Equitable Reduction Under the Defective Pricing Statute: Public Law 87-653

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COMMENTS

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INTRODUCTION

Each year the Department of Defense spends more tax money than any other agency of the United States Government. Since a great amount of this money is expended in the form of contracts with private industry for the procurement of weapons systems and other materials considered vital to national defense, both Congress and the Department of Defense are greatly concerned that the Government pay no more than a "fair and reasonable price" for any procurement. To insure the Government a fair and reasonable price in its dealings with the defense industry and to safeguard against realization of excessive profits by defense contractors, Congress enacted amendments to the Armed Services Procurement Act of 1947. In addition, through the Armed Services Procurement Regulations (ASPR) the Defense Department has prescribed a formidable and extensive system of procedures for negotiated procurements by the Armed Services. These regulations also require that some defense contracts contain various provisions calling for an adjustment of the contract price upon the occurrence of specified contingencies.

In recent years, there has been increasing concern that the

1 U.S. Bureau of the Census, STATISTICAL ABSTRACT OF THE UNITED STATES, 252 (88th ed. 1967). In 1966 the Defense Budget totaled $57,718,000,000. Expenditures equaled $55,686,000,000 and of that amount $38,243,000,000 was spent for military procurements. Id. at 254-55. During Fiscal Year 1965, the Defense Department entered into some thirteen million contracts. Note, Equitable Adjustment of Government Contracts, 42 N.Y.U.L. REV. 302 n.1 (1967).

2 Cf. Petit, The Defective Pricing Law and Implementing Regulations—A Year and a Half Later, 29 LAW & CONTEMP. PROB. 552, 553 (1964). Of particular concern are contracts involving non-competitive procurement in which the force of competition in the open market is absent, and therefore the possibility that the contractor will receive an excessive profit is correspondingly greater.


4 See, 32 C.F.R. §§ 3.100-3.904 (1967). The ASPR also prescribe procedures and requirements for contracts procured by competition, formal advertising, and other special methods. See generally 32 C.F.R. §§ 1-30.7 (1967).

Department of Defense has been paying contractors higher prices than it would have if the contractors had furnished accurate, complete and timely cost and pricing data that were available to the contractor. In 1959, the General Accounting Office submitted a report to Congress documenting numerous instances of overcharging due to the failure of the contractor to disclose current, accurate and available data. As a result, the Defense Department extensively revised the ASPR pertaining to negotiated procurements, and added a provision requiring a contractor to execute a Certificate of Current Cost or Pricing Data certifying that to the best of the contractor’s knowledge and belief the data submitted to the Government in support of a bid were complete, current, and accurate. Subsequently, in 1961, the Defense Department again revised the ASPR relating to contract negotiations, and required that negotiated, fixed price type contracts in excess of $100,000 contain a Price Reduction for Defective Pricing Data clause. The clause in part provided that:

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 covered by (C) below, either (i) failed to disclose any significant and reasonably available cost or pricing data, or (ii) furnished any significant and reasonably available 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.

One year later, Congress enacted Public Law 87-653, often

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7 Id. Overcharges appeared to occur most frequently in the aircraft and missile industries and under fixed-price incentive contracts. Fixed-price incentive contracts are those in which there is a fixed target cost (or successive target costs), or price ceiling, and a provision for the adjustment of profit and establishment of the final price by the use of a formula which reflects the risk assumed by the contractor, difficulty of the contract effort, the investment of the contractor and other factors. 32 C.F.R. § 3.404-4 (1967). For a general discussion of incentive contracting see Nash, Incentive Contracting, 22 Fed. B.J. 195 (1962).
8 Id.
Under the earlier regulations the contractor was required to certify as to estimated costs as well as pricing data. The certificate was required when the amount of the procurement exceeded $100,000 and was based more on the contractor’s cost than competitive or regulated prices.
10 American Bosch Arma Corp., ASBCA No. 10305, 65-2 BCA ¶ 5280 at 24,848 (1965). This revision was the result of recommendations made by the Armed Services Committee of both houses. It is interesting to note that at the time of the revision to the ASPR, legislation requiring reduction in price for incomplete, inaccurate or defective data had been introduced in the House and had passed, but had not been acted upon by the Senate. 106 Cong. Rec. 14255-58 (1960).
referred to as the “Truth in Negotiations Act” or the “Defective Pricing Statute.”\textsuperscript{13} Although the statute speaks to more than just price reduction for the submission of inaccurate data,\textsuperscript{14} it has had its greatest impact in the area of price reduction.\textsuperscript{15} As applied to cost and pricing data, P.L. 87-653 provides that in certain negotiated contracts\textsuperscript{10} the contractor must execute a certificate of pricing data as to the accuracy, completeness and currency of the data and provides for downward adjustments of the contract price when the Government discovers that the price has been significantly increased as a result of submitting inaccurate, incomplete, or non-current cost or pricing data.\textsuperscript{17}

In implementing the price adjustment provisions of the statute, the ASPR were again revised to include the present form of the Certificate of Current Cost or Pricing Data\textsuperscript{18} and the Price Reduc-
tion for Defective Pricing Data clause\(^{19}\) (hereinafter referred to as the Price Reduction clause). The present Price Reduction clause provides in part that:

(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.\(^{20}\)

In form, the present clause differs significantly from the pre-legislative clause. The new clause eliminates the requirements of "any significant and reasonably available cost or pricing data" and "equitable reduction." Rather, it provides for a price reduction if the contract price is merely increased by any "significant amount" because of the submission of defective data. In addition, there is now an explicit relationship between the Certificate of Current Cost or Pricing Data and the Price Reduction clause, and there may be a reduction if the significant increase in price is the result of data not current as certified in the Contractor's Certificate. Finally, under the present clause any reduction apparently need not be "equitable."

