



MORSE DIESEL INTERNATIONAL V. UNITED STATES **IMPLICATIONS & LESSONS**

**PRESENTED TO THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA
DURING ITS ANNUAL MEETINGS ON SURETY BONDING AND CONSTRUCTION RISK MANAGEMENT
IN LONGBOAT KEY, FLORIDA, ON FEBRUARY 6-8, 2008¹**

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Overview

The purpose of this paper is to address concerns posed by AGC members that arise out of, or relate to, the 2005 and 2007 United States Court of Federal Claims decisions in *Morse Diesel*.² Broadly speaking, the 2005 decision determined that a surety bond broker's sharing of commission payments with Morse Diesel were illegal kickbacks. The first 2007 decision determined that the contractor submitted false claims when it sought reimbursement for the bond premium under the Progress Payment for Fixed-Price Construction Contracts clause of the Federal Acquisition Regulation ("FAR")³ because the bond premium invoices were unpaid at the time they were presented for reimbursement and were inflated to the extent they included the amount of the broker's rebates. Based upon those determinations, Morse Diesel's apparently unrelated affirmative claims and equitable adjustment requests in excess of \$53 million were forfeited under the Forfeiture of Claims Act.⁴ A second 2007 decision awarded the United States damages and imposed penalties for the violations of those statutes found in the earlier decisions.⁵ This paper (1) gives a brief introduction, (2) provides an analytical framework for

¹ This paper is intended to provide general information on the topics addressed. It is not intended to provide specific legal advice. In assessing specific factual situations and contracts, advice and counsel should be sought from experienced professionals. Thomas J. Kelleher and Mark B. Carter assisted with preparation of this paper.

² *Morse Diesel Int'l, Inc. v. United States*, 66 Fed. Cl. 788 (2005); *Morse Diesel Int'l, Inc. v. United States*, 74 Fed. Cl. 601 (2007); *Morse Diesel Int'l, Inc. v. United States*, 79 Fed. Cl. 116 (2007).

³ 48 C.F.R. § 52.232-5(g). All subsequent references to the FAR are from 48 C.F.R.

⁴ 28 U.S.C. § 2514.

⁵ The descriptions of the *Morse Diesel* holdings are summary. A detailed discussion and/or analysis of the *Morse Diesel* opinions are beyond the scope of this paper.

addressing questions arising out of, or relating to, *Morse Diesel*, and (3) answers the questions presented by AGC members.

- **KEY STATUTES & REGULATIONS**

Any analysis of the questions posed by AGC members is more meaningful if a basic framework is initially provided. The framework involves consideration of selected key statutes and regulations and the application of these laws and regulations by the courts. Attached to this page as Exhibit A is a table listing many of the federal statutes seeking to address fraud and false claims. Key statutes for the analysis of the questions include the Anti-Kickback Act, 41 U.S.C. § 51-58, the criminal and civil False Claims Acts, 18 U.S.C. § 287; 31 U.S.C. §§ 3729-3733, and the Forfeiture of Claims Act, 28 U.S.C. § 2514.

In addition to these three statutes, federal government construction contractors and their advisors need to appreciate the increasing significance of the Truth in Negotiations Act (TINA), 10 U.S.C. § 2306a; 41 U.S.C. § 254 and the Cost Principles found at Part 31 of the FAR. While the Cost Principles have traditionally applied to the pricing of equitable adjustments (*see* FAR § 31.103(b)(6)) and other cost-type contract actions, the increasing use of negotiated construction contracts where the price is not based on adequate price competition (*see* FAR § 15.403-1(b)(1)) make the application of the Cost Principles and TINA an important consideration and risk for contractors even if the eventual contract is firm fixed-price. A key overriding issue is whether the price is based on adequate price competition. A sole source task order award under a MATOC (multiple award task order contract) is an example of where the Cost Principles and TINA would apply to the overall pricing of the contract. Whenever the concept of “cost” is a key factor in determining the contract price or seeking payment from the federal government, contractors need to appreciate that the analysis is not controlled by the fact that the contract is firm fixed-price.

- **FALLOUT FROM PROHIBITED CONDUCT**

In the *Morse Diesel* decision, one of the consequences of the Court of Federal Claims’ (“COFC”) findings of wrongdoing was the forfeiture of over \$53 million in claims or requests for equitable adjustments that were apparently unrelated to the specific findings of wrongdoing. The authority for this very severe sanction is found in the Forfeiture of Claims Act that provides as follows:

28 U.S.C. § 2514 Forfeiture of Fraudulent Claims

A claim against the United States shall be forfeited to the United States by any person who corruptly practices or attempts to practice any fraud against the United States in the proof, statement, establishment, or allowance thereof.

