

CHAPTER 4

CONTRACT REMEDIES

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CHAPTER 4

CONTRACT REMEDIES

The United States does not stand on the same footing as an individual in a suit to annul a deed or lease obtained from him by fraud. . . . The financial element in the transaction is not the sole or principle thing involved. This suit was brought to vindicate the policy of the Government. . . . The petitioners stand as wrongdoers, and no equity arises in their favor to prevent granting the relief sought by the United States. Pan Am. Petroleum and Transp. v. United States, 273 U.S. 456, 509 (1927).

I. INTRODUCTION.

A. Government Policy.

1. Department of Defense (DOD) policy requires the coordinated use of criminal, civil, administrative, and contractual remedies in suspected cases involving procurement fraud. See U.S. DEPT OF DEFENSE, DIR. 7050.5, COORDINATION OF REMEDIES FOR FRAUD AND CORRUPTION RELATED TO PROCUREMENT ACTIVITIES (7 June 1989); U.S. DEP'T OF ARMY, REG. 27-40, LITIGATION, 19 Sept. 1994; U.S. DEP'T OF AIR FORCE, DIR. 51-11, COORDINATION OF REMEDIES FOR FRAUD AND CORRUPTION RELATED TO AIR FORCE PROCUREMENT MATTERS, 21 Oct. 1994; U.S. DEP'T OF NAVY, INST. 5430.92A, OP-008, ASSIGNMENT OF RESPONSIBILITIES TO COUNTERACT FRAUD, WASTE, AND RELATED IMPROPRIETIES WITHIN THE DEPARTMENT OF THE NAVY, (20 Aug. 1987); .
2. Department of Justice (DOJ) policy requires the coordination of parallel criminal, civil, and administrative proceedings so as to maximize the government's ability to obtain favorable results in cases involving procurement fraud. See U.S. DEP'T OF JUSTICE, U.S. ATT'YS MAN. ch. 1-12.000 (Coordination of Parallel Criminal, Civil, and Administrative Proceedings) June 1998.
3. Among the many remedies available, contractual remedies are a potentially powerful weapon in the government's battle against procurement fraud.

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B. Historical Right

1. Under common law, where a party to a contract committed an act of fraud affecting a material element of the contract, the fraudulent act constituted a breach on the part of the party committing the act. The innocent party could then, at its election, insist on continuation of contract performance, or void the contract. Once voided, the voiding party would be liable under equity to the other party for any benefit received. Stoffela v. Nugent, 217 U.S. 499 (1910); Diamond Coal Co. v. Payne, 271 F. 362, 366 (App. D.C. 1921) (“equity refuses to give to the innocent party more than he is entitled to”).
2. Since the U. S. government was often viewed as acting in a “commercial capacity” when it engaged in commercial transactions, the rules of common law and equity applied to resolution of disputes. As such, if the government sought to rescind a contract, it was obligated to restore the contractor to the position it would be in, but-for the breach. Cooke v. United States, 91 U.S. 389, 398 (1875) (“If [the government] comes down from its position of sovereignty, and enters the domain of commerce, it submits itself to the same laws that govern individuals there.”); Hollerbach v. United States, 233 U.S. 165 (1914); United States v. Fuller Co., 296 F. 178 (1923).
3. The Supreme Court rejected the general rule that the government should be treated like any other party to a contract when fraud. Pan American Petroleum and Transport Co., v. United States, 273 U.S. 456 (1927).
4. Courts and boards have developed an implied or common-law right to terminate or cancel a contract in order to effectuate the public policy in a statute or regulation. See United States v. Mississippi Valley Generating Co., 364 U.S. 520, reh’g denied 365 U.S. 855 (1961); Four-Phase Sys., Inc., ASBCA No. 26794, 86-2 BCA ¶ 18,924.
5. A contractor that engages in fraud in dealing with the government commits a material breach, which justifies terminating the entire contract for default. Joseph Morton Co., Inc. v. United States, 3 Cl. Ct. 120 (1983), aff’d 757 F.2d 1273 (Fed. Cir. 1985).

