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Ninth Circuit Holds That False Estimates in Federal Bids Are Actionable Under the False Claims Act

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In a groundbreaking opinion, the United States Court of Appeals for the Ninth Circuit recently ruled that a bidder's submission of a fraudulently low false estimate in a bid for a cost reimbursement contract may give rise to False Claims Act ("FCA") liability. The opinion only denied the defendant's summary judgment motion, so the plaintiff will still have to prove its case at trial. Nonetheless, the court's extension of "fraud-in-the-inducement" liability to this situation cautions bidders for cost-type contracts to review their estimating processes and methodologies to ensure that the assumptions underlying their bids are supportably within the bounds of sound business and engineering judgment.

In *Hooper v. Lockheed Martin Corp.*, No. 11-55278, 2012 U.S. App. LEXIS 16003 (Aug. 2, 2012), the whistleblower and former Lockheed employee alleged that the company's management instructed employees to lower their initial cost estimates in a bid for a space launch operations support contract, even though there was no engineering basis for doing so. Hooper further alleged that Lockheed knowingly underestimated its costs to improve its chances of winning the contract and actually intended to charge more than its bid indicated.

Lockheed defended by arguing that estimates of future costs necessarily are opinions or predictions and that, because estimated costs are based on "inherently judgmental information," the estimates are not actionable as false statements within the meaning of the FCA. Lockheed offered as evidence an Air Force memorandum that questioned Lockheed's "optimistic" inputs regarding potential cost savings, and that found Lockheed's risk analysis to be "unrealistic" for understating the severity of certain risks. Due to these findings, the Air Force recognized the risk of "cost growth beyond target cost," but it nevertheless concluded that Lockheed's proposal provided the "best overall value."

The United States did not intervene in the action, but filed an amicus brief urging the appeals court to hold that false estimates and fraudulently low bids may be actionable under the FCA.

Acknowledging that the case presented a matter of first impression, the Ninth Circuit analogized the allegations against Lockheed to other circumstances under which knowingly false cost estimates and opinions that have long been recognized as false claims. Thus, for example, the court observed that other Circuits have held that practices such as collusive bidding and other forms of bid-rigging have given rise to false claims liability. The Ninth Circuit also relied heavily on *Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776

(4th Cir. 1999), which held actionable under the FCA a contractor's outcome-oriented "make or buy" analysis that knowingly underestimated the complexity of a project in order to induce the government to award the work to its subcontractor. *Hooper* favorably cited the Fourth Circuit's reasoning that "an opinion or estimate carries with it an implied assertion, not only that the speaker knows no facts which would preclude such an opinion, but that he does know facts which justify it."

The Ninth Circuit determined that Hooper had submitted sufficient evidence of Lockheed's fraudulent underbidding to survive summary judgment. Specifically, Hooper had presented testimony that Lockheed employees were instructed "to lower their bids without regard to actual costs." Further, in this summary judgment context, the court credited testimony that in other instances employees were excused from bid preparation meetings when they refused management's directions to lower cost estimates and that Lockheed "was dishonest in the productivity rates that it used to determine the cost for a contract." Because in the court's view Lockheed did not present compelling evidence at this preliminary stage to justify its lowering of cost estimates to the levels contained in the company's winning bid, the Ninth Circuit concluded that a trial must be held on the issue of whether Lockheed "had actual knowledge, deliberately ignored the truth, or acted in reckless disregard of the truth when it submitted its allegedly false bid."

Other cases have touched upon the issue, but *Hooper* is the first to establish liability under the False Claims Act for offers that consciously understate proposed costs in the expectation that the contractor will recoup overruns that occur. In *Mayman v. Martin Marietta Corp.*, 894 F. Supp. 218 (D. Md. 1995), a motion to dismiss was denied where the FCA allegation was that the contractor knowingly underbid a contract to design and build a prototype missile while planning to bill the shortfall to an unrelated, general research and development contract. Although *Mayman* is not entirely clear on the point, it appears that the false claim was predicated on the false billing under the R&D contract and not on the intentional underbidding on the missile contract. And the D.C. Circuit in *Bettis v. Oderbrecht Contractors of California, Inc.*, 393 F.3d 1321 (D.C. Cir. 2005), in affirming summary judgment on the evidence presented in the case, refused to address the plaintiff's claim, supported, as in *Hooper*, by the government as amicus curiae, that a fraudulent low bid that helps secure the contract award in itself could be the basis for a false act claim.

