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Contract Remedies & Their Impact on Fraud Investigations

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Defense Contract Management Agency

- **Terminology**
- **Agency Acquisition Perspectives**
 - **Right Item, Right Time, Right Price**
- **Agency Counsel / Fraud Counsel**
 - **Responsibilities**

What ARE Contractual & Non-Contractual Remedies?

- **Contractual actions are taken by virtue of contract provisions**
- **Non-contractual actions are taken on the basis of regulations or procedures, because of statutory provisions or as actions at common law**



Some Examples

Terminations

Rescission of Contract

Warranties

Payment Actions

Withhold Payments

Offsets of Payments

**Disallowance of
Contract Costs**

**Increased Payment
Review**

Inspections Clause

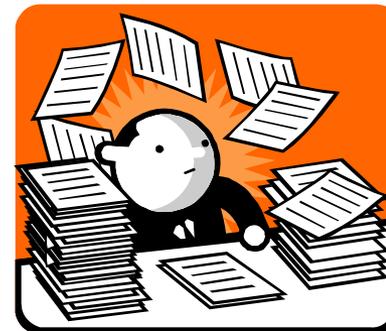
Price Reduction

Revocation of Acceptance

**Denial of Contractor
Claims**

Product Rejection

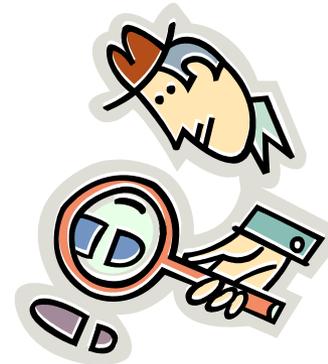
Correction of Defects



IMPORTANT.....

- **41 U.S.C. § 605(a) - Agency cannot “settle, compromise, pay, or otherwise adjust any claim involving fraud”**
- **Settlements of civil fraud matters without proper authorization from DOJ are without force or effect**
- **U.S. v. U.S. Cartridge Co., 78 F.Supp. 81 (1948) – US is not bound by acts of its officers that are not within the scope of the conferred authorities**

- **If a contractor is unable to support any part of a claim due to misrepresentation or fraud, the Contracting Officer (KO, PCO, ACO, CO) “shall refer” the matter for investigation.**



IMPACT– A contracting officer can not take an action paying or settling a matter involving fraud.

HOWEVER, while most are aware of this, what if they do not recognize (or ignore) the issue as possibly involving fraud?

- **Agencies need to avoid taking action that may prejudice pending or potential fraud litigation**
- **BUT, agencies may be compelled by independent administrative or programmatic concerns to take actions that may be adverse to DOJ, and, within the limits previously discussed, such action is within the ultimate authority of the agency**

TWO TYPES of TERMINATIONS:

- (1) DEFAULT (RARE) - Must have reason**
- (2) CONVENIENCE - GOV OPTION**

ONLY the Buying Activity has the authority to terminate contracts

Default Termination “T4D”

- **These terminations are based on a contractor’s actual or anticipated failure to perform**
 - **Includes product and delivery issues**
- **Cure Notice/Show Cause**
- **C.O. determination - detailing the contract requirements, contractor failures and the basis for termination**
- **The C.O. decision is served on the Contractor providing notice of time in which to file an appeal**

- **Fraud CAN be grounds for a T4D**
 - **falsified test reports, altered CoCs or other documents**
 - **falsified Progress Payment Requests**
- **Unlike T4C's, T4D's ARE considered a black mark on the Contractor's Performance Record**

- **The GOVERNMENT, as sovereign, can unilaterally terminate a contract**
- **NO Reason or Fault is necessary.**
- **Effectively converts Fixed Price contracts into Cost-type**



May I Digress?

- **In T4C the terminated contractor must submit a “Proposal” to settle the terminated contract**
- **IF he commits fraud in the termination process – as to costs, inventory or other matters you may have a new fraud case or an additional offense in an existing investigation**

- **You'd think that terminations occurring during the course of an investigations Would be T4D's, BUT**
 - **T4C's are easier**
 - **T4C's generally do not hurt the Contractor**
 - **The Government basically pays all of the contractor's incurred costs**
- **But what is the viability of a case where the agency has failed to T4D and basically paid the contractor for everything?**