Although the contract price adjustments for the utilization of defective pricing data were not unknown prior to the statute, the Act has raised questions as to the definition of "significant increase" and "data," what form the adjustments will take, and whether the law may work an unwarranted hardship on the contractor. It is the purpose of this comment to examine the application of the Defective Pricing Statute by the Armed Services Board of Contract Appeals (ASBCA)\(^{21}\) and to determine whether the statute significantly alters

\(^{19}\) 32 C.F.R. § 7.104-29 (1967). The Price Reduction for Defective Data clause has also been referred to as the "Defective Data clause."

\(^{20}\) Id. (emphasis added).

\(^{21}\) The ASBCA is the administrative body which hears appeals from the decisions of the Contracting Officer, and is composed of civilian and military attorneys selected by the Defense Department. The Board has jurisdiction to interpret contract provisions and to resolve disputes arising under the contract, including adjustments of the contract price. However, the Board cannot determine whether the contract has been breached or award money damages, which are for the courts to decide. For a general discussion of the Appeals Board and its role in settling contract disputes, see Shedd, *Disputes and Appeals: The Armed Services Board of Contract Appeals*, 29 LAW & CONTEMP. PROB. 39 (1964).

the practice of price adjustments prior to P.L. 87-653, and if so, whether it results in an undue hardship on the contractor.

PRICE REDUCTIONS PRIOR TO P.L. 87-653

Equitable Adjustment

"Equitable adjustment" is a phrase found in numerous clauses of fixed price type contracts and the fee aspect of cost-plus-fixed-fee contracts. Its application generally results in a modification of the contract price, although it may also modify the time for performance. It is apparently unavailable if not specifically provided for in the contract, but when present, the process of equitable adjustment permits the contractual relationship to continue where otherwise there might have been a breach. An equitable adjustment may be utilized only in case an act or change is not inconsistent with the existence of the contract. Although the point at which a modification to the contract ceases to be sufficiently within the scope of the contract to permit equitable reduction is not clear, the distinction between breach and equitable adjustment is extremely important. Equitable adjustment may result in compensation and an extension in time for performance, while the only remedy for breach of contract is money damages. In addition, the procedure for resolving disputes differs in each case: equitable adjustments are resolved more rapidly by an administrative procedure subject to court review, while a breach of contract action must be litigated in the appropriate federal court.

The equitable adjustment approach to government contract administration promotes flexibility throughout the performance of the contract, aids in avoiding work stoppages due to negotiation over changes and provides an expeditious method of settling disputes.

22 See Spector, Confusion in the Concept of Equitable Adjustment in Government Contracts, 22 Fed. B.J. 5, 6 (1962). The cost-plus-fixed-fee contract is one kind of incentive provision, and although the fee, or profit negotiated does not vary with actual cost, it may be adjusted as a result of subsequent changes in the contract. 32 C.F.R. § 3.406-5 (1967). See also Nash, supra note 7.
23 Id. at 5.
25 Id.
26 Id.
27 Id. at 306. See also Spector, supra note 22 at 9.
28 Id. at 319. "The average time between the docketing of an appeal and the rendering of a decision by a board in those cases where a hearing is held is approximately fourteen months; this contrasts with a delay of two and one-half years on motions in the Court of Claims and five and one-half years on disposition by trial."
29 Id. at 305.
30 Id.
Although there is little disagreement as to the value of equitable adjustments, there is considerable controversy and confusion as to the proper method of calculating the amount of the adjustment.\textsuperscript{31} To determine the amount of the adjustment, the difference between the cost of the modified performance and the cost of performance originally contemplated by the parties is calculated. This calculation necessarily involves the determination of two cost figures: original performance and modified performance.\textsuperscript{32} The appeals boards have utilized two methods of calculating these figures: the "objective" method which is based upon the reasonable value (or cost) of the work involved,\textsuperscript{33} and the "subjective" method which is based upon the contractor's actual costs of performing the work involved.\textsuperscript{34}

It has been argued that since there are two methods of calculating each cost figure, there are four ways to determine the amount of the equitable adjustments, at least where the determination is retroactive:

(1) (actual cost of changed work) - (bid price of original work);

(2) (actual cost of changed work) - (reasonable cost of original work);

(3) (reasonable cost of changed work) - (reasonable cost of original work);

(4) (reasonable cost of changed work) - (bid price of original work).\textsuperscript{35}

Inconsistent application of the various methods of calculating the equitable adjustment has characterized the decisions of the


\textsuperscript{32} Note, Equitable Adjustment of Government Contracts, 42 N.Y.U.L. Rev. at 320.

\textsuperscript{33} Spector, supra note 22 at 6 n.3: "In speaking of an objective, or reasonable cost approach, there is meant the reasonable cost to a typical contractor similarly situated. The 'similarly situated' element thus blending into the definition some of the subjective characteristics of the particular contractor involved."

\textsuperscript{34} Id. at 6.