Particularly troublesome here is the possibility that the court's ruling reflected a fundamental misunderstanding of the operation of cost-reimbursement contracts. The court cited the existence of an Independent Government Estimate (IGE), performed for the Air Force, presumably as part of the "cost realism" analysis required by FAR 15.404-1. The IGE recognized Lockheed was "optimistic" about some cost inputs and had "overstated" the potential for cost savings. Despite these known risks of cost growth, and though it was not the lowest bid, the Air Force concluded that the Lockheed bid was the "best overall value." Nowhere did the court consider that the government could not have been defrauded where it chose to select Lockheed knowing the cost growth risk. Nor was there any recognition that when the government uses a cost-plus-award fee contract, as here, it has control over the total funding of the contract, the amount and nature of services to procure, and the award fee.

The court explicitly relied upon *United States ex rel. Marcus v. Hess*, 317 U.S. 537 (1943), a decision that the court describes as finding contractors liable under the FCA for claims submitted as a consequence of "collusive bidding." *Hess* was sufficient for the Ninth Circuit to embrace the "fraud-in-the-inducement" theory, which it applied to Hooper's allegation. This is a strained if not strange extension of *Hess*. No "collusion" among actors produced the Lockheed cost estimate. Hooper's contentions do not involve payment claims submitted under contracts procured by fraudulent conspiracy. They involve prospective estimates of costs, potentially payable in the future, submitted by a single company, where the government accepted the estimates knowing of risks that the estimates were optimistic.

The *Hooper* decision is very troubling. To be sure, the government has an interest in preserving the integrity of the bidding process. But it is doubtful that the False Claims Act should apply in the circumstances here. The government regularly conducts competition encouraging companies to be aggressive to cut costs and to bid low to win. The government, as evident from the cost realism analysis requirement of the FAR, recognizes that companies may bid lower than is realistic. Where the government, as here, on an informed basis determines an estimate is "realistic" despite documented doubts and risks, it is bad policy and bad law to subject the estimating function to FCA exposure.

Nonetheless, companies should review their bidding practices in light of *Hooper*. One lesson is that a bidder should not rely on an agency's cost realism analysis to protect against false claims accusations. If there are internal disagreements about the composition or amount of costs, or performance risks, these should be resolved and the reasoning should be documented and supported by the proposal team. As indicated by *Hooper*, in the absence of a documentary record of the basis for the cost estimates submitted with a bid, the testimony of a single employee may be enough to expose a company to FCA liability (or at least sufficient to survive summary judgment). Further, *Hooper* suggests contractors should re-examine cost estimating functions and controls to ensure bids do not go out with risks that could give rise to FCA exposure.

Another way that *Hooper* may work against the government's interests is that it may force companies to submit higher cost estimates than management believes supportable and attainable. At trial, Lockheed may need to reconstruct the competing considerations that lay behind its estimating decisions, never an easy task years after the events. In addition, to answer the appearance of over-charging, as arises from the fact that Lockheed was paid twice as much under the contract than it originally estimated, Lockheed may have to show the many events, acts and decisions that explain and justify the cost-reimbursement vouchers it submitted over the course of performance. This too will be a painstaking exercise, but it may be necessary, as irrespective of the estimates in 1995, Lockheed may need to prove that costs actually incurred and invoiced over the years of later performance represented reasonable and allowable costs properly allocated and assigned to the launch operations contract.

It should be noted that these lessons should be heeded too by contractors who bid on state and local projects that do not involve federal funds. Many state false claims acts are designed on the federal model, and state courts often view decisions under the federal FCA

as authoritative. It likely will not be long before *Hooper's* reasoning is tested not only in other federal Circuits, but in state courts as well.

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