- **Rescission is available when (1) final conviction for bribery, conflict of interest, where Contractor bid/ proposal or source selection info disclosed for money or to give advantage or (2) Agency head determines Contractor bid/ proposal info or source selection info disclosed for money or advantage**
- **Conduct relates to Contract formation**
- **FAR not exclusive right – Common Law also exists**

Where non-conforming product is supplied – the Government may invoke warranty provisions. Need:

- 1. Existence of defect**
- 2. Defect within scope of warranty**
- 3. Failure of product most probably caused by warranted defect**
- 4. Defect occurred during warranty period**
- 5. Required notice given to contractor under clause**

Warranty Remedies

1. Order the contractor to repair or replace defective product
2. Retain the product at a reduced price
3. Correct the defect in-house or by contract
4. Permit equitable adjustment of contract price

BREACH OF WARRANTY!

Cost Mischarging:

- **Improper allocation of costs, charging of unallowable costs, or artificially inflating costs resulting in overcharging for goods and services**

Defective Pricing:

- **Failure to submit current, complete, and accurate cost or pricing data to the government on a negotiated contract**

- **Different typeface on invoice**
- **Services that could not be performed**
- **Submission of cost/price info through multiple channels**
- **Non-payment of subs or suppliers**
- **High turnover of personnel making payment requests**

Payment Actions

- **Withhold or Suspend Contract Payments**
- **Offset Payments from other Contracts**
- **Disallowance of Costs**
- **Increased Payment Review**
- **Reduction in Progress Payments**



FRAUD RELATED - FAR 32.006

- **The Government can reduce or suspend contract payments upon a determination that there is substantial evidence of fraud**
- **Applies only to DOD and NASA**
- **Agency head cannot delegate below the SES Level IV**

WORK RELATED - FAR 32.006

- **The Government can withhold payments as a mechanism to become whole.**
- **Where work covered by invoice or payment request is not acceptable or complete, the Government can withhold part OR all of contract price or progress payment.**
- **Withhold limited to portion of work not satisfactory with rational relationship between payment and work**

Set Off or Offset

- **Common law right of Creditor - to offset or setoff debts/overpay due on ONE contract against other contracts where the Government owes contractor payments.**
- **Initially a demand letter is sent which describes the debt; directs payment to be within 30 days; and adds interest after 30 days**
- **If contractor has invoices pending for payment on another contract, the Govt can Offset against the debt**

CO can disallow unsupported costs, before or after incurrence:

- **Written notice of costs, basis for disallowance**
- **Contractor can respond w/in 60 days**
- **CO/ACO reviews submission - either withdraws notice or affirms by decision**
- **CO/ACO issues a Final Decision disallowing costs giving appeal rights**

“Unallowable” Costs

There may be penalties for including unallowable costs in Indirect Cost Submissions to Government



What is disallowed: Amount of the claimed Unallowable Cost

The Penalty: *Double* Penalties for costs previously determined to be unallowable

- **In cost contracts, (DoD) DCAA generally does not audit vouchers on direct billing after the first one is submitted (approved contractor billing systems)**
- **DCAA receives the voucher and may perform only a cursory review**
- **Where an issue arises, DCAA notifies the contractor, ACO, and payment office that direct billing is being withdrawn. Each voucher must then be *reviewed* before payment**

- **Progress Payments allow for reimbursement of costs incurred during performance**
- **Performance-Based Payments allow for payments based upon achieving milestones**



- **Poor Financial Condition**
- **Complaints from Subcontractors**
- **Unavailable Documentation**
- **Irregularities in Estimating, Accounting or Billing Systems**
- **Product Substitution**
- **Data Fields that Do Not Add Up Logically**



- **For Progress Payments – the ACO or CO can increase oversight - usually a results in a prepayment review of the Progress Payment Requests for accuracy**
- **In addition, the ACO can have DCAA audit before payment, have Industrial Specialist (IS) do contract performance analysis, and then make adjustments in Progress Payment amounts**

Basis for Reducing Payments

- **Contractor fails to comply with material requirement of contract**
- **Unsatisfactory financial condition - too risky**
- **Delinquency in payment of costs of performance, e.g., subcontractors**
- **Disallowance of costs or reduction due to unallowables in Progress Payments**
- **Inventory exceeds contract requirements**
- **Unliquidated Progress Payments exceed Fair Value of undelivered work (Contract is in a loss position)**