\textsuperscript{35} Note, Equitable Adjustment of Government Contracts, 42 N.Y.U.L. Rev. at 321. Where the adjustment occurs prior to completion of performance and therefore is prospective, the only disputed item will be the cost of the original work. Consequently, only two methods of computation are available. The author indicates that there is a third method, the "modified subjective approach" which is merely a formula to be utilized in determining whether to apply the subjective or objective method in a particular situation.
contract appeals boards, and it has been suggested that no single method of calculation should be applied to all situations. Rather, the cases should be categorized and the correspondingly appropriate method of computation applied.30

Elements for Reduction

Although most equitable adjustments are resolved by contracting officers without the need for a detailed explanation of how the result was reached,37 the Armed Services Board of Contract Appeals (ASBCA) has adjudicated disputed adjustments and set forth the requirements entitling the Government to a price reduction. In decisions involving reductions under the pre-statute Price Reduction for Defective Pricing Data clause, the ASBCA generally required that the Government prove: (1) that the contractor failed to disclose significant and reasonably available cost or pricing data relating to a specific cost item, and (2) that the failure to disclose resulted in an overstatement of price.38 Whether these elements were satisfied by the Government in a given case often involved a determination of what constituted “pricing data,” what was meant by “significant data,” and defining the limits of “reasonably available,” and “disclosure.”

What constituted cost or pricing data for the defective pricing clause was a particularly troublesome problem for the ASBCA in the pre-statute decisions.39 Prior to the regulations implementing the Defective Pricing Statute, the Board apparently had no official guidelines to use in determining whether an item was cost or pricing data.40 There is an indication in some cases that for the purposes of a price reduction under the defective pricing data clause, there was no clear distinction between data that were factual in nature, and therefore verifiable, and estimates of future costs based upon the contractor’s judgment.41 The Board remedied this situation in 1966 by applying to pre-statutory cases the definition of cost or pricing

36 Id. at 330.
40 Cases cited note 38 supra.
data found in the post-statutory ASPR regulations. Under the regulations a clear distinction is drawn between factual data and estimates based upon the contractor's judgment, and only data which are factual and verifiable constitute cost or pricing data within the defective data clause.

Although the ASPR definition makes a distinction between fact and judgment, in application the distinction is not always easily made, for pricing data "may encompass information far beyond historical information and may include many other future factors having a bearing on the cost." In FMC Corp., a case involving price reduction arising under contracts for M-113 personnel carriers, the ASBCA was forced to consider whether the continuation of an experiment to increase the production of track shoes for the carriers constituted cost or pricing data. The Board held that under the circumstances, continued experimentation did not constitute pricing or cost data within the meaning of the Price Reduction clause because the experiments had been unsuccessful, and there were no data reasonably available at the time of negotiation to indicate probable success in the immediate future. However, the Board did not foreclose the possibility that experimentation might be cost or pricing data "if data were reasonably available for the negotiation process which indicated probable short-range, rather than possible or probable long range, success of experimentation."

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43 32 C.F.R. § 3.807-3(e) (1965). "'Cost or pricing data' as used in This Part refers to that portion of the contractor's submission which is factual. . . . Cost or pricing data, being factual, is that type of information which can be verified. Because the contractor's certificate pertains to 'cost or pricing data,' it does not make representations as to the accuracy of the contractor's judgment as to the estimated portion of future costs or projections. It does, however, apply to the data upon which the contractor's judgment is based. This distinction between fact and judgment should be clearly understood."


45 Id. The ASPR provision describes cost or pricing data as including more than historical accounting data; "[I]t also includes, where applicable, such factors as vendor quotations, nonrecurring costs, changes in production or procurement volume, unit cost trends such as those associated with labor efficiency, and make-or-buy decisions or any other management decisions which could reasonably be expected to have a significant bearing on costs under the proposed contract. In short, cost or pricing data consists of all facts which can reasonably be expected to contribute to sound estimates of future costs as well as to the validity of costs already incurred." 32 C.F.R. § 3.807-3(e) (1967) (emphasis added).


47 Id. at 25,703-04.

48 Id. at 25,704. The Board also stated that continuation of unsuccessful experiments that might result in changes in production should not be included in the negotiation of a firm fixed-price contract.
Lockheed Aircraft Corp., Lockheed Georgia Co. Division, involved a contract for the production of a malfunction detection and recording system for use in B-52 aircraft. Although the case primarily involved materials cost items as the basis for the claimed reduction, one primary item involved the labor rate of a subcontractor. The contractor estimated a projected labor rate of $2.12 an hour, while the General Accounting Office claimed that there was reasonably available evidence supporting a $2.01 an hour rate. The ASBCA found that the $2.12 rate was not cost data within the ASPR definition, since it was not factual in nature. In reviewing the historical data upon which the estimate was based, the Board found that the evidence presented by the Government was "too minimal" to justify a reduction under the defective data clause.

From FMC and Lockheed it appears that since the fact-judgment distinction is difficult to apply, the Board scrutinizes items involving projected costs. If it finds that they are in the nature of a judgment, these items will not serve as a basis for a price reduction under the Price Reduction clause, unless there is strong evidence indicating that the data upon which the judgment is based were defective within the meaning of the clause.

Implicit in the general pre-statute requirements entitling the Government to a price reduction was the requirement that the Government must have made a demand or request for the cost or pricing data. What constituted a sufficient demand for the purposes of a reduction under the Price Reduction clause was settled by the ASBCA in American Bosch Arma Corp. In that case the Air Force contracted for the production of electronic guidance sets for the Titan Missile. The Government made a number of changes in the quantity of sets to be delivered, and was making other contract modifications at the rate of approximately four per week. In response to a request for proposals, the contractor submitted estimates based on a fewer number of sets than were ultimately produced. Some months later the Government required the contractor to execute a Certificate of Current Cost or Pricing Data. The Board held that the original request for proposals and the subsequent execution of the certificate were sufficient to satisfy the demand requirement, even though the Government made no further specific requests for current pricing data.

