, would provide uniformity in this area as well as remove many of the burdensome requirements of the present law to which many contractors have objected. Additionally, it would assure that there would be a reasonable amount of data available to the Government so that an accurate price can be agreed upon. Furthermore, this proposed amendment would be entirely consistent with the standard which was proposed when dealing with vendor’s quotation.

IV. The Scope of The Causation Requirement

The problem of when defective cost or pricing data causes an increase in the contract price has been a source of concern to the Board and commentators alike. The Truth In Negotiations Act provides that the contract price be reduced to exclude “any significant sums by which it may be determined . . . that such price was increased because the contract . . . furnished cost or pricing data which . . . was inaccurate, incomplete, or noncurrent . . . .” It would appear from this language alone that Congress has imposed upon the Government the burden of proving that the defective data caused a significant price increase. However, the decisions that have been handed down on this question have put a different gloss on this language of the Act.

In American Bosch Arma Corp., American had contracted to furnish the Government missile guidance systems comprised of complex electronic equipment. American had failed to disclose certain data which resulted in an overstatement of the contract price by $45,529, which was less than one-half of one percent of the total contract price of $15,000,000. In the instant decision, which was handed down prior to the passage of the Act.

45. See note 43 supra.
46. See note 43 supra.
47. If the proposed amendment is adopted it would not entirely alleviate any necessity for a complementary standard in the area of vendor’s quotes. The problem of vendor’s quotations might be considered to present a special situation since, as previously noted, certain vendor’s quotes could be intentionally withheld from the cost data submitted in the hope of later achieving certain cost savings and a corresponding increase in profits. While the proposed amendment envisions the contractor submitting all data developed by his estimating personnel this would not appear to require the contractor to submit all of the vendor’s quotes which have not been discarded as clearly unreasonable.
49. ASBCA No. 10305, 65-2 BCA 24,838 (1965).
50. Actually, the Board had before it a contract provision typical of the prestatutory defective pricing clause. For an example of this type of provision, see note 7 supra.
the Board explicitly held that the Government must prove that the contractor provided it with inaccurate, incomplete and noncurrent data and that this data caused a significant increase in the contract price. However, the Board did recognize the problem which exists in attempting to determine the effect of an overstated cost when the contract was negotiated on a firm fixed-price basis in which costs are not individualized. In rejecting any notion of determining the effect of nondisclosed data based on mere speculation the Board stated:

In the absence of any more specific evidence tending to show what effect the nondisclosure of the pricing data had on the negotiated target cost, we are of the opinion that we should adopt the natural and probable consequence of the nondisclosure as representing its effect.

The Board concluded that the Government was entitled to a price reduction since the “natural and probable consequence” of the failure to disclose the cost data was to significantly increase the contract price. This interpretation of the Act seemed to reveal a disposition on the part of the Board to lighten the Government’s burden of proof where the Board felt it to be appropriate.

However, the Board appeared to revert to a more strict interpretation of the Act’s causation requirement in Defense Electronics, Inc. In that case, the Government had awarded a contract to Defense Electronics for telemetry pre-detection systems to be used on the Atlantic Missile Range. The Government claimed that the submitted data was defective since it did not disclose certain relevant data bearing on the costs of certain conversion kits. The Board rejected the Government’s claim holding that it was “incumbent on the Government to show that the change order price adjustment was overstated BECAUSE of the contractor’s failure to disclose or its improper disclosure of data.” This shift in position by the Board on the issue of causation was more apparent than actual. In Cutler-Hammer, Inc., the contractor had failed to disclose certain pertinent vendor’s quotations which he had received for components of a complex reconnaissance system. The Board remarkably admitted that at the time of contract negotiations the untired vendor’s quotations were not reliable

51. The Board stated on this matter:

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

ASBCA No. 10305, 65–2 BCA at 24,853.

52. Id.


54. ASBCA No. 11127, 66–1 BCA at 26,202.

data upon which to negotiate a price but, despite this admission, held that the nondisclosure by the contractor caused a significant increase in the contract price since the Government might have delayed execution of the contract until the pertinent data was submitted or, in the alternative, might have excluded this particular item of cost from the contract price, thus, reserving it for further negotiation. Despite the uncertainty as to what effect the nondisclosure actually caused, the Board glossed over the causation requirement:

While we recognize that we could never find with complete certainty just what the parties would have done if this matter had been disclosed to the Government, we are convinced that something contractually different would have been developed to cover the situation as it then existed. In Defense Electronics, Inc. . . . we held that the Government has the burden of proving the causal relationship between significant, non-disclosed, pricing data and the resulting contract price reduction. However, we did not then, nor do we here, intend that that burden be an unreasonably heavy one.