Budget cost – Actual Cost – Actual Performance

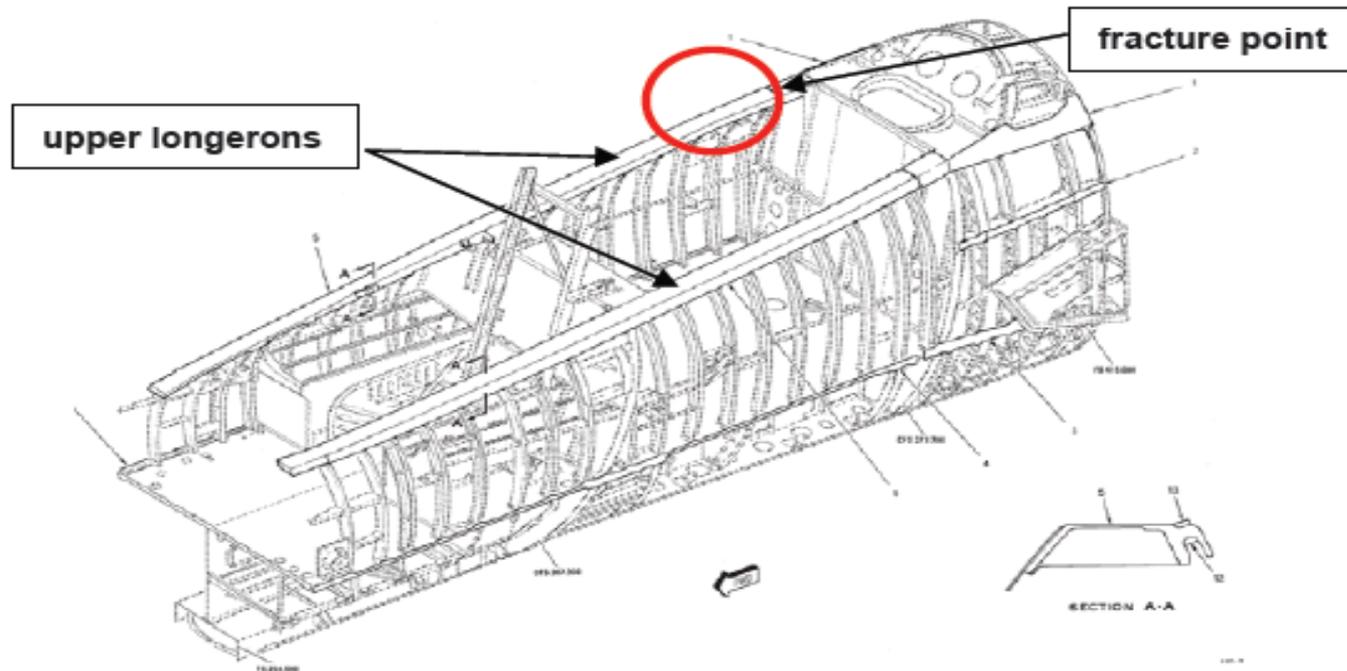
- **Requests for payment that are inconsistent with earlier cost reports**
- **Material performance and accounting misalignment**
- **Application of MR to offset cost overruns**
- **CPR data does not reflect actual cost, performance and schedule indices**
- **Alterations of the Estimate at Completion**



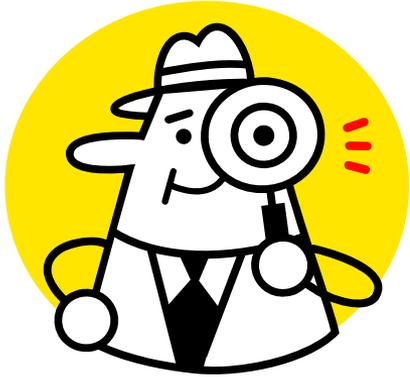
Product Issues: “You Waived What?”



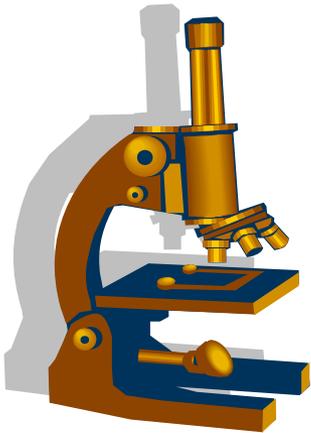
What Happened?