50 Id. at 29,450.
51 Id.
53 Id.
We have no hesitancy in holding that the Price Reduction clause applies to overstatements resulting from a contractor's failure to disclose current data showing previously furnished costs to be too high, without any demand having been made for such current data other than such as implicit in the requirement that the contractor execute the certificate of current pricing data.\(^{54}\)

The problem of demand appears to have been more academic than real, for all contractors had to submit proposals and were required to execute Certificates of Current Cost or Pricing Data.\(^{65}\)

Pricing data demanded by the Government and not disclosed by the contractor had to be "reasonably available" to the contractor to entitle the Government to an equitable price reduction under the defective data clause.\(^{56}\) The "reasonably available" requirement was defined largely in terms of a "cut-off date" beyond which cost information was not reasonably available to the contractor for the purposes of price negotiations.\(^{57}\) In determining this date, the ASBCA considered the contractor's system of receiving, recording and disseminating cost information from subcontractors; Government records of negotiations indicating the date beyond which the Government thought the data were not reasonably available; and the amount of time normally required to prepare a cost estimate for a particular item.\(^{58}\) In short, the cut-off date was determined only after a thorough review of the price negotiations, the surrounding circumstances, and a study of the particular contractor's method of recording data received from other sources.

To justify reductions under the pre-statute Price Reduction clause, the Government had to show that the non-disclosed data were "significant" as well as reasonably available to the contractor. According to the ASBCA, pricing data were significant if "it would have any significant effect for its intended purpose, which was an aid in negotiating a fair and reasonable price;"\(^{59}\) i.e., data were signifi-

\(^{54}\) Id. at 24,851. It should be noted, however, that recovery under the pre-P.L. 87-653 Price Reduction clause is not dependent upon the existence of "a valid and meaningful Certificate of Current Pricing Data." Rather, the two clauses are independent of each other. Lockheed Aircraft Corp., Lockheed Ga. Co. Div., ASBCA No. 10453, 67-1 BCA ¶ 6356, at 29,446 (1967).

\(^{55}\) But cf. Lockheed Aircraft Corp., Lockheed Ga. Co. Div., ASBCA No. 10453, 67-1 BCA ¶ 6356, at 29,446 (1967) suggesting that mere knowledge that the Price Reduction clause will be included in the contract is sufficient to satisfy "demand."

\(^{56}\) See cases cited note 38 supra.


\(^{58}\) See American Bosch Arma Corp., ASBCA No. 10305, 65-2 BCA ¶ 5280, at 24,851 (1965). The ASBCA found that there was a time lag of approximately two weeks to a month between the receipt of a price quotation and recording.

\(^{59}\) Id. at 24,852.
cant if they would have a "practicable" effect on the negotiation of a reasonable price. The significance of the data was expressed in terms of a dollar figure representing the reduction in total estimated costs below what was otherwise indicated but was not determined as a percentage of the total price. Although there were no established limits as to the lowest amount that might be considered significant, the Board has held that $500 was a significant sum.

In deciding whether the Government was entitled to a price reduction under the Price Reduction clause, the ASBCA had to give content to the word "disclose" and determine the extent to which the contractor failed to disclose reasonably available and significant pricing data. It has been held that where the contractor made available all pricing data and records, and where the Government examines them during an audit, there has been disclosure as of the date of the audit within the meaning of the Price Reduction clause. Any errors not discovered by the examination may not be attributed to the contractor's failure to disclose information.

Under the old Price Reduction clause, the Government had to establish a causal relationship between the failure to disclose (or improper disclosure of) pricing data and a resulting overstatement in contract price. This requirement could have caused considerable difficulty when applied to a specific cost element in a contract for which a total contract price was negotiated and there was no agreement or understanding with respect to the specific cost elements. Although the contractor may have overstated one cost element, the

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60 FMC Corp., ASBCA Nos. 10095 & 11113, 66-1 BCA ¶ 5483, at 25,705 (1966). "In other words, significance of data . . . is equivalent to its capability of being used for its intended purpose."


64 Pre-negotiation and pre-contract price audits are frequently conducted by the Branch of the Service for whose benefit the contract is negotiated.


66 See Defense Electronics, Inc., ASBCA No. 11127, 66-1 BCA ¶ 5604, at 26,202 (1966). "The only explanation of the erroneous breakdown in the audit report that is supported by any evidence in the record is that the auditor, through lack of understanding of the technical aspects of the change order and failure to ask questions and seek verifications of his own independent conclusions, made mistakes in his own construction of a breakdown. . . ."

67 See cases cited note 38 supra.


The Board observed that the lack of "agreement as to specific cost elements [appeared] to be typical of contracts containing the Price Reduction clause."
Government might have underestimated some other element in its cost breakdown, and therefore there might not be a resulting increase in the total contract price.

To avoid the difficulty in determining whether nondisclosure caused an increase in contract price, the Board imposed what appeared to be a rebuttable presumption to the effect that absent evidence to the contrary, nondisclosure results in a corresponding increase in contract price. The ASBCA believed that since the lack of agreement as to specific cost elements was a common occurrence, and both parties were aware that there was no agreement when they included the Price Reduction clause, the presumption of an increase in contract price was justified.

We do not think that the absence of any understanding or agreement on amount of materials costs operates to defeat the effectiveness of the Price Reduction clause when both parties knew such to be the situation when they included the Price Reduction clause in the contract.

In *FMC Corp.*, the Board made it clear that the method of negotiation was immaterial for the purposes of determining the effect of the nondisclosure on contract price within the meaning of the Price Reduction clause. All that need be shown was that "the Government relied upon data furnished to it, or negotiated a price in the absence of data which should have been furnished to it within the context of the applicable clause."