II. CONTRACTING OFFICER AUTHORITY.

- A. Actions Clearly Exceeding Authority. The Contract Disputes Act, 41 U.S.C. § 605(a), as implemented by FAR 33.210, prohibits any contracting officer or agency head from settling, paying, compromising or otherwise adjusting any claim involving fraud.
- B. Actions Clearly Within KO Authority.
1. Refusing Payment. It is the plain duty of administrative, accounting, and auditing officials of the government to refuse approval and to prevent payment of public monies under any agreement on behalf of the United States as to which there is a reasonable suspicion of irregularity, collusion, or fraud, thus reserving the matter for scrutiny in the courts when the facts may be judicially determined upon sworn testimony and competent evidence and a forfeiture declared or other appropriate action taken. To the Secretary of the Army, B-154766, 44 Comp. Gen. 111 (1964).
 2. Suspend Progress Payments. 10 U.S.C. § 2307(e)(2); Brown v. United States, 207 Ct. Cl. 768, 524 F.2d 693 (1975); Fidelity Construction, DOT CAB No. 1113, 80-2 BCA ¶ 14,819.
 3. Withhold Payment.
 4. When a debarment/suspension report recommends debarment or suspension based on fraud or criminal conduct involving a current contract, all funds becoming due on that contract shall be withheld unless directed otherwise by the Head of the Contracting Activity (HCA) or the Commander, U.S. Army Legal Services Agency. AFARS 9.406-3.
 - a. Labor standards statutes provide for withholding for labor standards violations. WHA – 41 U.S.C. § 36; DBA – 40 U.S.C. § 276a-2; SCA – 41 U.S.C. § 353(a).
 - b. Specific contract provisions may provide for withholding (e.g., service contract deductions for deficiencies in performance).

5. Terminate Negotiations. FAR 49.106 (terminate settlement discussions regarding a terminated contract upon suspicion of fraud); K&R Eng'g Co., Inc., v. United States, 222 Ct. Cl. 340, 616 F.2d 469 (1980).
6. Determine Contractor to be Nonresponsible. FAR Subpart 9.4.

III. CONTRACTUAL REMEDIES.

A. Denial of Claims.

1. Section 605(a) of the CDA prohibits an agency head from settling, compromising or otherwise adjusting any claim involving fraud. 41 U.S.C.S § 605(a) (LEXIS 2002). This limitation is reflected in FAR 33.210, which states that the authority of a contracting officer to decide or resolve a claim does not extend to the “settlement, compromise, payment, or adjustment of any claim involving fraud.” Subpart 33.209 of the FAR further provides that contracting officers must refer all cases involving suspected fraud to the agency official responsible for investigating fraud.
2. As a practical matter, the term “denial” is a misnomer in that the contracting officer is precluded from making a final decision on a contractor’s claim where fraud is suspected. As such, denial of a claim consists simply of doing nothing with the claim while other courses of action are pursued.
3. Denial of a claim should be viewed as simply the first of possibly many steps in the resolution of a fraudulent claim.

B. Counterclaims Under the CDA

1. IAW 41 U.S.C. § 604 (LEXIS 2002): “[i]f a contractor is unable to support any part of his claim and it is determined that such inability is attributable to misrepresentation of fact or fraud on the part of the contractor, he shall be liable to the Government for an amount equal to such unsupported part of the claim in addition to all costs to the Government attributable to the cost of reviewing said part of his claim.”

2. This provision of the CDA has been applied in only a small number of cases. This may in part be due to the deterrent effect of this statute. See United States ex. ral. Wilson v. North American Const., 101 F. Supp.2d 500, 533 (S.D. Tex 2000) (district court unwilling to enforce 41 U.S.C. § 604, in part because there were “very few cases applying 41 U.S.C. 604”).
3. It is not possible to enforce this section of the CDA in litigation before the boards because of the language at 41 U.S.C. Section 605 (a), which states: “[t]he authority of this subsection shall not extend to a claim or dispute for penalties or forfeitures prescribed by statute or regulation which another Federal agency is specifically authorized to administer, settle or determine.” The boards have generally interpreted this language as meaning only Department of Justice (DOJ) has the authority to initiated a claim under this provision. This is because (in the eyes of the boards) only DOJ has the authority to administer or settle disputes involving fraud under the current statutory scheme. See TDC Management, DOT BCA 1802, 90-1 BCA ¶ 22,627.