In such cases the United States Court of Federal Claims shall specifically find such fraud or attempt and render judgment of forfeiture.

Morse Diesel illustrates the application of this statute to an unrelated claim or request for an equitable adjustment. However, the *Morse Diesel* decision is not an isolated application of

this statute. Following the first two COFC decisions in *Morse Diesel*, the United States Court of Appeals for the Federal Circuit reversed a COFC decision awarding in excess of \$435 million to a bank on its breach of contract claim against the United States. In an **en banc** decision, the Federal Circuit reversed the COFC on the grounds that a false certification by a bank officer related to the initial agreement with the United States tainted the entire agreement and rendered it void *ab initio* (void from the outset).⁶ As the decisions of the Federal Circuit are binding precedent on the COFC, the *Long Island Savings Bank* decision provides a clear insight to current judicial attitude regarding sanctions for fraud and false claims.

In *Long Island Savings Bank*, the bank's CEO, James Conway, was also a partner in a law firm that handled the bank's mortgage closings. Even though Mr. Conway no longer practiced law, he maintained 60% ownership of the law firm. While Mr. Conway was CEO of the bank, he was paid compensation by the law firm that was in part received from work done for the bank. Later, in order to be in compliance with a thrift regulation restricting ownership in the law firm to less than 10%, Mr. Conway transferred 51% of his interest in the law firm to his daughter and daughter-in-law, while maintaining 9% ownership interest for himself. The problems began when the bank applied for conversion from a state-chartered mutual savings bank, to a Federal mutual savings bank charter. As part of that process, the bank had to disclose certain information to be in conformance with federal and insurance regulations. Neither Mr. Conway, as the bank's CEO, nor the bank ever disclosed the financial relationship whereby Conway received compensation from the law firm for services relating to the bank's work. Federal law prohibited such a relationship. Mr. Conway, as the bank's CEO, made false certifications on the representation and warranty provisions of a contract. Knowledge of the falsity of the certification was imputed to the Bank. Not only were the representations false, Mr. Conway admitted to committing a crime by corruptly receiving over \$3.0 million in compensation from the law firm while serving as a bank officer. As a consequence, the Bank forfeited an otherwise meritorious claim in an amount exceeding \$ 435 million.

- **REPRESENTATIONS & CERTIFICATIONS**

In contracts with the United States, it would be almost impossible to overstate the importance of contractor representations and certifications. In *Long Island Savings Bank*, Mr. Conway, as an officer of the Bank, by signing a certificate, failed to disclose the financial relationship between the Bank and his law firm, even though he clearly had actual knowledge of the relationship. In *Morse Diesel*, the contractor provided certifications in conjunction with its progress payment requests as required by the Payments under Fixed-Price Construction Contracts provision (FAR § 52-232-5). The COFC ruled that the effort to obtain reimbursement for overstated and unpaid bond premiums violated those certifications. In both cases, the miscertifications and related conduct led to criminal convictions and subsequent civil sanctions and forfeitures.

⁶ Similarly, a contract tainted by a conflict of interest has been held by the U. S. Supreme Court to be void *ab initio*, *United States v. Mississippi Valley Generating Co.*, 364 U.S. 520 (1961) as has a contract tainted by kickbacks. See *United States v. Acme Process Equipment Co.*, 385 U.S. 138 (1966).

In addition to the certifications noted in these cases, contractors and their advisors need to consider the significance of the requirements of the TINA.⁷ Under the TINA, a government contractor or subcontractor is required to submit “cost or pricing data” if any negotiated contract, subcontract, or modification is expected to exceed \$650,000. Once the contract pricing action is subject to a cost analysis, a contractor must also consider the provisions of FAR Part 31, Cost Principles.⁸

The FAR defines “cost or pricing data” as all facts that prudent buyers and sellers would reasonably expect to affect price negotiations significantly.⁹ The submission of such data allows the contracting officer to ascertain the reasonableness of the offered prices. In addition, the contractor and subcontractor must certify that the data are accurate, current, and complete.¹⁰ Pursuant to the TINA, the contracting officer may seek a reduction of the contract price if the contracting officer learns that the contractor submitted data which were not accurate, current, and complete.¹¹

The seriousness with which certification requirements are viewed is not new. No doubt, *Morse Diesel* and *Long Island Savings Bank* are troubling decisions, with potentially far-reaching implications in the current atmosphere of Department of Justice (“DoJ”) anti-fraud task forces and *qui tam* actions. However, under FAR § 15.403-1(b)(1), a contractor’s TINA certification can also have significant financial implications to any contract covered by that statute and the related FAR provisions. If the contract or contract modification (equitable adjustment) is subject to the TINA threshold, the contractor must provide the following certification.