Implicit in the requirement that nondisclosure (or improper disclosure) of pricing data result in an increase in contract price, was the requirement that the Government relied on the data supplied or would have relied on it. If the Government independently constructed its own estimate and did not utilize data submitted by the contractor, there would seem to be no basis for finding that the contractor's improper disclosure or failure to disclose caused a price increase. However, there is some indication that the Board invoked a rebuttable presumption to the effect that the Government would have relied on the undisclosed information (and did in fact

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60 Id. at 24,853. "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."

70 Id.

71 Id.


73 Id. at 25,699. However, the ASBCA pointed out that the method of negotiations might be significant "in determining whether the Government did in fact rely upon the data furnished or would have relied upon absent data in reaching agreement on price."

74 Id. See also American Bosch Arma Corp., ASBCA No. 10305, 65-2 BCA ¶ 5280, at 14,853 (1965).
rely on data that were improperly disclosed). In *Lockheed Aircraft Corp.*, *Lockheed Georgia Division*, the contractor argued that the Government negotiators had not relied upon a price negotiated between the contractor and a subcontractor, and therefore the Government was not entitled to a reduction under the Price Reduction clause. The Board rejected the argument and held that there could be no reliance on information not disclosed.

The inevitable response to the "reliance" theory is that a party cannot be charged with something of which it had no knowledge. It is erroneous to argue that because reduction agreements were arrived at in three areas, this precludes a party from its rights under the defective pricing data clause without regard to what data was disclosed.

From the language of *Lockheed* it would seem that the reliance requirement applied only to data disclosed and that the presumption of reliance with respect to information not disclosed was conclusive.

Equitable Setoff

Under the pre-statute Price Reduction clause it was possible for a contractor to set off underestimates in the contract price against overestimates in determining the amount of the equitable reduction. Before setoff was permitted, the contractor had to demonstrate that the items to be offset were related to cost items "concerning which the pricing data were defective." The Board has stated that:

To permit unrelated offsets would be tantamount to repricing the entire contract, which is not within the contemplation of the clause.

In addition, setoff under the equitable reduction provision of the Price Reduction clause seemed to apply only to costs for materials. Consequently, the ASBCA has held that a royalty expense resulting from a patent infringement judgment against a contractor and which was not included in the cost estimate, was not an appropriate cost item for setoff against over-statements of materials costs.

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76 ASBCA No. 10453, 67-1 BCA ¶ 6356 (1967).
77 Id. at 29,448.
78 Id.
79 See, e.g., *Lockheed Aircraft Corp.*, *Lockheed Ga. Co. Div.*, ASBCA No. 10453, 67-1 BCA ¶ 6356, at 29,450 (1967). The Board discussed the possibility of setoff but did not grant it noting that the contractor had made a "vague effort to offset," and that the items were "only remotely related" to the overstated items.
80 Id.
81 Id.
82 Id.
Equitable reduction within the meaning of the Price Reduction clause placed the burden on the Government to prove that it was entitled to a reduction. In determining whether there should be a reduction and the amount of the reduction, the ASBCA considered all the circumstances surrounding the contract negotiations, and made numerous factual determinations concerning the nature, availability, disclosure of the data, and whether the failure to disclose caused an increase in price. To mitigate any reduction, the contractor was permitted to set off understatements of related material cost items against overstatements.

**PRICE REDUCTIONS UNDER THE DEFECTIVE PRICING STATUTE**

Although the Defense Department believed that the procurement regulations then in force provided an adequate and more flexible solution to the defective pricing data problem,^83^ Congress enacted P.L. 87-653^84^ to curtail “windfall profits” and to “restore the rule of law to the military procurement process. . . .”^85^ The Senate Committee report favoring the legislation stated that:

> Although not all elements of cost are ascertainable at the time a contract is entered into . . ., [i]f the costs . . . are not furnished accurately and currently as is practicable, the Government should have the right to revise the price downward. . . .^86^

> The opposition to the bill pointed out that it was a “one-way street . . . heads, the Government wins; tails the contractor loses;”^87^ and noted that:

> This new provision is directed against human error. It has the effect of requiring that a contractor's foresight must be as precisely accurate as an auditor's hindsight, a state of perfection not attainable this side of transmigration to a higher state of existence.88

While there was no opposition to controlling windfall profits, the apparent lack of concern for windfall losses suffered by contractors was questioned.89 Because there was such great concern among some members of Congress that P.L. 87-653 apparently eliminated

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^84^ 10 U.S.C. §§ 2304, 2306, 2311. For the pertinent language concerning pricing data see 10 U.S.C. § 2306(f) supra note 17.
^86^ Id. at 9968 (emphasis added). Neither the legislative history nor the act itself defines “practicable.”
^87^ Id. (Remarks of Congressman H. A. Smith). The Congressman also pointed out that 18 U.S.C. § 1001 already prescribed penalties for false representations made to the Government.
^88^ Id.
^89^ Id.
the possibility of equitable setoff,\textsuperscript{90} H.R. 7909 was introduced in the 88th Congress.\textsuperscript{91} This bill specifically provided for equitable setoffs and limited price adjustments to discrepancies known to the contractor.\textsuperscript{92} However, Congress failed to act on the bill, and there have been no subsequent modifications of the Defective Pricing Statute.