Accordingly . . . we are of the opinion that the Government has established the reasonable probability that with a disclosure of the Transco quotation, the parties would have agreed that the cost of the Luneberg Lens would be excluded from the contract price, and reserved for further negotiations and addition to the contract price at a later date. 57

It is suggested that the decision in Cutler-Hammer, coupled with the latest regulations 58 have shifted the burden of proof to the contractor to show that a nondisclosure of information did not cause a significant increase in the contract price to the Government. 59 This is apparent from the fact that in Cutler-Hammer, even though the vendor’s quotations were admitted to be unreliable at the time of contract negotiations and that the Board could not conclude what effect the nondisclosure had on the total contract price, the Board still held that the Government was entitled to an equitable reduction of the contract price. It is obvious that the Board

56. The Board stated: The foregoing resumé of the development [of the vendor’s quotation problems] can only lead to the conclusion that at the time of contract negotiations . . . and again on the date of execution of the Defective Pricing Certificate . . . the . . . quotation was far from being data upon which a firm price reduction could have been reached. . . .

57. Id. at 29,828 (emphasis added).
58. The Armed Services Procurement Regulations appear to even further weaken the causation requirement in providing that:

In the absence of evidence to the contrary, the natural and probable consequence of defective data is an increase in the contract price in the amount of the defect plus related burden and profit or fee; therefore, unless there is a clear indication that the defective data was not used, or was not relied upon, the contract price was reduced in that amount.


59. Compare Hannah, supra note 43, at 41, with Comment, The Truth-In-Negotiations Act — An Examination of Defective Pricing in Government Contracts, 54 Va. L. Rev. 505, 520 (1968), where the notewriter contends that the requirement of causation has been properly eliminated by the Cutler-Hammer opinion.
was imposing on the contractor the burden of proving that his nondisclosure did not effect the total contract price or the negotiations upon which the price was based. This burden of proof clearly places the Government in the advantageous position of being able to utilize "hindsight." If the Government only has to establish, as it did in Cutler-Hammer, that if certain data had been disclosed to it during negotiations it would have either delayed execution of the contract or would have reserved negotiations on that particular cost item for a future date, then the contractor has the near-impossible task of disproving such a statement. Moreover, to establish that the Government might have adopted one of these alternatives has no bearing at all on the effect which the nondisclosure had on the contract price but only reveals how the Government might have altered its contract negotiations.

It is posited that the Board is wrong in the approach it has adopted in Cutler-Hammer and that it should revise its position on the causation requirement. The statutory language of the Act reflects an intent on the part of Congress that the Government establish that the contract price was increased because of defective data submitted by the contractor. It would be difficult to imagine a contrary intent since it is only the Government that could establish that the undisclosed data would have caused it to seek a lower contract price. While this view may present difficulties in light of the acknowledged practice of the Government to negotiate on the basis of "total price" and not the individualization of costs, it would appear to be unfair and inequitable to impose on the contractor the heavy burden of disproving what is only speculation on the part of the Government merely because of a method of negotiation which the Government, and not the contractor, has elected to pursue. It can be presumed that Congress was aware of this method of negotiation when the Act was passed, but neither the congressional hearings nor the Act itself provide any hint that Congress intended to impose on the contractor the onerous burden which the Board has imposed in Cutler-Hammer.

Consequently, it is suggested that the Board should reappraise its current approach to the causation requirement and reaffirm the test which it formulated in Defense Electronics, Inc. where it stated:

In order for the Government to have any valid claim, it must be established (1) that the contractor furnished inaccurate, incomplete or non-current pricing data in connection with the negotiation of the price adjustment for the change order, (2) that the inaccurate, incomplete or non-current pricing data caused the price adjustment for the change order to be increased, and (3) the dollar amount by which

60. Hannah, supra note 43, at 41.
61. See note 20 supra.
62. But see Bannerman, supra note 42, at 36, where the writer approves of a method which creates a rebuttable presumption that the cost overstatement by the contractor caused the increase in contract price which the contractor has a right to challenge.
63. ASBCA No. 11127, 66-1 BCA 26,191.
the price adjustment for the change order was increased as a result thereof. The Government has the burden of proving every element in the chain of proof necessary to substantiate its claim. . . . It is incumbent on the Government to show that the change order price adjustment was overstated BECAUSE of the contractor's failure to disclose or its improper disclosure of data. 64

This approach would assure that once the Government has successfully shown that its contract price was significantly higher because of defective cost or pricing data, it will be entitled to an equitable reduction of the contract price. This view is entirely consistent with the language of the statute and promotes the purpose of the Act in that once the Government has met its burden of proof, the contractor will not be allowed to retain the benefits of his deception.