C. Default Terminations Based on Fraud.

1. Where a contractor challenges the propriety of a default termination before a court or board, the government is not precluded under the CDA from introducing evidence of fraud discovered after the default termination, and using that evidence to support the termination in the subsequent litigation.
2. Some grounds for default termination.
 - a. Submission of falsified test reports. Michael C. Avino, Inc., ASBCA No. 317542, 89-3 BCA ¶ 22,156.
 - b. Submission of forged performance and payment bonds. Dry Roof Corp., ASBCA No. 29061, 88-3 BCA ¶ 21,096.
 - c. Submission of falsified progress payment requests. Charles W. Daff, Trustee in Bankruptcy for Triad Microsystems, Inc. v. United States, 31 Fed. Cl. 682 (1994).

D. Voiding Contracts Pursuant to FAR 3.7

1. Subpart 3.7 of the FAR establishes a detailed mechanism for voiding and rescinding contracts where there has been either a final conviction for illegal conduct in relation to a government contract, or an agency head determination of misconduct by a preponderance of the evidence.
2. Subpart 3.7 of the FAR cites three specific authorities that empower the government to void or rescind contracts in instances of procurement fraud. They are:
 - (1) 18 U.S.C. § 218, (LEXIS 2000);
 - (2) Executive Order 12448, 50 Fed. Reg. 23,157 (May 31, 1985); and,
 - (3) Subsection 27(e)(3) of the Office of Federal Procurement Policy Act (41 U.S.C.S. § 423 (LEXIS 2002)).
3. Under this FAR provision, a federal agency shall consider rescinding a contract upon receiving information that a contractor has engaged in illegal conduct concerning the formation of a contract, or there has been a final conviction for any violation of 18 U.S.C. §§ 201-224.
4. The decision authority for this provision is the agency head, which for DOD has been delegated to the Under Secretary of Defense (Acquisition, Technology, and Logistics).
5. No recorded cases of this provision of the FAR being applied.

E. Suspending Payments Upon a Finding of Fraud, FAR 32.006.

1. FAR 32.006 allows an agency head to reduce or suspend payments to a contractor when the agency head determines there is “substantial evidence that the contractor’s request for advance, partial, or progress payments is based on fraud.”

2. The authority of the agency head under this provision may be delegated down to Level IV of the Executive Schedule, which for the Department of the Army is the Assistant Secretary of the Army for Acquisition, Logistics, and Technology (ASA (ALT)).
3. This provision of the FAR is a potentially powerful tool in that the government can stay payment of a claim without the danger of a board treating the claim as a deemed denial, thus forcing the government into a board proceeding before the government's case can be developed.
4. Only one recorded board decision involving this provision of the FAR. TRS Research, ASBCA No. 51712, 2001-1 BCA ¶ 31,149 (contracting officer suspended payment on invoices pending completion of an investigation involving fraud allegation, but failed to seek written permission from the agency head to take such act; ASBCA found the government in breach of the contract and sustained the appeal).

F. Voiding Contracts pursuant to the Gratuities Clause, FAR 52.203-3.

1. Allows DOD to unilaterally void contracts upon an agency head finding that contract is tainted by an improper gratuity. Decision authority for the Department of the Army has been delegated to the ASA (ALT).
2. Authority stems from 10 U.S.C. § 2207, which requires the clause in all DOD contracts (except personal service contracts).
3. Considerable due process protections for the contractor.
4. Exemplary damages of between three to ten times the amount of the gratuity.

5. Procedures used very effectively in response to a fraudulent bidding scheme centered out of the Fuerth Regional Contracting Office, Fuerth, Germany. See Schuepferling GmbH & Co., ASBCA No. 45564, 98-1 BCA ¶ 29,659; ASBCA No. 45565, 98-2 BCA ¶ 29,739; ASBCA No. 45567, 98-2 BCA ¶ 29,828; Erwin Pfister General-Bauunternehmen, ASBCA Nos. 43980, 43981, 45569, 45570, 2001-2 BCA ¶ 31,431; Schneider Haustechnik GmbH, ASBCA Nos. 43969, 45568, 2001 BCA ¶ 31,264. See also Colonel Roger Washington, German Bribery Cases: Convicted German Contractor Loses Appeals to Recover Offsets, PROCUREMENT FRAUD UPDATE May 1998.