CERTIFICATE OF CURRENT COST OR PRICING DATA

This is to certify that, to the best of my knowledge and belief, the cost or pricing data (as defined in section [2.101](#) of the Federal Acquisition Regulation (FAR) and required under FAR subsection [15.403-4](#)) submitted, either actually or by specific identification in writing, to the Contracting Officer or to the Contracting Officer's representative in support of [INSERT PROPOSAL DESCRIPTION] are accurate, complete, and current as of [INSERT DATE]. This certification includes the cost or pricing data supporting any advance agreements and forward pricing rate agreements between the offeror and the Government that are part of the proposal.

In that context, FAR § 15.406-1 provides the following guidance to the contractor and the contracting officer regarding the purpose and effect of the TINA certification:

⁷ 10 U.S.C. § 2306(a), 41 U.S.C. § 254(b).

⁸ FAR § 31.103(a).

⁹ FAR § 15.401.

¹⁰ *Id.*; FAR § 15.406-2.

¹¹ TINA does exempt from its coverage a contract of any dollar amount where (1) the price agreed upon is based on adequate price competition, (2) the price is set by law or regulation, (3) the agency is acquiring a “commercial item” as defined by FAR 2.101, or (4) the agency grants a waiver. FAR 15.403-1(b). The FAR also provides guidance for determining when these exceptions apply. *See* FAR 15.403-1(c).

(b) The certificate does not constitute a representation as to the accuracy of the contractor's judgment on the estimate of future costs or projections. It applies to the data upon which the judgment or estimate was based. This distinction between fact and judgment should be clearly understood. If the contractor had information reasonably available at the time of agreement showing that the negotiated price was not based on accurate, complete, and current data, **the contractor's responsibility is not limited by any lack of personal knowledge of the information on the part of its negotiators.** (Emphasis added)

Nearly 40 years ago, the Armed Services Board of Contract Appeals ("ASBCA") addressed TINA certification issues in *Aerojet-General Corp.*¹² *Aerojet* involved a contract for the production of the Minuteman ICBM. At the time of the contract price negotiations, Aerojet failed to disclose to the government one potential subcontractor's quote for the production of one of the components. The subcontractor's initial quote was lower, but nonresponsive, due to delivery limitations. At the time of the closure of the price negotiation with the government, the subcontractor had not removed the qualification that made its bid nonresponsive and Aerojet deemed the information irrelevant. Later, the delivery limitation qualification was removed from consideration and Aerojet used that subcontractor for a limited production of the component. Ultimately, after a review of the contract by the then General Accounting Office, the government sought a price reduction on the basis that Aerojet's TINA certification was defective because it failed to disclose the existence of factual data (the subcontractor's initial non-responsive quotation). The ASBCA looked to Aerojet's certification that the pricing data was complete and found that Aerojet failed to disclose the subcontractor's price quotation, even though it was nonresponsive. The ASBCA, relying on government testimony, found that even though the quote was nonresponsive, disclosure of the quote would have affected price negotiations. Therefore, Aerojet should have included the price quote in the data provided to the government.

One thing has changed is the current atmosphere surrounding government waste, whether real or perceived. In *Aerojet*, the result was a price reduction in favor of the government. In the 21st Century a TINA miscertification may provide grounds for DoJ allegations of violations of one or more of the statutes listed on Exhibit A. Even if DoJ is not involved in either a civil or criminal action for a violation of one or more of these statutes, the contractor's certification under TINA presents the occasion for a significant financial exposure to the government. With the growing use of negotiated contracts with prices that are not based on "adequate price competition" as well as typical contract equitable adjustment modifications, TINA disclosures and certifications and the application of the Cost Principles present a major exposure even under fixed-price contracts.