F-15 Forward Section Structural Schematic



Defective Performance
BEFORE / ON / AFTER
Required Delivery Date



- **Correction of Defects - where product has been tendered that is non-conforming the Govt. must give the contractor an opportunity to correct or replace**
 - **if within delivery period, at no added cost to the Govt.**
 - **Government may also have the right to charge contractor for cost of re-inspection**

Other Government Options:

- 1. Corrective Action Requests (CARs)**
- 2. Termination for Default (Anticipatory Breach)**
- 3. Grant Waiver or Deviation**

- **WAIVER:** Written authorization to accept an item that departs from specified requirements but is nevertheless considered suitable “as is” or after approved rework
- **DEVIATION:** Written authorization granted prior to manufacture of an item, to depart from a particular performance or design requirement of a specification, drawing, or other standard

- **Material Review Boards provide suppliers with a vehicle for the occasional submittal of nonconforming material that can be used by the Government , when a delay in acceptance or receipt of that material will cause a detriment to the Government, either directly or as a result of a hardship to the supplier.**

Prior to Acceptance - Government Options:

- 1. Reject**
- 2. Accept at reduced price**
- 3. Require Correction/Replacement -
give notice of defects/time cure if product
is in substantial compliance**
- 4. Terminate for Default**
- 5. Grant waiver**

HOW IS THE GOVT MADE WHOLE?

IF CONTRACTOR FAILS TO CORRECT OR REPLACE IN A REASONABLE TIME THE GOVERNMENT MAY:

- 1. CORRECT OR REPLACE;**
- 2. CONTRACT WITH ANOTHER ENTITY TO CORRECT**
- 3. TERMINATE FOR DEFAULT**

When in the best interest of Government, there can be a conditional acceptance based upon technical advice that the item is safe and will perform as intended

- must have concurrence of using activity**
- contract price adjustment**

Where product has already been accepted and a nonconformity is discovered that is related to contractor fraud, acceptance may be REVOKED.

REQUIREMENTS:

- 1. Intent to Deceive,**
- 2. Misrepresentation of fact, and**
- 3. Government reliance on misrepresentation to its detriment**

Freeze Product - CODE L

- **Where product can potentially impact performance or safety - Option to freeze it from going into the supply chain**
- **If at depots, it can be placed in Code L**
- **To accomplish, you must ask agency Fraud Counsel, PCO or product manager to initiate action.**



Recall from Field

- **Product manager or Activity User - can initiate a recall from the field**
- **To start the process - contact either agency counsel or fraud counsel**
- **Decision will be made by Agency often based upon mission needs, product condition and SAFETY**



Where to Test?

- **Finding Testing Facilities and getting testing done can be a challenge**
- **Contact the Procuring Activity or the Engineering Activity**
- **Testing can sometimes be at the facility (i.e. Defense Logistics Agency has testing facilities)**
- **But there are times where contracting with an outside firm is necessary**

- **Wrongfully obtaining source selection information or another contractor's bid or proposal information; improper compensation of former officials**
- **HCA may cancel the procurement; disqualify the offeror; price/fee adjustment; void/rescind contract; refer for suspension or debarment**

- **Withdrawal of Systems Approvals**
- **Suspension, Debarment, and other Non-Responsibility Determinations**
- **Removal of “Fast Pay” Procedures**
- **Removal from Qualified Products or similar list**
- **Require Higher Level of Inspection**