IV. RELATED REMEDIES

A. Use of Inspection Clause Rights.

1. Provisions include: FAR 52.246-2 (fixed-price supply); FAR 52.246-4 (fixed-price service); FAR 52.246-12 (fixed-price construction); FAR 52.246-3 (cost reimbursement supply); FAR 52.246-5 (cost reimbursement service).
2. General Inspection Clause Requirements. FAR Subpart 46.2.
 - a. Contractor required to maintain an inspection system acceptable to the government. David B. Lilly Co., ASBCA No. 34678, 92-2 BCA ¶ 24,973.
 - b. Government right to inspect work performed during the course of performance or before acceptance.
 - c. Government right to require correction, replacement or rework of nonconforming tenders or to equitably reduce the contract price based on the decreased value of the nonconforming work.
 - d. Government rights to perform correction, replacement, or rework, at the contractor's expense or to default terminate the contract if the contractor fails to perform directed corrective work.

3. Government's inspection test must be reasonable. Al Johnson Constr. Co., ENG BCA No. 4170, 87-2 BCA ¶ 19,952; General Time Corp., ASBCA No. 22306, 80-1 BCA ¶ 14,393; Nash Metalware Co. v. Gen. Servs. Admin., GSBCA No. 11951, 94-2 BCA ¶ 26,780.
4. Government Remedies Prior to Acceptance.
5. Nonconforming goods tendered within the delivery period.
 - a. Reject the nonconforming goods.
 - b. Accept nonconforming goods at a reduction in price.
 - c. Require correction/replacement – must give contractor notice of defects and reasonable time to cure. Trataros Constr. Co., Inc., ASBCA No. 42845, 94-1 BCA ¶ 26,592.
6. Nonconforming goods delivered on required delivery date.
 - a. Terminate for default if performance is not in substantial compliance with contract requirements.
 - b. Accept nonconforming goods at a reduction in price. Federal Boiler Co., ASBCA No. 40314, 94-1 BCA ¶ 26,381.
 - c. Require correction/replacement – must give contractor notice of defects and reasonable time. Andrews, Large & Whidden, Inc. and Farmville Mfg. Corp., ASBCA No. 30060, 88-2 BCA ¶ 20,542.
7. Nonconforming goods delivered on the required delivery date and which are in substantial compliance with contract requirements.
 - a. Cannot terminate for default. Radiation Tech., Inc. v. United States, 366 F.2d 1003 (Cl. Ct. 1986).
 - b. Must allow reasonable time to correct defects. Id.

- c. Accept Nonconforming goods at reduction in price.
- 8. Nonconforming goods which the contractor has failed to correct or replace after a reasonable time.
 - a. Government may correct or replace defective items.
 - b. Government may contract with another contractor to correct or replace. Lenoir Contractors, Inc., DOTCAB No. 78-7, 80-2 BCA ¶ 14,459.
 - c. Terminate for default. Radiation Tech., Inc., *supra*.
- 9. Providing notice to the contractor.
 - a. Should be in writing.
 - b. Specify why goods/services are nonconforming.
 - c. Not required to inform contractor that fraud is suspected—coordinate to ensure fraud investigation is not adversely affected.
- 10. Remedies After Acceptance.
 - a. Revocation of acceptance for fraud.
 - (1) Elements of proof. Dale Ingram, Inc., ASBCA No. 12152, 74-1 BCA ¶ 10,436.
 - (a) Intent to deceive;
 - (b) A misrepresentation;
 - (c) Must be misrepresentation of fact, not of law, opinion, or judgment; and

- (d) Government reliance on the misrepresentation to its detriment.
- (2) No ASBCA jurisdiction over this remedy. 41 U.S.C. §§ 605 and 607.
- b. Revocation of acceptance for gross mistake amounting to fraud.
 - (1) “Constructive” fraud as opposed to actual fraud. Catalytic Eng’g & Mfg. Corp., ASBCA No. 15257, 72-1 BCA ¶ 9,432; Kaminer Constr. Corp. v. United States, 488 F.2d 980 (Ct. Cl. 1973); Z.A.N. Co., ASBCA No. 25488, 86-1 BCA ¶ 18,612.
 - (2) Elements of proof are the same as for actual fraud except no need to prove intent to deceive. Must show a major mistake so serious that it would not be expected of a reasonable contractor.
 - (3) ASBCA has jurisdiction over this remedy. Z.A.N. Co., supra.