V. Offsets

Since the enactment of the Truth-In-Negotiations Act, considerable controversy has arisen as to whether only a downward revision of the contract price, due to overstated costs by the contractor, would be allowed. Many commentators have expressed the view that the statute should not be a "one-way street" and that if a contractor inadvertently understates the costs of certain items then the contract price should be revised upward. 65 Prior to the passage of the Act, the ASPR contained price adjustment provisions which stipulated that the contract price "shall be equitably reduced" because of defective cost or pricing data. 66 This provision was construed in American Bosch Arma Corp. 67 to allow the contractor to offset certain cost items which would have reduced the contract price against those cost items which would have increased the contract price. However, in Lockheed Aircraft Corp. 68 the Board greatly re-

64. Id. at 26,201-26.
65. E.g., Cibinic, note 44 supra; Petit, The Defective Pricing Law and Implementing Regulations — A Year and a Half Later, 29 LAW & CONTEMP. PROB. 552, 560-61 (1964); Comment, supra note 29, at 617-20.
66. Most government contracts contain a price reduction clause similar to the following:
   (a) If the Contracting Officer determines that any price negotiated in connection with this contract was overstated because the Contractor, or any first-tier subcontractor in connection with a subcontract covered by (c) below, either (i) failed to disclose any significant cost or (ii) suppressed any significant cost or pricing data which he knew or reasonably should have known was false or misleading, then such price shall be equitably reduced and the contract shall be modified in writing accordingly.
   (b) Failure to agree on equitable reduction shall be a dispute concerning a question of fact within the meaning of the "Disputes" clause of this contract.
   (c) The Contractor agrees to insert the substance of paragraph (a) of this clause in any of his subcontracts hereunder in excess of $100,000 unless the price is based on adequate price competition, established catalogue or market prices, or prices set by law or regulation.
14 C.C.F. 88, 617, at 88,623 (emphasis added).
68. ASBCA No. 10453, 67-1 BCA 29,439 (1967).
stricted the contractor's right to offset. In this case Lockheed had attempted to offset against certain overstated costs its claims for royalties and development costs which it excluded from its price proposal. The Board rejected the contractor's claim holding that only "closely related" costs may be offset against each other. It stated that:

It is obvious to us that these two cost items were only remotely related to the "material costs" in issue. . . . The obvious answer to the offsetting suggestion is that the equitable reduction permitted under the clause is intended to cover solely the cost item concerning which the pricing data was defective. To permit unrelated offsets would be tantamount to repricing the entire contract which is not within the contemplation of the clause.69

It had become clear, therefore, that the Board and the Defense Department had adopted, prior to the passage of the Act, the rather narrow and restricted view that offsets were to be allowed only when the costs were closely related.

It is not clear from the legislative history of the Act whether offsets in favor of the contractor were contemplated by Congress. The congressional hearings on P.L. 87-653 do indicate an effort to assure that contractors would not be injured by honest understatements of costs. These efforts did not result in any specific language favoring contractors but the debate on this issue was lively and in some instances rather enlightening. For example, William H. Moore, an industry spokesman, advocated express language in the statute favoring contractors who understate their costs. The following discussion ensued:

Mr. Moore: The language as it stands provides only a one-way street. It is unfair, I believe, to contractors, because it says nothing about the situation in which hindsight may reveal that there have been mistakes that accrued to the Government's benefit.

Senator Symington: Don't reach out for the last cherry to the point where you break this branch . . . you do not want to make an excess profit even as the result of an honest mistake.

Senator Cannon: Now, Senator Symington has just simply said that you would not want to use, to be in a position of advocating by the use of inaccurate, incomplete and noncurrent data and building up your target price, even though it was inadvertent at the time, that you would then want that measurement to determine how much of an incentive you were going to get.