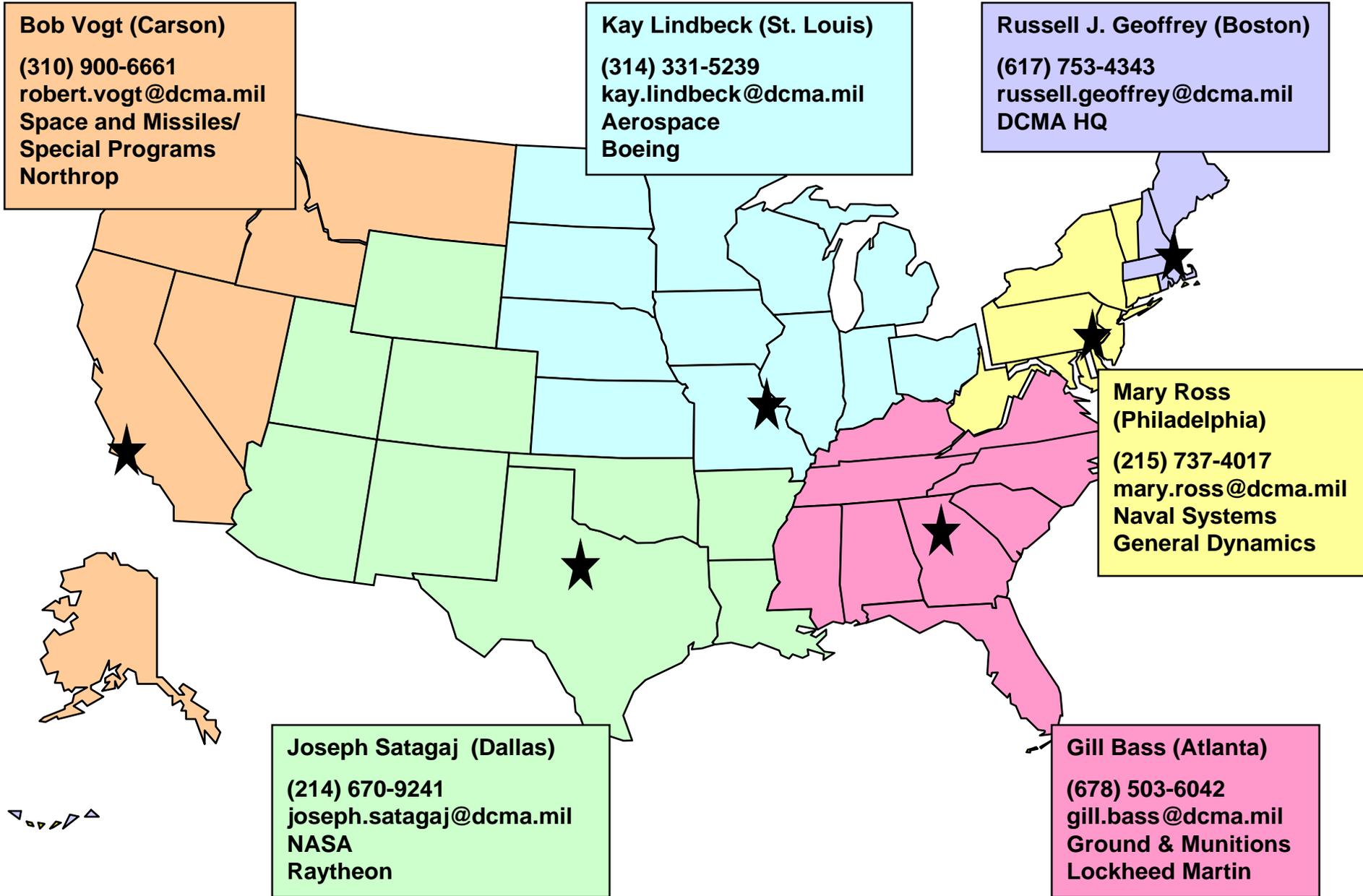
Coordination of Remedies





- **WE CAN SAVE YOU TIME!**
 - **Impact upon contract, case and mission**
 - **Understanding the contract / problem**
 - **Locate key contracting players**
 - **Determine prime contract activity**
 - **Locate and retain evidence**
 - **Explain contract provisions, manufacturing processes and payment issues**
 - **Damage Control**

CIC Attorney Geographic Areas and Customer Assignments



Questions?



- **Example: QA reports that the items presented for final inspection are not in accordance with contract requirements. Termination actions have been considered, but are not practicable at this time. The PCO has indicated interest in processing a waiver.**
- **What actions should be considered for use?**

- **Issue Corrective Action Request**
- **If minor nonconformance, acceptance with consideration after MRB**
- **Allow correction if delivery schedule permits**
- **Revise Delivery Schedule with consideration**
- **Demand for re-inspection costs if performed**
- **Progress payment review**
- **Quality assurance review**
- **Process waiver**
- **S&D if pattern exists**

- **Example: A QA finds that the contractor has been substituting an inferior, less costly material than required by the contract specifications. Some of the items have already been accepted, and others await inspection and acceptance.**
- **What actions should be considered under these circumstances?**

- **Issue a Corrective Action Request**
- **Termination for default**
- **Recovery of re-inspection costs**
- **Revocation of acceptance by PCO**
- **Recall from field**
- **Warranty action**
- **Independent testing**
- **Advise receiving activity**
- **Acceptance at reduced price**
- **Suspension & Debarment**

- **PRODUCT ASSURANCE IS:**
 - ***AN AGENCY PROCESS COMPRISED OF:***
 - **QUALITY ASSURANCE SPECIALISTS**
 - **ENGINEERS**
 - **INDUSTRIAL SPECIALISTS**
 - **SOFTWARE ACQUISITION MANAGEMENT SPECIALISTS**
 - **ACQUISITION LOGISTICIANS**

- **GOAL: PROVIDE CONFIDENCE TO CUSTOMERS THAT PROGRAM/CONTRACT TECHNICAL REQUIREMENTS ARE BEING FULFILLED BY THE SUPPLIER**

- **PRODUCT ASSURANCE IS NOT 100% ABSOLUTE CERTAINTY**
- **WHY NOT?**
 - *LIMITED RESOURCES*
 - *THOUSANDS OF PROCESSES*
 - *THOUSANDS OF INSPECTIONS*

SO WHAT DO WE DO?