While the certification requirements certainly are not new, the consequences for failure to adhere to federal law and any perceived impropriety on the part of contractors will be vigorously pursued by the DoJ. Both *Morse Diesel* and *Long Island Savings Bank* highlight just how conscientious, diligent, and conservative contractors must be when certifying as to costs.

¹² *Aerojet-General Corp.*, ASBCA No. 12873, 69-1 BCA ¶ 7585.

FRAMEWORK FOR ANALYZING THE QUESTIONS

There are three fundamental inquiries that apply when answering all of the questions presented to us, as well as any other question arising out of, or relating to, the *Morse Diesel* decisions. This section provides an analysis of those inquiries.

Inquiry #1: IS IT AN ALLOWABLE COST?

Whenever the price negotiation is based upon an analysis of cost¹³ or the contractor seeks to be reimbursed for its “cost”, the Cost Principles in FAR Part 31 must be considered and followed. If the Cost Principles apply, the contractor should not seek reimbursement for anything that is not a true cost or for any cost that is not allowable. We cannot overstate the importance of this first question. Under the FAR’s Cost Principles, the total cost of a project is the sum of the allocable costs plus the allowable costs, less allocable credits.¹⁴ Allowable costs to the government are limited to costs allocable to the contract in accordance with FAR Part 31.¹⁵ In order to determine whether a cost is allowable, the cost must meet requirements of reasonableness, allocability, standards of accounting, terms of the contract, and any limitations contained in the FAR. FAR Part 31 provides general guidelines for determining the reasonableness and the allocability of some fifty specific types of contract costs. Whether a cost is allowable also determines when the contractor owes the government a credit for any credit or rebate the contractor receives.¹⁶

Inquiry #2: DID THE CONTRACTOR DISCLOSE THE COST ACCURATELY?

The contractor should always disclose everything to the government accurately. Under one recurring scenario, a false claim assertion may be based on certifications that a contractor must submit with requests for progress payments.¹⁷ That certification includes the following required language:

I hereby certify, to the best of my knowledge and belief, that—

(1) The amounts requested are only for performance in accordance with the specifications, terms, and conditions of the contract;

Therefore, everything in the payment application must be true and accurate. In *Morse Diesel*, as one example, Morse Diesel represented that it had already paid the surety the bond premium when requesting reimbursement, when Morse Diesel actually had not yet paid the premium. Certifying that the payment had been made, when it had not, constituted a false claim. In *Aerojet*, the contractor did not disclose a nonresponsive bid from a subcontractor on which

¹³ The FAR Cost Principles apply to any contract price that is not determined by adequate price competition (typically competitive “bids”) and to any equitable adjustment regardless of the dollar amount. FAR § 31.105 provides guidance on the application of FAR Part 31 to construction contracts. Much of that section addresses the treatment of equipment costs, job site office expenses, and rental costs.

¹⁴ FAR § 31.201-1(a).

¹⁵ FAR § 31.201-1(b).

¹⁶ FAR § 31.201-5.

¹⁷ FAR § 52.232-5(c).

Aerojet subsequently relied for its costs or price. This meant that the TINA certification was not accurate and complete, hence liability under TINA attached. If a contractor does not disclose costs accurately and completely, the contractor simply makes the DOJ's job of proving a false claim very easy.

Inquiry #3: DID THE CONTRACTOR DISCLOSE ITS COST DOCUMENTATION?

The contractor should always disclose and document the reasonableness of a cost. The court in *Morse Diesel* highlighted the fact that the government had no knowledge whatsoever of the commission-sharing agreement. The court did not address whether the commission-sharing agreement would be acceptable if the government knew about it and consented. Recall the reasonableness requirement for an allowable cost.¹⁸ If a cost does not exceed that which would be incurred by a prudent person in a competitive business environment, the cost is reasonable.

Assuming that the rebate or commission sharing would not violate the Anti-Kickback Act, *which may not be a good assumption*, if *Morse Diesel* had documented and disclosed the fact that the commission-sharing was (1) taken into account when bidding the project, and/or (2) resulted in a volume discount that saved the government money, the government could have had an opportunity to agree up front that the "cost" was allowable or that it could be evaluated as additional profit for additional risk. For other thoughts, see question and answer No. 7, below.

QUESTIONS AND ANSWERS

1. Does the Morse Diesel decision or do other related statutes forbid a contractor to accept a refund of some portion of the commissions in the contractor's bond or insurance premiums?

