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Going Low: Ninth Circuit Holds that False Estimates and Fraudulent Underbidding Can Lead to False Claims

Government Contracts Law360
August 7, 2012

In a startling decision of "first impression," the U.S. Court of Appeals for the Ninth Circuit has held that a contractor's proposed cost estimates for a cost-reimbursable contract may give rise to false claims under the False Claims Act (FCA) where the proposal is based on "false estimates" or "fraudulent underbidding." *U.S. ex rel. Hooper v. Lockheed Martin Corp.*, No. 11-55278, (9th Cir. Aug. 2, 2012).

After the trial court granted the defendant's motion for summary judgment on the ground that the *qui tam* relator had not presented sufficient evidence of fraudulent underbidding, the appellate court reversed and remanded the case to the district court for trial on whether the contractor, a predecessor of Lockheed Martin Corp., "acted either knowingly, in deliberate ignorance of the truth, or in reckless disregard of the truth when it submitted its bid" with a low cost estimate.

The decision continues the trend of broad interpretation and enforcement of the FCA, increases substantially the liability that contractors may face for proposing unrealistically low costs to win a contract and heightens the risk of parasitic *qui tam* litigation that contractors may face as a consequence of cost overruns.

In reaching its decision, the Ninth Circuit relied on case law in which relators or the government allege that false claims are predicated on a "fraud-in-the-inducement" theory of liability, and that requests for payment during contract performance are tantamount to false claims "where there is fraud surrounding the efforts to obtain the contract" in

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the first instance.

Lockheed argued that cost proposal estimates could not be the basis for false claims, because estimates are "a type of opinion or prediction," and "what costs might be in the future are based on inherently judgmental information, and a piece of purely judgmental information is not actionable as a false statement."

The court disagreed, but provided little discussion or analysis to rebut Lockheed's argument, except to point to a Fourth Circuit decision where the court reasoned that "an opinion or estimate carries with it an implied assertion, not only that the speaker knows no facts which would preclude such an opinion, but that he does know facts which justify it." *Hooper*, No. 11-55278 at 8561 (quoting *U.S. ex rel. Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776, 792 (4th Cir. 1999)).

Nevertheless, the Ninth Circuit's willingness to extend the FCA to cover contracts obtained through allegedly false or fraudulent cost estimates is troublesome and creates a palpable risk of parasitic *qui tam* litigation for contractors. Especially in the current competitive environment where the government frequently places a premium on low-cost proposals, yet programs remain subject to changes in scope and potential cost overruns, it is not uncommon for a contractor's actual costs to exceed its initial estimates.

After all, one of the reasons agencies may use cost-reimbursable contracts in the first place is because there are uncertainties in contract performance that do not permit costs to be estimated with sufficient accuracy to use a fixed-price contract. *See* FAR 16.301-2(a)(2).

Following *Hooper*, however, it seems that any relator can point to cost increases and hold them out as *ipso facto* evidence of fraud and false claims. Even if these cases fail on the merits because relators lack any hard evidence of fraud, *Hooper* may increase the nuisance value of such allegations, similar to the way that investors use "strike suits" to pursue settlements from publicly traded companies when share prices decline.

In *Hooper*, the U.S. Air Force conducted a competition in 1995 for a cost-plus-award-fee-type contract to "automate, standardize and modernize software and hardware used to support [the] government's space launch operations at Vandenberg Air Force Base (Western Range) and Cape Kennedy (Eastern Range), while also providing continued support for and transition from legacy systems."

Out of six evaluation factors, cost was the fifth most important; only past performance was weighted lower. Lockheed's initial proposed cost was $439.2 million, which it lowered to $432.7 million in its best and final offer. The Air Force received two other offers, and Lockheed's was the second-highest proposed cost.