69. Id. at 29,450.

70. After the enactment of the Truth-In-Negotiations Act, the Department of Defense adopted a policy which prohibited offsets and opposed an amendment which would have allowed offsets. See Comment, supra note 59, at 523; H.R. 7909, 88th Cong., 1st Sess. (1963). This was coupled with a change in ASPR which eliminated the phrase "price shall be equitably reduced" and substituted that the price "be reduced accordingly." ASPR, 32 C.F.R. § 7-104.29 (Supp. 1970). The Board's decision in Lockheed has necessarily altered that policy.
Senator Symington: *Again, if you make an honest mistake, you should not be rewarded with additional profit; and if you cheat as to what is estimated cost, you should pay for it.***

There can be little doubt that this language indicates an intent that the Government did not seek to act as an insurer for the contractor's mistake so that he could be rewarded with additional profit if he understated his contract price. However, the language cannot be understood to stand for the proposition that understatements cannot be offset against overstatements *to the extent* of any overstatements. The Court of Claims in *Cutler-Hammer, Inc. v. United States*** adopted this approach in allowing offsets in favor of the contractor finding that neither the statute nor the legislative history provided a clear-cut answer. In *Cutler-Hammer, Inc.*,*** the Board considered for the first time since the enactment of the Truth-In-Negotiations law the problem of offsets. As previously noted,*** Cutler-Hammer had contracted to develop and manufacture a highly-complex reconnaissance system. In formulating its price proposal, the contractor inadvertently duplicated certain materials causing a cost overstatement. However, the contractor had also underestimated the costs of certain other materials in an amount exceeding the overstatements. The costs involved in both the overstatements and understatements were closely related since both involved purchased parts and components. Despite the closely related nature of the costs, the Board rejected the contractor's contention that offset should be allowed. The Board made the following pertinent remarks:

> Although reasonable men may certainly differ on this interpretation, it is our conclusion that the Defective Pricing Statute (PL 87-653, 10 Sept. 1962; 76 Stat. 528) was intended solely as a vehicle for recoupment by the Government of overpricing resulting from any of the causes enumerated therein. On the other hand, there are now and were prior to the enactment of that legislation certain remedies available to contractors for the correction of mistakes such as appellant proposes by way of counterclaims and offset here. We must assume the Congress was aware of these remedial avenues when it enacted PL 87-653. In this regard we have not overlooked the fact that these remedies may be more restrictive than the corresponding remedy of the Government under the Defective Pricing procedure. The simple answer to this is that both the statute and the contractual provision which it implements, literally limit the adjustment to pricing deficiencies which tend to overstate the contract price. As such we would need to be shown a clear Congressional intent that all costs and pricing deficiencies, regardless of their nature or direction, were correctable under the statute before we could grant that relief here. On this point we must, of course, recognize that there is some indication in the leg-

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71. See Hearings, *supra* note 12, at 100-02.
72. 416 F.2d 1306, 1310-13 (Ct. Cl. 1969).
73. ASBCA No. 10900, 67-2 BCA 29,822 (1967).
74. See text accompanying notes 29 & 30 *supra*.
islative history that the result we here reach may not have been intended. By the same token there is just as much, if not more, evidence that such was the Congressional purpose. As a consequence we cannot say that the Congressional purpose in this regard is conclusively evident one way or the other. We are therefore constrained to adopt a literal interpretation of the statute, and, if we err, it is for others, be it the Congress or the courts, to set the matter right. 75

On appeal, the United States Court of Claims reversed the Board on the offset issue holding that the Truth-In-Negotiations Act permitted overstatements in cost estimates to be offset by underestimates, but only to the extent of overestimates.76

As previously indicated, the court felt that neither the statute nor legislative history clearly indicated Congress’ intent on the question of offsets,77 although it was absolutely clear that when only overstatements were involved a downward revision in the contract price was proper. The court in reaching its conclusion that offsets should be allowed to Cutler-Hammer looked to the purpose behind the Truth-In-Negotiations Act. Clearly, one of the purposes was to not only prohibit contractors from withholding known information about costs but to reward them for efficient performance in negotiation. However, offsetting inaccurate cost data in the instant case would not have the effect of rewarding the contractor but only of assuring him that he is entitled to the same price adjustments as the Government. Moreover, any excess of overstatements above underestimates would reduce the contract price by that amount.78

The court also rejected the Government’s contention that allowing offsets would permit “buying-in” on Government contracts.79 The court realized that to permit upward revision of the contract price would encourage contractors to underestimate their costs in order to buy into a contract and

75. ASBCA No. 10900, 67–2 BCA 29,822, 29,826–27.
76. As previously indicated, the cost items involved in this case were closely related and therefore the Court of Claims did not address the question of whether offsets would be allowed when the cost items were not closely related. However, it would seem that only closely related costs will be offset against each other since the Lockheed decision specifically limits offsetting to that category and the Court of Claims in the instant decision gave no indication of altering that position. See text accompanying note 68 supra.
77. See text accompanying notes 71–72 supra.
78. The court also rejected the Government’s argument that only a downward revision of price is allowed under the Act since the language of the Act only refers to “reducing” the contract price. The court interpreted this language to mean “that where overstatements exceed understatements, the excess reduces the price; conversely, where understatements exceed overstatements, the price is not raised.” 416 F.2d at 1312 (emphasis added).
79. “Buying-in” has been defined in the following terms:
   Attempting to obtain a contract award by knowingly offering a price or cost estimate less than anticipated costs with the expectation of either (1) increasing the contract price or estimated cost during the period of performance through change orders or other means, or (2) receiving future “follow-on” contracts at prices high enough to recover any losses on the original “buy-in” contract.
later have the contract price adjusted upwards to recover the amount of the understatement. The court, in recognizing the injustice which would result to the Government from this practice, stated that:

 In our case, however, there were both overstatements and understatements, and to the extent that the dollar amount of overstatements matched the dollar amount of understatements, the contract price was not reduced to effect "buying-in." Since, in our opinion, offsets should be allowed to the extent of overstatements only, and no more, the contractor cannot lower his costs and thereafter attempt to recoup any of his understatements in excess of overstatements. By virtue of this limitation, there is nothing to be gained by a contractor underestimating his costs, since he can never get an upward revision in price later on.  

It is suggested that the Court of Claims was correct in mitigating the harsh rule adopted by the Board in Cutler-Hammer, Inc. One commentator had proposed an amendment after the Board's decision, claiming that "as a minimum, all honest errors in the same cost element should be considered." However, if the decision in Cutler-Hammer, Inc. v. United States is uniformly adhered to in subsequent cases, there would not appear to be a need for legislative revision, since the decision does not appear to frustrate any of the purposes of the Act and is firmly supported by basic considerations of fairness.

As previously noted, the purpose of the Truth-In-Negotiations Act is to provide the Government with detailed cost information in order to prevent excessive profiteering by contractors. This purpose does not seem frustrated by allowing a contractor to offset understatements to the extent of overstatements on closely related cost items. There is no upward revision of the contract price which would result in the contractor receiving "windfall profits" or which might encourage "buying-in." Rather, it would

80. 416 F.2d at 1312. Judge Davis dissented on this issue of offsets for two basic reasons. First, he felt that what little legislative history there was dealing with offsets appeared to favor the Government's position. See Hearings, supra note 12, at 100-02; and Roback, supra note 19, at 23. Secondly, Judge Davis felt that one of the goals of the Act was to achieve more carefully prepared and more accurate price proposals and that the decision of the majority would condone carelessness instead of penalizing it. 416 F.2d at 1317-18 (dissenting opinion).

81. Cibinic, supra note 44, at 55. It should also be noted that in 1967 the Department of Defense agreed to limited offsets in two types of situations: (1) When data represents an average or composite rate and there is a question concerning a specific item of that data; and (2) When the understatement and overstatement relate to the same particular type of item then the two costs can be offset against each other. Defense Procurement Circ. No. 57 amending ASPR, 32 C.F.R. § 3-807.5 (Supp. 1970). It can be seen that this amendment greatly restricts the permissible types of offsets by limiting them to items of the same type, whereas the decisions in Lockheed and Cutler-Hammer allow offsetting of closely related costs. See text accompanying notes 68 & 76 supra.

82. See S. Rep. No. 1884, 87th Cong., 2d Sess. 3 (1962). See also Gusman, supra note 36, at 709, where the author states the Act "is primarily directed to the problem of assuring reasonable prices for items procured where there is neither adequate price competition nor the safeguards which normally flow from economic forces at work in a truly competitive market."
appear that the purpose of the Act is being served since a contractor is put on notice by the Court of Claims decision in *Cutler-Hammer* that he has nothing to gain by withholding or underestimating pertinent cost data since the contract price will never be revised upward. 83

Moreover, this decision, in allowing offsets to the contractor, is firmly grounded in considerations of fairness. It is clearly inequitable to penalize the contractor for one honest mistake of an overstatement and yet not allow him to have the benefit of a similar honest mistake of an understatement. Furthermore, the Act should not be viewed solely as a vehicle for Government recovery but should also encompass the goal of assuring the contractor that the standards implemented for Government recovery will also be the standards implemented for contractor recovery.