Yes. The FAR expressly addresses the allowability of bonding costs,¹⁹ and insurance and indemnification costs.²⁰ Generally speaking, bond and insurance premiums are allowable and will be paid by the government. Therefore, if the contractor receives a refund, that amount must be credited to the government.²¹ Keep in mind the distinction between the uncertainty of the refund and its contingency on circumstances that are not and cannot be anticipated versus the known and agreed "rebate" arrangement in *Morse Diesel*. If the contractor is aware of a known "rebate" ahead of pricing, the contractor should take the "rebate" into consideration during price formulation. In all instances, the contractor should document how the contractor used pricing factors to arrive at a price and indicate whether the factor was factual or judgmental. In a sealed bid firm-fixed price situation (bid price and original contract price), for competitive purposes if nothing else, pricing should take into consideration historical factors and/or amounts related to refunds of insurance commissions. Refunds would not necessarily be reported and returned to the government if uncertain and contingent on future circumstances. Bond premiums are a different matter because the FAR treats these as a cost item, to be reimbursed only to the extent of actual costs. Therefore, only the actual premium paid may be billed and collected. If a refund

¹⁸ FAR § 31.201-3(a).

¹⁹ FAR § 31.205-4. (See **Exhibit B** for the text of this cost principle.)

²⁰ FAR § 31.205-19. (See **Exhibit C** for the text of this lengthy cost principle.)

²¹ FAR § 31.201-5. (See **Exhibit D** for the text of this cost principle.)

is known, the contractor should not include it in the billing. If an unknown refund is later realized in the context of a prior reimbursement of costs, the contractor should disclose it to the government (and likely credit it back to the government).

That brings us to other cost-type pricing, such as with a change order. In that situation, the proposal price should be based on actual costs to the extent known. The contractor should disclose to the government any pricing breakdown that reveals or takes into consideration any known refunds. Again, the conservative approach would also be to subsequently disclose later refunds that had not been factored into the price. The less conservative approach, after the change order price is agreed, is to treat the price as fixed. This is similar to certification of cost and pricing data in situations where the TINA applies. When the final price handshake is made, the contractor takes a “snapshot” of the price and certifies that the underlying data are current, accurate, and complete. If the government later determines that the underlying, factual cost and pricing data were not current, accurate, and complete, the government can claim a price reduction. In the current legal climate, data that is not current, accurate and complete may also give rise to allegations of false claims.

2. *If the contractor has an interest (majority or minority) in a licensed insurance agency, may the contractor accept and retain the commission embedded in the contractor’s bond or insurance premiums?*

The affiliated firms must keep segregated books. The insurance agency/provider should charge rates to the parent company/owner/member companies that would be charged to most-favored customers on the open market. Bond premiums are a different matter as explained above. The contractor should document and disclose business affiliations and historical costs to the government. The treatment of insurance costs, self-insurance and captive insurance companies is addressed in FAR Subpart 28.3 and in the cost principle on insurance costs.²²

3. *In some states it is common for sureties to pay a dividend to a contractor with a high credit rating. Should the contractor pass this credit to the government?*

The contractor should factor into the bond price any historical or known “dividend” up front. With bond premiums being expressly defined as a cost-type item, expect to bill and collect only actual costs, including disclosure and repayment of later dividends or discounts received. The contractor should document and disclose this to the government.

4. *If a local contractor joint ventures with a strong national contractor to take advantage of the latter’s surety program, can the joint venture include an additional fee (a “surety credit enhancement fee”) in the bond premiums the joint venture seeks to recover from the government?*

Not as a *cost*. This charge is a fee charged by the JV partner for indemnifying the surety. This should be considered as added profit to the national JV partner for taking on the additional risk. While there is nothing wrong with taking additional profit in exchange for additional risk, it is not an allowable cost because it is profit and not part of the premium (cost) for the bond.

²² FAR § 31.205-19. See **Exhibit C**.

5. *If a contractor’s workers compensation, CGL, or other liability rates drop during the course of a project (for any reason), must the contractor pass the financial benefit of that change to the government?*

Workers Compensation and other insurance rates can go up or down. Therefore, there is uncertainty in the pricing. That uncertainty distinguishes this situation from the known rebate indicated in *Morse Diesel*. Refer to the answer to question number 1, above for further discussion.

6. *For loss sensitive programs with a stop loss feature that limits the contractor’s risk, may a contractor use its worst case scenario to prepare its bid or to justify a cost for an equitable adjustment?*

Our response assumes that what is being described by the question is a program that involves a deductible above which stop loss features absorb further loss. In that context, there are two answers, depending on whether the program provides a known refund or rebate.