In the Air Force's cost evaluation, the evaluation team determined that Lockheed had employed "realistic methods" in its cost estimate, but that it "was optimistic about some of the inputs to the methodology, resulting in an overstated potential for cost savings." Lockheed also prepared a cost "risk analysis" that evaluators found to be "unrealistic"—the methodology was "sound in theory, but the inputs (severity of certain risks) [were] understated, so the total risk [was] understated."

Evaluators also determined that there were "risks" in Lockheed's proposal that could "lead to cost growth beyond target cost," but that this risk was "acceptable." The Air Force awarded the contract to Lockheed, and eventually paid more than $900 million for its work—more than double Lockheed's initial estimate, although the court did not indicate the extent to which any cost increases were due to Lockheed's faulty estimates, increased work scope or other changes to the contract.

The district court granted Lockheed's motion for summary judgment because it determined that the relator, Nyle Hooper, had not presented sufficient evidence of fraudulent underbidding to allow his claim to move forward to trial. Hooper did not work for Lockheed during the competition, but based his allegations that Lockheed intentionally underbid the work on second-hand information he later heard from other employees.

Given the procedural posture of the case on appeal, the Ninth Circuit construed the record in the light most favorable to Hooper to determine whether any genuine issues of material fact warranted a trial.

The court seemed most concerned by deposition testimony from a Lockheed "insider" employee regarding Lockheed's cost estimating and proposal methodology, although even these facts seem thin, since the same employee also testified that he did not see Lockheed's final proposal to the Air Force, but saw only "workups" used for the proposal and concluded that the inputs Lockheed used were based on "bad, bad guesses" but were not false:

- The employee testified that the Air Force did not "accept Lockheed's initial bid" because it was "too high." The employee claimed he was later asked by Lockheed's management "to change the cost" even though the employee did not believe that a change was "based on any engineering judgment." The decision noted, however, that this employee was not involved in preparing Lockheed's modest $6.5 million cost reduction in its best and final offer, and the decision did not discuss whether Lockheed had technical or business justifications for the reduction.
- The employee testified that, in bidding on another contract, he was told to lower the cost. When he told his supervisors, "We can't. This is the real cost. This is what it's going to cost, if not more," he claimed he was dismissed from a proposal team meeting. The employee later learned that "Lockheed lowered the cost by almost half and was awarded the contract." The decision does not indicate how Lockheed's alleged proposal effort for another program was relevant to the allegations in *Hooper*, or whether Lockheed had technical or business justifications for the reduction in the other competition.
- The employee also testified that "Lockheed was dishonest in the productivity rates that it used to determine the cost for a contract."

It appears that this kind of "insider" testimony is what earned *Hooper* his trial, and what future relators will hunt for during discovery. The court also thought that the Air Force cost evaluation team's findings raised an issue of fact about whether Lockheed's proposed costs were fraudulently understated, since evaluators determined that Lockheed's estimates were "optimistic" with "overstated potential for cost savings," and that there were risks that could "lead to cost growth beyond target cost."

The court did not analyze, however, whether or how the Air Force could have been "fraudulently induced" by Lockheed's allegedly fraudulent cost estimates, when the contemporaneous evaluation record showed that evaluators had already determined that Lockheed's cost estimates were risky and invited potential overruns.

Contractors should take even more care to closely analyze and be prepared to justify the technical and business judgments used to prepare proposal cost estimates. *Hooper* serves notice that fraudulent underbidding may result in criminal or civil FCA liability, and that cost overruns may open the door to costly *qui tam* litigation.

While the summary judgment posture of the case no doubt colored the Ninth Circuit's treatment of the factual allegations in its decision, and it would be surprising to see a trial verdict in the relator's favor, the fact that the relator survived summary judgment with so little evidentiary support increases the likelihood of more *qui tam* litigation in the future based on similar allegations.

Postscript

Although the U.S. Department of Justice (DOJ) did not intervene in *Hooper*, it filed an *amicus* brief with the Ninth Circuit arguing that false estimates or fraudulent underbidding could create liability under the FCA. The DOJ's *amicus* position signals that in the future the government may take a similarly aggressive litigation position on overrun programs.