Prior to the first ASBCA decisions interpreting Public Law 87-653, there was some question whether the Act would adequately protect the interest of both the Government and defense contractors.\textsuperscript{93} One commentator contended that the provision of the statute that requires a contractor or subcontractor "to certify that to the best of his knowledge and belief, the cost or pricing data he submitted was accurate, complete, and current ..."\textsuperscript{94} created a loophole: defense contractors could avoid full disclosure of necessary data and then, "as an excuse ... rely on error, oversight, or the general carelessness of [their] staff in investigating the reliability of the price data."\textsuperscript{95} Another writer expressed the fear that the statute would "exclude from consideration such equities as a contractor's reduction in profit or loss due to his own incorrect cost or pricing data."\textsuperscript{96}

The belief that P.L. 87-653 would work against the interest of the Government has not been realized, but the fear that the Act might work against the contractor has become a reality.\textsuperscript{97}

\textit{American Bosch Arma Corp.}

Although the ASBCA did not have occasion to decide a price reduction case under the Act until 1966,\textsuperscript{98} as early as 1965 the Board compared the new regulations implementing the statute with the older regulations.\textsuperscript{99} In \textit{American Bosch Arma Corp.},\textsuperscript{100} the Board reviewed the history of the Price Reduction clause and compared

\textsuperscript{90} See Cutler-Hammer, Inc. ASBCA No. 10900, 67-2 BCA ¶ 6432, at 29,826 n.3 (1967).
\textsuperscript{91} 109 Cong. Rec. 13,930 (1963).
\textsuperscript{92} Id.
\textsuperscript{94} 10 U.S.C. § 2306(f).
\textsuperscript{95} McClelland \textit{supra} note 93 at 442.
\textsuperscript{96} Petit, \textit{supra} note 93 at 555.
\textsuperscript{98} Defense Electronics, Inc., ASBCA No. 11127, 66-1 BCA ¶ 5604 (1966).
\textsuperscript{100} ASBCA No. 10305, 65-2 BCA ¶ 5280 (1965).
the new ASPR provisions with the earlier regulations in the contractor's contract. The Board observed that under the new law, the Price Reduction clause explicitly refers to the Certificate of Current Cost or Pricing Data and relates directly to the data certified. Under the pre-statute regulations the clause made no reference to the Certificate, and the two were independent of each other. Whether this distinction in form makes any significant difference in application was not answered. Since the pre-statute Certificate had the effect of a demand for all current cost data for the purpose of the Price Reduction clause, it would seem that the specific reference in the clause after the statute merely makes explicit a relationship that had been implicit.

The Board in Bosch Arma also construed the new Defective Pricing Statute as imposing an "affirmative" duty on the contractor to disclose data certified to be complete, current and accurate as of a specific date. The old ASPR directed Government negotiators to be in possession of current, accurate data and "to require the contractor to furnish such data 'promptly' . . . ."

The only contractual duty to furnish pricing data is such as can be implied from the contractor's obligations under the Price Reduction for Defective Data clause in conjunction with the Certificate of Current Pricing Data.

As applied, however, the pre-statute duty to disclose differed only slightly from the "affirmative duty" under the Act. The Board held in American Bosch Arma that an original request for data coupled with the knowledge that a Certificate must be executed was sufficient to impose on the contractor a duty to disclose even though there was no further demand for pricing data.

The Board also observed that the new Certificate of Current Cost or Pricing Data covers only factual cost and pricing data, and

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101 Id. at 24,849.
104 But see Lockheed Aircraft Corp., Lockheed Ga. Co. Div., ASBCA No. 10453, 67-1 BCA ¶ 6356, at 29,446 (1967) (a case arising under the old ASPR). "Perhaps there is a relationship between the two and perhaps they were so intended. However, the action to be taken under either, or the obligations under either, are separate and distinct."
106 Id.
107 Id.
108 Id. at 24,851.
eliminates estimates from the Certificate. Thus, the new Certificate
draws a clear distinction between "fact" and "judgment."\textsuperscript{109}

\textit{Defense Electronics}

In \textit{Defense Electronics, Inc.},\textsuperscript{110} the ASBCA construed the
Defective Pricing Statute in a case arising under the new Price
Reduction clause.\textsuperscript{111} That case concerned a contract for telemetry
pre-detection systems for the Atlantic Missile Range. Even before
the contract was awarded, the Government ordered changes in some
of the tape recorders to be included in the systems. In its response,
the contractor also proposed to purchase recorders and other parts
from Ampex, a manufacturer not listed in the original proposal,
and whose price for the recorders was higher. Together, the modifi-
cation of the recorders and the proposal to purchase from Ampex
resulted in a substantial increase in the contract price. The Govern-
ment claimed that the contractor had furnished inaccurate, incom-
plete, or non-current pricing data with respect to negotiations be-
tween the contractor and Ampex (as well as other data relating to
the change order), and as a result, the contract price had been in-
creased by $400,296.\textsuperscript{112} Pursuant to the Price Reduction clause, the
Contracting Officer reduced the contract price in that amount, and
the contractor appealed. On appeal, the Board held that the Gov-
ernment was not entitled to a price reduction on the ground that it
failed to prove that the furnishing of inaccurate data resulted in a
price increase.\textsuperscript{113}

The Board made it clear that P.L. 87-653 did not shift to the
contractor the burden of proof under the Price Reduction clause,
and that the Government must satisfactorily establish every element
under the clause.\textsuperscript{114} Generally, the basic elements entitling the
Government to a price reduction under the new statute are the
same as those under the older regulations: (1) that the contractor
furnished inaccurate, incomplete, or non-current data; (2) that the
defective data caused an increase in price; (3) that the Government
proved the amount of the increase.\textsuperscript{115}

In its opinion, the Board indicated that "disclosure" under the

\textsuperscript{109} \textit{Id.} at 24,449. As noted earlier, the ASBCA applied the judgment-fact distinc-
tion to cases arising prior to P.L. 87-653.

\textsuperscript{110} ASBCA No. 11127, 66-1 BCA \textsuperscript{\textcopyright} 5604 (1966).