If the program involves unknown, future, contingent refunds or rebates, then the sealed bid price resulting in a fixed-price contract would involve classic bidding business decisions and considerations. How much can the bid be and remain competitive? How much contingency can the bid (and market) bear? If a cost proposal, the contingency to be included to cover any loss up to the stop loss amount would be presented in that manner: a contingent, judgmental estimate of the cost, to be negotiated. The treatment of contingencies in contract pricing actions is specifically addressed in the cost principles.²³ See question and answer No. 7, below.

If the program involves known rebates or refunds, see the answer to question No. 1, above. Bond premiums are different for the reasons explained above. Justification for an equitable adjustment differs for the reasons explained above in connection with pricing change orders. In any situation where the uncertainty of obtaining a refund is removed before pricing, that is, the refund is known, then the conservative approach is to reflect the actual cost, taking the known refund into consideration. The contractor should document and disclose these matters to the government. In connection with actual costs that are unknown until some future date, such as G&A rates or insurance rates, uncertainty is in the contractor’s favor so long as the cost and pricing data used at the outset (the “snapshot” at the time of agreement) reflected current, accurate, and complete data (which may include judgmental estimates and/or historical cost and pricing data). Bond premiums or other cost-reimbursable items are different for the reasons explained above. In a cost-type contract action, if actual costs become known before the contract is financially closed,²⁴ the conservative approach would be to document and disclose any cost reduction (expecting to be asked to make a refund to the government). The treatment of “credits” or “rebates” is specifically addressed in the FAR Cost Principles.²⁵ If this seems one-sided, with the government obtaining all the advantages and the contractor suffering all the disadvantages,

²³ See FAR § 31.205-7. See **Exhibit E**.

²⁴ By “financially closed,” we mean that the construction work has been physically completed and accepted, final releases without reservation have been executed, and final payment has been disbursed and received without exception.

²⁵ See FAR § 31.201-5. See **Exhibit D**.

you are correct. We perceive that the government views these matters as the risk (or rewards, that is, potential profits) of doing business. The government is not in business for a profit and has a duty to protect the public fisc or purse.

7. *May a contractor add a percentage over and above the actual insurance premiums to take into account in-house costs of risk management and safety programs, as well as claims management and legal services?*

In documenting cost and pricing data, call the price and cost factors by what they actually are – not “insurance premiums,” but “costs of managing risk,” priced by a historical factor that calculates an estimate based on a percentage of insurance premiums paid or by whatever method of pricing is actually used. This makes clear the nature of the estimate for covering “costs of managing risk.” The contractor should document and disclose this to the government.

8. *If a contractor pays insurance premiums to a single parent or group captive insurance company, can the contractor retain investment income or underwriting profits the captive insurance company earns on the premiums?*

See answer to question number 2.

KEY POINTS TO REMEMBER

EACH AND EVERY TIME “COSTS” AND “CERTIFICATIONS” COLLIDE DURING THE LIFE OF A PROJECT, YOU MUST:

- A. Document the allowability and allocability of all costs and pricing data.**
- B. Distinguish costs from profit.**
- C. Distinguish known factual costs and pricing data from judgmental estimated pricing data.**
- D. Disclose all data.**
- E. Bond prices are different.**
- F. Distinguish sealed bid fixed-price situations from cost-based matters.**
- G. Read, understand, and diligently check the underlying facts and judgments before signing certifications.**

EXHIBIT A
FEDERAL ANTI-FRAUD/FALSE CLAIMS LAWS

Criminal Statutes

| TITLE | STATUTORY REFERENCE | SUBJECT MATTER/NOTES |
|--|-------------------------------------|---|
| Anti-Kickback Act | 41 U.S.C. §§ 51-58 | Prohibits payments by subcontractors at any tier to prime contractors or subcontractors to obtain a Government contract |
| Conspiracy to Defraud | 18 U.S.C. § 286; 18 U.S.C. § 371 | Addresses claims and general conspiracy to defraud the government |
| False Claims Act, Criminal Liabilities | 18 U.S.C. § 287 | False claim need not have been paid by government to provide basis of liability |
| Theft from Federal Programs | 18 U.S.C. § 666 | Applies to theft from state and local public agencies receiving federal funds by “agents” of those agencies |
| False Statements Act | 18 U.S.C. § 1001 | Includes statements, false entries, oral and unsworn statements |
| Mail and Wire Fraud | 18 U.S.C. §§ 1341–1350 | Applies to use of mails and telecommunications to execute a scheme to defraud the United States |
| Major Fraud Act | 18 U.S.C. § 1031 | Applies to procurement fraud on a government contract or subcontracts thereunder valued at \$1 million or more |
| Obstruction of Federal Audit | 18 U.S.C. § 1516 | Applies to any person employed on full-, part-time, or contractual basis to conduct an audit or a <i>quality assurance inspection</i> for or on behalf of the United States |

