We've reported on quite a number of military servicemen and civilian employees of the DOD who've been accused, indicted, and/or convicted of corruption and bribery charges. But we also understand that defense contractors are just as frequently accused of similar crimes: either attempting corrupt actions or violating one of the myriad requirements of the typical government contract. Today's article concerns two different defense contractors—two of the largest in the industry—who separately settled suits under the **False Claims Act**.

First, on June 10, 2010, the Department of Justice (DOJ) **announced** that Pratt & Whitney-Rocketdyne, Inc. (PWR) "has agreed to pay the government almost $3 million to resolve allegations … rising out of a dispute over fees charged on a contract with NASA after Pratt & Whitney merged with Rocketdyne in 2005." As the DOJ announcement reports—

Prior to the merger, Rocketdyne had subcontracted with Pratt & Whitney for work on a Space Shuttle flight support services contract Rocketdyne had with NASA. Following the August 2005 merger, Pratt & Whitney Rocketdyne billed NASA fees under the pre-merger subcontract. In December 2006, the Defense Contract Audit Agency questioned whether those subcontract fee billings allowed the merged company to reap excess profits.

This case raises a very interesting question: whether a subcontract in place prior to an acquisition should continue to be treated in the same manner after the acquisition, or whether it should then be treated as an inter-organizational transfer. If the latter, then profit should be stripped-out pursuant to the requirements of the Cost Principles found at 31.205-26(e). Clearly, we know how DCAA and DOJ felt about the proper treatment. And just as clearly, it would be cheaper for PWR to settle the matter rather than to litigate the question.

The second matter involved Northrop Grumman. Before we delve into Northrop's issue, let's also note that on June 3, 2010, the **DOJ announced** that

the company had agreed to pay $700,000 to resolve allegations that it billed the government "for lodging expenses for Northrop employees who actually stayed in accommodations provided by the government" related to two "defense procurement contracts." But that's not really a news-worthy item, in our view. What's seems more interesting (at least to us) are the various news stories **reporting** that the company agreed to pay $12.5 million in order to settle false claims allegations related to commercial items used in military navigation systems. Reportedly, Northrop Grumman failed to properly test those items "to ensure that they would function at the extreme temperatures required for military and space uses." According to **this article** at Bloomberg BusinessWeek, "the U.S. alleged that the failures to test parts continued from November 1998 until February 2007." Moreover, this **LA Times article** notes that the settlement relates to a whistleblower suit filed in May 2006 by Allen Davis, a former quality assurance manager for Northrop. The article reports Mr. Davis will receive roughly $2.4 million of the settlement.

Under the False Claims Act, companies are liable for up to $11,000 per false claim, plus up to treble damages. In Northrop's case, the allegedly fraudulent testing went on for nearly six-and-a-half years, and involved multiple military departments—and presumably multiple contracts, each with its own set of invoices. Looks to us like Northrop (as with PWR), settled very smartly for perhaps pennies on the dollar—which is usually a good indication that the Government's case was perceived to be weak or too complex to be confidently brought before a jury. Where the Government believes it has a strong or easily litigable case, settlements are typically much **higher**.

We have **reported** on the recent emphasis on contractor past performance and the revitalization of the notion that a “responsible” contractor is one with a good record of integrity and ethics. Although these two companies appear to have made smart business decisions to avoid costly litigation, it is not clear how these settlements ultimately will affect their ability to win new work from their Defense customers.