\textsuperscript{111} The original contract was placed by formal advertising and therefore was not
subject to P.L. 87-653, except as to changes and modifications in excess of $100,000.

\textsuperscript{112} \textit{Id.} at 26,191. In its opinion, the Board pointed out that if the reduction were
sustained in full the contractor would realize a net loss of some $275,400.

\textsuperscript{113} \textit{Id.} at 26,206.

\textsuperscript{114} \textit{Id.} at 26,201-02.

\textsuperscript{115} \textit{Id.}
new law is identical to "disclosure" under the old ASPR. For purposes of the Price Reduction clause, it is sufficient that the contractor make data available to a Government auditor and the auditor examine the information.\footnote{116} In addition, the Government is bound by the auditor's report, and liability for any errors in cost data not discovered by the Government in its study may not be attributed to the contractor.\footnote{117}

Although the form of the current Price Reduction clause eliminates the requirement that the defective cost or pricing data be "reasonably available" and "significant," language in \textit{Defense Electronics} suggests that in practice they are still necessary.\footnote{118} In discussing the contractor's duty to disclose pricing data, the Board stated that:

\begin{quote}
The duty to disclose is satisfied when all \textit{FACTS} (sic) reasonably available to the contractor which might reasonably be expected to affect the negotiated price are accurately disclosed.\footnote{119}
\end{quote}

The qualification that the facts must "reasonably be expected to affect the negotiated price" is strikingly similar to the definition of significant data found in \textit{American Bosch Arma Corp.}\footnote{120} and refined in \textit{FMC Corp.}\footnote{121} In \textit{American Bosch Arma}, pricing data was significant "if it would have any significant effect for its intended purpose, which was an aid in negotiating a fair and reasonable price."\footnote{122} In \textit{FMC}, the Board stated that significant data "is equivalent to its capability of being used for its intended purpose."\footnote{123} The Board in \textit{Defense Electronics} went on to hold that the contractor's failure to disclose two letters from Ampex relating to a reduced price for the sale of the recorders did not justify a reduction under the Price Reduction clause, because:

\begin{quote}
It is unlikely that this information would have had any effect on the change order price negotiations, as the record of negotiations shows that the Government negotiations team knew that appellant's reduced option price was firm until 15 September.\footnote{124}
\end{quote}

Thus, \textit{Defense Electronics} indicates that under P.L. 87-653 and the Price Reduction clause, data not disclosed must be reasonable and significant, and that this requirement is implied from the concepts of what constitutes cost data, and the duty to disclose.

\footnotesize{
\begin{itemize}
\item \footnote{116} \textit{Id.} at 26,202.
\item \footnote{117} \textit{Id.}
\item \footnote{118} \textit{Id.} at 26,203-04.
\item \footnote{119} \textit{Id.} (emphasis added).
\item \footnote{120} ASBCA No. 10305, 65-2 BCA \textsuperscript{\texttrade} 5280 (1965).
\item \footnote{121} ASBCA Nos. 10095 & 11113, 66-1 BCA \textsuperscript{\texttrade} 5483 (1966).
\item \footnote{122} ASBCA No. 10305, 65-2 BCA \textsuperscript{\texttrade} 5280, at 24,852 (1965).
\item \footnote{123} ASBCA Nos. 10095 & 11113, 66-1 BCA \textsuperscript{\texttrade} 5483 (1966).
\item \footnote{124} \textit{Defense Electronics, Inc.}, ASBCA No. 11127, 66-1 BCA \textsuperscript{\texttrade} 5604, at 26,204 (1966).
\end{itemize}
}
Defense Electronics also emphasized that there is no relaxation of the older requirement that nondisclosure of data (or improper disclosure) must cause the increase in contract price.

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.125

Cutler-Hammer

Approximately one year after Defense Electronics, the Armed Services Board of Contract Appeals again had occasion to construe the Defective Pricing Statute in the case of Cutler-Hammer, Inc.126 The contract in that case involved the development and manufacture of an airborne electronic reconnaissance system, a complex system composed of 120 antennas and over 40,000 individual electronic parts. Although the contractor considered that at least three months were required to prepare a proposal, the Government insisted that proposals be submitted in approximately five weeks. Due to the short time permitted for the preparation and submission of proposals, a number of computational errors were made in the contractor's final proposal.127 The errors in computation resulted in an overstatement in the contract price of over $500,000. However, there were a number of understatements which, the contractor claimed, understated the contract price in excess of $500,000. If the understatements were set off against the overstatements, the net reduction in price would have been approximately $18,000. Cutler-Hammer claimed it was entitled to the setoff and argued that "the 'accuracy' and 'completeness' warranted in the Defective Pricing Clause [Price Reduction clause] is over-all accuracy and not that of each and every part thereof."128 In addition to the overstatements due to errors in computation, the Government claimed an additional reduction for Cutler-Hammer's failure to disclose a low bid received from an unknown, untried subcontractor.129

The Board held that under the Price Reduction for Defective Data clause implementing P.L. 87-653, a contractor may not set off understatements of materials costs against related overstatements resulting from computational errors.130 In addition, the Board held

125 Id. at 26,202.
126 Id. at 29,824.
127 Id. at 29,825.
128 Id. at 29,827. The subject of the bid was a particular type of antenna composed of a number of other antennas.
129 Id. at 29,827. The subject of the bid was a particular type of antenna composed of a number of other antennas.
130 Id.
that the Government was entitled to a reduction for the contractor's failure to disclose the subcontractor's proposal.\textsuperscript{131}