| | | |
|----------------------------|------------------|---|
| Sarbanes-Oxley Act of 2002 | 18 U.S.C. § 1519 | Applies to anyone who knowingly alters a document with intent to influence proper administration of any matter within jurisdiction of department or agency of the United States; violators subject to fines or imprisonment up to 20 years, or both |
|----------------------------|------------------|---|

Civil Statutes

| TITLE | STATUTORY REFERENCE | SUBJECT MATTER/NOTES |
|-------------------------------|---------------------------------------|---|
| Anti-Kickback Act | 41 U.S.C. § 51-58 | Prohibits kickback by subcontractors and suppliers |
| Contract Disputes Act of 1978 | 41 U.S.C. § 604 | False or unsupported claims submitted to contracting officer; necessity for certification |
| False Claims Act | 31 U.S.C. §§ 3729–3733 | Applies to any request related to the payment of money by the United States, directly or indirectly |
| Forfeiture of Claims Act | 28 U.S.C. § 2514 | Allows a special plea in United States Court of Federal Claims providing for forfeiture of entire claim if any part of it is tainted by fraud |
| Program Fraud Act | 31 U.S.C. §§ 3801–3812 | Administrative alternative to litigation in civil false statements and smaller false claims cases |
| Truth in Negotiations | 10 U.S.C. § 2306a; 41 U.S.C. § 254 | Cost or pricing data on negotiated contracts or subcontracts; modifications of contracts in excess of \$650,000; necessity for certification |

Exhibit B

FAR Part 31 – Cost Principles

31.205-4 Bonding Costs

(a) Bonding costs arise when the Government requires assurance against financial loss to itself or others by reason of the act or default of the contractor. They arise also in instances where the contractor requires similar assurance. Included are such bonds as bid, performance, payment, advance payment, infringement, and fidelity bonds.

(b) Costs of bonding required pursuant to the terms of the contract are allowable.

(c) Costs of bonding required by the contractor in the general conduct of its business are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

Exhibit C

FAR Part 31 – Cost Principles

31.205-19 Insurance and indemnification

(a) Insurance by purchase or by self-insuring includes—

(1) Coverage the contractor is required to carry or to have approved, under the terms of the contract; and

(2) Any other coverage the contractor maintains in connection with the general conduct of its business.

(b) For purposes of applying the provisions of this subsection, the Government considers insurance provided by captive insurers (insurers owned by or under control of the contractor) as self-insurance, and charges for it shall comply with the provisions applicable to self-insurance costs in this subsection. However, if the captive insurer also sells insurance to the general public in substantial quantities and it can be demonstrated that the charge to the contractor is based on competitive market forces, the Government will consider the insurance as purchased insurance.

(c) Whether or not the contract is subject to CAS, self-insurance charges are allowable subject to paragraph (e) of this subsection and the following limitations:

(1) The contractor shall measure, assign, and allocate costs in accordance with 48 CFR 9904.416, Accounting for Insurance Costs.

(2) The contractor shall comply with (48 CFR) [Part 28](#). However, approval of a contractor's insurance program in accordance with [Part 28](#) does not constitute a determination as to the allowability of the program's cost.

(3) If purchased insurance is available, any self-insurance charge plus insurance administration expenses in excess of the cost of comparable purchased insurance plus associated insurance administration expenses is unallowable.

(4) Self-insurance charges for risks of catastrophic losses are unallowable (see [28.308\(e\)](#)).

(d) Purchased insurance costs are allowable, subject to paragraph (e) of this subsection and the following limitations:

(1) For contracts subject to full CAS coverage, the contractor shall measure, assign, and allocate costs in accordance with 48 CFR 9904.416.