VI. RESPONSIBILITY OF A PRIME CONTRACTOR FOR A SUBCONTRACTOR'S DEFECTIVE DATA

The Truth-In-Negotiations Act requires a subcontractor to submit cost or pricing data. 84 The problem has arisen as to whether the prime contractor is liable if the data submitted by the subcontractor is defective. The Armed Services Board of Contract Appeals addressed itself to this problem in *Lockheed Aircraft Corp.* 85 which involved a fixed priced subcontract between the prime contractor — Lockheed and the subcontractor — Midwestern. The subcontract provided that Midwestern was to furnish Lockheed with a necessary component of an electronic monitoring and recovery system which Lockheed had contracted to furnish to the Government. The Government required the prime contractor to insert in the subcontract a price reduction clause which stipulated that if the subcontract price was overstated because of nondisclosure of significant cost or pricing data, then either the Government or the contractor could equitably reduce the subcontract price. 86 The prime contract between the

83. Assuming that the dissent in *Cutler-Hammer, Inc. v. United States* is correct in stating that one of the purposes of the Act is to promote more careful price proposals from the contractor, (see note 80 supra), there is no evidence whatsoever that the instant decision will result in careless price proposals. One commentator rejected the dissent's view in the following terms:

The argument that permitting offsets would encourage lax and sloppy pricing practices on the part of the contractors is not convincing. A contractor would have very little to gain in following such practices. Offsets can only be used defensively. By using poor pricing practices, the contractor takes the very real risk that his price will be grossly understated, which is definitely to his disadvantage. Thus, it is difficult to see how equitable treatment would motivate contractors in that direction.

Cibinic, supra note 44, at 55.


85. ASBCA No. 10453, 67-1 BCA 29,439 (1967).

86. Lockheed's subcontract contained the following clause:

If the buyer or the Government determines that any price negotiated in connection with this contract was overstated because the Seller either (1) failed to disclose any significant cost or pricing data, or (2) furnished any significant cost or pricing data which he knew or reasonably should have known was false or misleading, then such price shall be equitably reduced and the contract shall be modified in writing accordingly.

See 14 C.C.F. 88,617, at 88,622.
Government and Lockheed also provided that the Government was entitled to a reduction of the prime contract price if either the contractor or the subcontractor submitted defective cost data. At the time the subcontract was negotiated, Midwestern had already purchased more than 90% of the materials required to produce the component, yet, the data it submitted to Lockheed overstated significant costs. It appeared that prior to completion of the negotiations with Lockheed, a Government audit was made of the subcontractor’s records at which time the subcontractor offered to submit to the Government a list of materials already purchased. This information would have revealed the overstatements, however, the Government audit team rejected the offer. Additionally, the prime contractor had also neglected to solicit the subcontractor’s list of historical costs and, therefore, also failed to discover the cost overestimates. When the error was discovered, the Government brought suit against the prime contractor claiming a refund from the reduction of the prime contract price.

On these facts the Board held that the prime contractor was liable to the Government under the price reduction clause of the prime contract to the same extent that the subcontractor was liable to the prime contractor under the price reduction clause of the subcontract since Midwestern had failed to disclose the pertinent cost data during contract negotiations. The Board emphasized the fault of the subcontractor and concluded that Lockheed was liable even though Midwestern had totally failed to inform Lockheed of the significant cost data. Furthermore, it took the position that since the prime contractor’s own subcontractor had failed to disclose significant data the prime contractor could be penalized for this breach even though the subcontractor was at fault.

On appeal, the Trial Commissioner for the Court of Claims reversed, holding that the Government was not entitled to a price reduction against Lockheed even though the prime contract had been overpriced. The

87. The prime contract provided in pertinent part:
   (a) If the Contracting Officer determines that any price, including profit or fee, negotiated in connection with this contract was increased by any significant sums because the Contractor, or any subcontractor in connection with a subcontract covered by (c) below, furnished incomplete or inaccurate cost or pricing data or data not current as certified in the Contractor’s Certificate of Current Cost or Pricing Data, then such price shall be reduced accordingly and the contract shall be modified in writing to reflect such adjustment.
   (b) Failure to agree on a reduction shall be a dispute concerning a question of fact within the meaning of the “Disputes” clause of this contract.
   (c) The Contractor agrees to insert the substance of paragraphs (a) and (c) of this clause in each of his cost-reimbursement type, price redeterminable, or incentive subcontracts hereunder, and in any other subcontract hereunder in excess of $100,000 unless the price is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation.