In its opinion, the Board determined that the Defective Pricing Statute "was intended solely as a vehicle for recoupment by the Government of overpricing resulting from any of the causes enumerated therein."\textsuperscript{132} A study of the legislative history of P.L. 87-653 failed to reveal a clear indication that Congress intended to permit equitable setoff.\textsuperscript{133} However, the Board conceded that "reasonable men may certainly differ in this interpretation" and that there was "some indication in the legislative history that the result we here reach may not have been intended."\textsuperscript{134} Balancing evidence that Congress intended to permit setoff against the legislative history indicating a contrary intent, the Board concluded that there was as much evidence, if not more, against setoff. Therefore, the Board stated:

[W]e 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 Congress or the courts to set the matter right.\textsuperscript{135}

By giving the statute a literal reading, the ASBCA abrogated the equitable setoff concept applied under the old regulations.\textsuperscript{136} Under \textit{Cutler-Hammer}, it would seem that a defense contractor may be penalized for committing computational errors in a good faith attempt to respond to Government induced pressure.

In the area of reductions for nondisclosure of data \textit{Cutler-Hammer} did not expressly alter the basic requirements enunciated in \textit{Defense Electronics, Inc.}\textsuperscript{137} According to the Board the Government still has the burden of proving that the undisclosed data were significant and establishing "the causal relationship between significant, non-disclosed pricing data and the resulting contract price reduction."\textsuperscript{138} However, the burden does not appear to be a particu-

\textsuperscript{131} \textit{Id.} at 29,829. The Board also permitted the contractor to subtract $75,000 from the claimed reduction, upon reviewing the evidence.

\textsuperscript{132} \textit{Id.} at 29,826.

\textsuperscript{133} \textit{Id.}

\textsuperscript{134} \textit{Id.}

\textsuperscript{135} \textit{Id.} at 29,826-27. \textit{Cutler-Hammer} has appealed the decision to the Court of Claims.

In a footnote, the Board observed that H.R. 7909 had been introduced into Congress after the passage of P.L. 87-653. This bill specifically provided for equitable setoff. The Board noted that it was impossible to determine why the bill failed to pass, but that "[T]here must necessarily have existed a body of opinion, that, as to the offset question, a change, or at least a clarification ... was in order."

\textsuperscript{136} See, \textit{e.g.}, \textit{Lockheed Aircraft Corp., Lockheed Ga. Co. Div.; ASBCA No. 10453, 67-1 BCA} \textit{5356}, at 24,450 (1967).

\textsuperscript{137} ASBCA No. 11127, 66-1 BCA \textit{5604}, at 26,201-02 (1966).

larly difficult one: the Government apparently need only establish
the effect of nondisclosure with "reasonable probability."

The Board admitted that at the time of negotiations, the quotation from
the subcontractor "was far from being data upon which a firm price
reduction could have been reached. . . ." In spite of this fact, it
seemed clear to the Board that "something contractually different
would have been developed to cover the situation as it then ex-
isted." The conclusion was inescapable that:

[T]he information was significant from the standpoint of over-all
contract negotiation. Of necessity, the very fact of its nondisclosure to
the Government leaves us to conjecture as to what precise effect a full
disclosure might have had on these negotiations. However, since it
was appellant's failure to disclose the information which created this
uncertainty the consequence, if any, must be borne by the appellant
and not by the Government.

Although the Government retains the burden of proving the
elements listed in Defense Electronics, Cutler-Hammer appears to
lighten that burden. Where certain data are available to the contrac-
tor but would not support a firm reduction and therefore are not dis-
closed, the Government may now be entitled to a reduction. The
causal relationship between nondisclosure and resulting price in-
crease may be satisfied by a mere showing of reasonable probability
that a disclosure would have resulted in excluding that cost item
and reserving it for future negotiation.

CONCLUSION

The Defective Pricing Statute makes significant changes in the
form of the Price Reduction clause required to be included in
enumerated negotiated procurement contracts. As construed by the
ASBCA in Defense Electronics and Cutler-Hammer, there seems to
be little difference from the old ASPR in the application of the
statute except in the area of equitable setoff. With minor differences,
the basic elements entitling the Government to a price reduction
under the Price Reduction clause are the same as they were under
the pre-statute regulations: that the contractor furnished inaccurate,
incomplete or noncurrent pricing data; and that the defective data
(or nondisclosure) caused an increase in the contract price. The
burden of proof remains on the Government, although Cutler-
Hammer appears to have somewhat eased that burden. Under the

139 Id.
140 Id. at 29,828.
141 Id. at 29,828-29.
142 Id. at 29,828.
143 Id. at 29,829.
new statute and implementing regulations, the Board has indicated that the pre-statute requirement of "significant and reasonably available data" will be implied.

A defense contractor may still question whether a particular item constitutes cost data; to what extent there has been disclosure; whether the data were significant; and whether the nondisclosure caused an increase in price. At least a limited form of equitable reduction is available under P.L. 87-653, even though the Price Reduction clause merely provides for a reduction. The cases indicate that the ASBCA will continue to consider all circumstances in determining whether the Government is entitled to a reduction and the amount of the reduction.

It is Cutler-Hammer's abrogation of equitable setoff that works the greatest hardship on the contractor. If the contractor understated items due to a failure to conduct a reasonable study within the allotted time, then it would seem that setoff should be denied. Where the Government pressures the contractor to respond to a demand on unreasonably short notice, and the contractor makes a good faith effort, to preclude him to set off understatements against computational errors serves as a penalty. Although Congress intended to protect the interests of the Government, it is doubtful that Congress intended to penalize the contractor for errors that do not result in substantial injury to the Government.

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