(2) For all contracts, premiums for insurance purchased from fronting insurance companies (insurance companies not related to the contractor but who reinsure with a captive insurer of the contractor) are unallowable to the extent they exceed the sum of—

(i) The amount that would have been allowed had the contractor insured directly with the captive insurer; and

(ii) Reasonable fronting company charges for services rendered.

(3) Actual losses are unallowable unless expressly provided for in the contract, except—

(i) Losses incurred under the nominal deductible provisions of purchased insurance, in keeping with sound business practice, are allowable; and

(ii) Minor losses, such as spoilage, breakage, and disappearance of small hand tools that occur in the ordinary course of business and that are not covered by insurance, are allowable.

(e) Self-insurance and purchased insurance costs are subject to the cost limitations in the following paragraphs:

(1) Costs of insurance required or approved pursuant to the contract are allowable.

(2) Costs of insurance maintained by the contractor in connection with the general conduct of its business are allowable subject to the following limitations:

(i) Types and extent of coverage shall follow sound business practice, and the rates and premiums shall be reasonable.

(ii) Costs allowed for business interruption or other similar insurance shall be limited to exclude coverage of profit.

(iii) The cost of property insurance premiums for insurance coverage in excess of the acquisition cost of the insured assets is allowable only when the contractor has a formal written policy assuring that in the event the insured property is involuntarily converted, the new asset shall be valued at the book value of the replaced asset plus or minus adjustments for differences between insurance proceeds and actual replacement cost. If the contractor does not have such a formal written policy, the cost of premiums for insurance coverage in excess of the acquisition cost of the insured asset is unallowable.

(iv) Costs of insurance for the risk of loss, damage, destruction, or theft of Government property are allowable to the extent that—

(A) The contractor is liable for such loss, damage, destruction, or theft;

(B) The contracting officer has not revoked the Government's assumption of risk (see [45.104\(b\)](#)); and

(C) Such insurance does not cover loss, damage, destruction, or theft which results from willful misconduct or lack of good faith on the part of any of the contractor's managerial personnel (as described in FAR [52.245-1\(h\)\(1\)\(ii\)](#)).

(v) Costs of insurance on the lives of officers, partners, proprietors, or employees are allowable only to the extent that the insurance represents additional compensation (see [31.205-6](#)).

(3) The cost of insurance to protect the contractor against the costs of correcting its own defects in materials and workmanship is unallowable. However, insurance costs to cover fortuitous or casualty losses resulting from defects in materials or workmanship are allowable as a normal business expense.

(4) Premiums for retroactive or backdated insurance written to cover losses that have occurred and are known are unallowable.

(5) The Government is obligated to indemnify the contractor only to the extent authorized by law, as expressly provided for in the contract, except as provided in paragraph (d)(3) of this subsection.

(6) Late premium payment charges related to employee deferred compensation plan insurance incurred pursuant to Section 4007 ([29 U.S.C. 1307](#)) or Section 4023 ([29 U.S.C. 1323](#)) of the Employee Retirement Income Security Act of 1974 are unallowable.

Exhibit D

FAR Part 31 – Cost Principles

31.201-5 Credits

The applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund. See [31.205-6\(j\)\(3\)](#) for rules governing refund or credit to the Government associated with pension adjustments and asset reversions.

Exhibit E

FAR Part 31 – Cost Principles

31.205-7 Contingencies

(a) “Contingency,” as used in this subpart, means a possible future event or condition arising from presently known or unknown causes, the outcome of which is indeterminable at the present time.

(b) Costs for contingencies are generally unallowable for historical costing purposes because such costing deals with costs incurred and recorded on the contractor’s books. However, in some cases, as for example, terminations, a contingency factor may be recognized when it is applicable to a past period to give recognition to minor unsettled factors in the interest of expediting settlement.

(c) In connection with estimates of future costs, contingencies fall into two categories:

(1) Those that may arise from presently known and existing conditions, the effects of which are foreseeable within reasonable limits of accuracy; *e.g.*, anticipated costs of rejects and defective work. Contingencies of this category are to be included in the estimates of future costs so as to provide the best estimate of performance cost.

(2) Those that may arise from presently known or unknown conditions, the effect of which cannot be measured so precisely as to provide equitable results to the contractor and to the Government; *e.g.*, results of pending litigation. Contingencies of this category are to be excluded from cost estimates under the several items of cost, but should be disclosed separately (including the basis upon which the contingency is computed) to facilitate the negotiation of appropriate contractual coverage. (See, for example, [31.205-6\(g\)](#) and [31.205-19](#).)