14 C.C.F. 88,617, at 88,622.

88. ASBCA No. 10453, 67-1 BCA 29,439 (1967).
89. Id. at 29,445.
Commissioner preferred not to base his decision on the admitted nondisclosure of Midwestern as the Board did, but rather limited his consideration to whether or not Lockheed was at fault. In reaching his decision the Commissioner reasoned that, while the prime contractor had a duty to disclose data relevant to its own costs, it would be unreasonable to hold the prime contractor liable for nondisclosure by the subcontractor since the subcontractor was in the best position to furnish such information and that finding the prime contractor liable would be tantamount to holding him responsible for the acts of the subcontractor. Clearly, Lockheed could not be as familiar with Midwestern's data as Midwestern would be. The Commissioner conceded that by not holding Lockheed responsible it would profit from the overpricing of the subcontractor. However, the Commissioner felt that when the prime contractor could not reasonably know that the subcontractor had withheld data, it should not be penalized. Furthermore, the Government is not without a remedy merely because it cannot reduce the price of the prime contract. Recognizing that Midwestern was not in privity with the Government, the Commissioner still held that the Government could proceed directly against Midwestern on the theory that the Government was a third-party beneficiary to the contract between Lockheed and Midwestern and that Midwestern, therefore, had a duty to disclose current, complete and accurate data to the Government. The Commissioner also felt that even though the Government was limited in its recovery to the overpricing of the subcontract and could not recover Lockheed's profit on this overpricing, this "is the price paid by the Government for the advantage of being allowed to dictate the terms of the subcontract, without being in privity with the subcontractor." He noted that Lockheed was at fault in not pursuing reasonable vigilance in obtaining

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91. This profit results from the fact that the prime contract price includes profit determined from a percentage of the cost of the prime contract, and the subcontract price is included in the prime contract price.

92. In reaching its decision that the Government was a third party beneficiary to the contract between Lockheed and Midwestern, the Commissioner relied on the RESTATEMENT OF CONTRACTS § 133(1)(a), which states in pertinent part:

(1) Where performance of a promise in a contract will benefit a person other than the promisor, that person is...
   (a) A donee beneficiary if it appears from the terms of the promise in view of the accompanying circumstances that the purpose of the promise in obtaining the promise of all or part of the performance thereof is to make a gift to the beneficiary or to confer upon him a right against the promisor to some performance neither due nor supposed or asserted to be due from the promisee to the beneficiary.

The Commissioner went on to state:

Applying the Restatement of the present case, it seems obvious that it was the view of the promisee (Lockheed) in obtaining the promisor's (Midwestern) promise to disclose data, to confer on the Government a right against the promisor. The subcontract clause states that "if the buyer or the Government determines that any price negotiated in connection with this contract was overstated ... then such price shall be equitably reduced ..." Since this clause was included because of the Government's insistence, it must be for the Government's benefit. (Emphasis supplied).

14 C.C.F. at 88,625.

93. Id.
the list of historical costs of Midwestern during their negotiations. However, the Commissioner further noted that Lockheed's breach was cured by the Government's audit of Midwestern's records since that audit should have revealed significant and reasonably available data. In relying on the doctrine of waiver and holding that to the extent of the Government's investigation, Lockheed was relieved of liability, the Commissioner stated that:

As we view it, the significance of the September 1962 audit is to give the Government an opportunity to be vigilant in its own behalf. To the extent the Government investigates, Lockheed's duty to protect the Government is superseded. The measure by which Lockheed's duty is superseded is the extent to which the Government had a reasonable opportunity to take advantage of the significant and reasonably available data which its investigation revealed, or should have revealed, to it. To hold otherwise would mean that Lockheed is under a greater duty to protect the Government's interest than the Government itself is. But Lockheed is a contractor — not a fiduciary. And our view is merely an application of the contract doctrine of waiver.94

It has been suggested by one commentator, prior to the Commissioner's decision, that the solution to the problem of the liability of the prime contractor would be to resort to the Disputes clause of the prime contract whereby the Government would reduce the price of the prime contract and the prime contractor would, in turn, pass the price reduction on to the subcontractor, simultaneously subrogating the prime contractor's right of appeal to the subcontractor.95 Perhaps the reasoning behind

94. Id. at 88,630 (emphasis added). The Commissioner went on to state: Continued performance, with knowledge that a condition (i.e., a duty) has not been performed, operates as a waiver. Of course, the Government will probably not want to terminate the contract just because it realizes the prime contractor has not protected the Government's interest in having subcontract data disclosed. The purpose of many of the specialized clauses in Government contracts is to enable the parties to go forward, and still preserve their rights, in situations where this would not be possible under the common law. So, too, under the defective data clause. The Government may continue performance after learning that available data has not been utilized in the subcontract negotiations, without losing its right to a price reduction; but it cannot proceed forever. The rational deadline, in connection with subcontract data, is the prime contract negotiations. At that point, the Government must take advantage of whatever utilizable subcontract pricing data it learned (or should have learned) of in its inspection (if any) prior to the prime contract negotiations. (Obviously, if the Government learned of subcontract pricing data only immediately prior to the negotiations, such data would not be "utilizable").