B. Exercise of Warranty to Correct Fraudulent Defect

- 1. Applicable provision: FAR 46.7.
- 2. Elements of Proof.
 - a. There is a defect.
 - b. The defect is within the scope of the warranty. S. Kane & Sons, Inc., VACAB No. 1316, 78-1 BCA ¶ 13,300.
 - c. The warranted defect was the most probable cause of the failure. R.B. Hazard, Inc., ASBCA No. 41061, 91-2 BCA ¶ 23,709; A.L.S. Elec. Corp., ASBCA No. 23128, 82-2 BCA ¶ 15,835.

- d. The defect arose during the warranted period. Phoenix Steel Container Co., ASBCA No. 9987, 66-2 BCA ¶ 5814.
 - e. The contractor received the required notice under the warranty clause. Mercury Chem. Co., ASBCA No. 12554, 69-1 BCA ¶ 7730.
3. Remedies for Breach of Warranty. FAR 46.706(b)(2).
- a. Correction or replacement of defective work.
 - b. Price reduction for lost value.
 - c. Correction or replacement of the work by another contractor or the government at the contractor's expense.

V. BOARD OF CONTRACT APPEALS' TREATMENT OF FRAUD.

A. Jurisdiction.

- 1. Theoretically, the boards are without jurisdiction to decide appeals tainted by fraud
 - a. Under the CDA, "[e]ach agency board shall have jurisdiction to decide any appeal from a decision of a contracting officer (1) relative to a contract made by its agency, and (2) relative to a contract made by any other agency when such agency or the Administrator has designated the agency board to decide the appeal." 41 U.S.C. § 607(d) (LEXIS 2002).
 - b. Because the CDA precludes contracting officers from issuing final decisions where fraud is suspected, and the boards only have jurisdiction over cases that can be decided by a contracting officer, the boards are effectively barred from adjudicating appeals involving fraud. See 41 U.S.C. § 605(a) (LEXIS 2002).

2. As a practical matter, the boards exercise a form a de facto jurisdiction in that a finding of fraud is often dispositive of the entire appeal

B. Dismissals, Suspensions and Stays.

1. Government must demonstrate that the possibility of fraud exists or that the alleged fraud adversely affects the Board's ability to ascertain the facts. Triax Co., Inc., ASBCA No. 33899, 88-3 BCA ¶ 20,830.
2. Mere allegations of fraud are not sufficient. General Constr. and Dev. Co., ASBCA No. 36138, 88-3 BCA ¶ 20,874. Four-Phase Systems, Inc., ASBCA No. 27487, 84-1 BCA ¶ 17,122.
3. Boards generally refuse to suspend proceedings except under the following limited circumstances:
 - a. When an action has been commenced in a court of competent jurisdiction, by the handing down of an indictment or by filing of a civil action complaint, so that issues directly relevant to the claim before the board are placed before that court;
 - b. When the Department of Justice or other authorized investigatory authority requests a suspension to avoid a conflict with an ongoing criminal investigation;
 - c. When the government can demonstrate that there is a real possibility that fraud exists which is of such a nature as to effectively preclude the board from ascertaining the facts and circumstances surrounding a claim; and
 - d. When an appellant so requests to avoid compromising his rights in regard to an actual or potential proceeding. See Fidelity Constr., 80-2 BCA ¶ 14,819 at 73,142.

C. Fraud as an Affirmative Defense.

1. Most often, the government elects to treat fraud as a jurisdictional bar, and pursues the issue in a motion to dismiss.

2. When fraud is cited as an affirmative defense, the boards generally treat the issue consistent with cases where it is presented as a jurisdictional bar. See ORC, Inc. ASBCA No. 49693, 97-1 BCA ¶ 28,750.

VI. CONCLUSION.