✓ WE ASSESS RISK...

CONTRACT CLAUSE REQUIREMENTS:

- **FAR 52-246-2 – Standard Inspection Clause**
 - *Right of Access*
 - *Documented Inspection Records (Acceptable to the Government)*



- **FAR 52-246-11 – Higher Level Quality System**
 - *MIL-STD 45208A*
 - ✓ **Inspection System Requirements**
 - *MIL-STD 9858A*
 - ✓ **Quality Program Requirements**
 - *ISO 9001-1994*
 - ✓ **Quality System (Design and Development)**
 - *ISO 9002-1994*
 - ✓ **Quality System (Excluding Design and Development)**
 - *ISO 9003-1994*
 - ✓ **Quality System (Final Inspection and Test)**
 - *ISO 9001-2000*
 - ✓ **Quality Management System Requirements**



Types of QA Contracts

- **PRIME CONTRACT** (Administered by DCMA XXXX)--
- full delegation function from buying activity

- **QA ONLY DELEGATION (2 Types)**
 - ✓ **1-- SUPPORT OF PRIME (Place of Performance)**
 - Administration by any Contract Management Office (CMO)-
Contract calls for QA at some other location for some aspect
of contract

 - ✓ **2. SUBCONTRACT SURVEILLANCE- QAR request to
another QAR at another site**
 - Purchase Orders/Interplant work orders

- **ORIGINATES FROM OTHER QARS**
- **ASSOCIATED WITH PURCHASE ORDERS**
- **CONSIDERED MANDATORY**
- **CAN BE ONE TIME REQUIREMENT OR LIFE OF THE CONTRACT**
- **CAN PASS DOWN QALI REQUIREMENTS**

- **Quality Assurance Letters of Instruction**
 - ✓ ***Sent from Buying Activities to QARs***
 - ✓ ***Over and Above Contract Requirements***
 - ✓ ***Considered Mandatory***
 - ✓ ***QAR must Perform Surveillance until Relief is Granted***

- **ITEM MANAGED STRATEGY:**

NON-COMPLEX/NON-CRITICAL PRODUCTS

FAR 52-246-2

USE OF COC (FAR CLAUSE 52-246-15 INVOKED)

ALTERNATIVE RELEASE PROCEDURES (ARP)

MINIMAL SURVEILLANCE

- **ALTERNATIVE RELEASE PROCEDURES**
 - ***DISCRETION OF QAR***
 - ***FORMAL WRITTEN NOTIFICATION TO CONTRACTOR***
 - ***RELIEF FOR QAR AT FINAL ONLY***
 - ***CANNOT BE USED ON CSI CONTRACTS***

- **STANDARD PA APPROACH:**
 - ✓ ***FAR 52-246-11 HIGHER LEVEL Q REQUIREMENT***
 - ✓ ***FOR COMPLEX OR CRITICAL PRODUCTS***
 - ✓ ***PA SURVEILLANCE PLAN***
 - ✓ ***FOCUS ON OPERATIONAL TESTS AND IN-PROCESS REVIEWS***
 - ✓ ***FORMAL AUDITS WHEN REQUIRED***
 - ✓ ***COMMERCIAL CONTRACTS WITH ADDENDUMS***

- **CRITICAL SAFETY ITEMS:**
 - ✓ ***FAR 52-246-11 HIGHER LEVEL Q REQUIREMENT***
 - ✓ ***CRITICAL CHARACTERISTICS***
 - ✓ ***ZERO-BASED SAMPLING PLAN***
 - ✓ ***CANNOT DISPOSE OF MINOR NONCONFORMANCES***
 - ✓ ***DEFINED AND UNDEFINED CRITICAL CHARACTERISTICS***
 - ✓ ***SAFETY-OF-FLIGHT: GENERALLY 100% SURVEILLANCE***