95. Id. See Cibinic, supra note 44, at 55-57.

The standard Disputes clause found in government contracts provide as follows:

(a) Except as otherwise provided in this contract, any dispute concerning a question of fact arising under this contract which is not disposed of by agreement shall be decided by the Contracting Officer, who shall reduce his decision to writing and mail or otherwise furnish a copy thereof to the Contractor. The decision of the Contracting Officer shall be final and conclusive unless, within 30 days from the date of receipt of such copy, the Contractor mails or otherwise furnishes to the Contracting Officer a written appeal addressed to the Secretary. The decision of the Secretary or his duly authorized representative for the determination of such appeals shall be final and conclusive unless determined by a court of competent
such a proposed solution is grounded in the belief that when the prime contractor has been relieved of responsibility for the subcontractor's wrong, it has the effect of penalizing the Government by depriving it of recovery of the excess profits secured by the prime contractor. Perhaps it is also felt that as between the Government and the prime contractor, the latter should bear the loss because the prime contractor selected the subcontractor. A third justification might be that because the prime contractor is in privity with the subcontractor, it makes it easier for the prime contractor to deal with the subcontractor.

However, it is suggested that there are two reasons why this solution is inappropriate and the Trial Commissioner's view should be adopted. First, any use of the Disputes clause presupposes that there is an agreement between the two parties to use the clause. This agreement would be highly doubtful where the subcontractor has already been paid the subcontract price. In this situation, the prime contractor would be required to litigate his claim in court with the result that the court may find that the subcontractor was not at fault, thereby penalizing the prime contractor.96

Secondly, based on essential considerations of fairness, it would appear that the position of the Commissioner is correct. While both the Board and the Commissioner recognized the fault of Midwestern, the Commissioner alone reached a solution most equitable to all the parties involved. The Board assumed that the unknowing prime contractor must bear the responsibility for the subcontractor's defective data, while the Commissioner emphasized the essential unfairness of penalizing the prime contractor. The purpose of the Act is to assure that the Government can secure a reduction in the contract price when a contractor fails to disclose accurate, complete, and current data and to see that the contractor at fault does not receive "windfall" profits from his deception. Clearly, the purpose of the Act is served by the Commissioner's decision, since the Government as third party beneficiary can directly recover from the subcontractor the amount of the overpricing created by his nondisclosure, and thereby deprive him of any windfall profits. Moreover, the unknowing prime contractor is not penalized by the deception of the subcontractor. It is suggested, therefore, that the Commissioner's approach be adopted

jurisdiction to have been fraudulent, or capricious, or arbitrary, or so grossly erroneous as necessarily to imply bad faith, or not supported by substantial evidence. In connection with any appeal proceeding under this clause, the Contractor shall be afforded an opportunity to be heard and to offer evidence in support of his appeal. Pending final decision of a dispute hereunder, the Contractor shall proceed diligently with the performance of the contract and in accordance with the Contracting Officer's decision.

(b) This "Disputes" clause does not preclude consideration of law questions in connection with decisions provided for in paragraph (a) above; provided, that nothing in this contract shall be construed as making final the decision of any administrative official, representative, or board on a question of law.


96. Cf. Id.
to effectuate the purposes of the Act and to assure that when the prime contractor is truthful in his negotiations and the subcontractor is untruthful, the Government can secure an equitable reduction of the subcontract price.97

VII. CONCLUSION

The value of truthful negotiations is unquestionable. The need for accurate, complete, and current cost or pricing data is obvious to achieve the Government objective of eliminating excessive profitmaking by contractors. However, in order for the Truth-In-Negotiations Act to remain effective, the administration of the Act should reflect fairness to all the parties connected with a Government contract. In seeking to achieve this fairness, it is suggested that clear guidelines be adopted so as to inform the contractor what cost or pricing data must be submitted. It also seems appropriate that the Government should bear the burden of proof as to what effect certain nondisclosures may have on the total contract price and, concomitantly, to relieve the contractor from the onerous burden of proving non-reliance. Clearly, considerations of fairness also dictate that since the Government is allowed to reduce the contract price the contractor should also be allowed to offset understated costs to the extent of any overstatements. The view has also been advanced that the knowing prime contractor should not be held responsible for defective data submitted by a subcontractor. Rather, the Government should seek a recovery from the subcontractor directly. It is urged that if these views are accepted by the Board and the courts, greater fairness will result to contractors and the Government will be able to continue to effectively enforce truthful contract negotiations.

Ward T. Williams

97. For a discussion of differing viewpoints on the problem of the prime contractor’s liability, see Cibinic, supra note 44, at 55; Gusman, supra note 36, at 740-43; Petit, supra note 47, at 558-59; Hannah, supra note 43, at 42.