Documentation

The indictment and motion to dismiss

The following are excerpts from the indictment of James Beggs, General Dynamics, and three of its managers, issued Dec. 1, 1985 by the U.S. District Court for the Central District of California.

E. THE CONSPIRACY

15. From on or about January 1, 1978, continuing until on or about August 31, 1981, the exact dates being unknown to the Grand Jury, in the Central District of California and elsewhere, Defendants GENERAL DYNAMICS, BEGGS, [RALPH] HAWES, [DAVID] MCPHERSON, and [JAMES] HANSEN, did willfully and knowingly combine, conspire, confederate, and agree together and with persons both known and unknown to the Grand Jury to defraud the United States of America and to commit offenses against the United States. . . .

F. THE CONSPIRATORIAL PURPOSE

16. It was the plan and purpose of the conspiracy for the defendants to obtain money for GENERAL DYNAMICS from the Department of Defense by fraudulently shifting to government-funded B&P and IRAD accounts several million dollars worth of expenses which should have been charged to the DIVAD prototype contract, or which were otherwise not legitimate B&P and IRAD expenses, all for the purpose of fraudulently reducing non-reimbursable losses on the DIVAD program.

The following are excerpts from the "Memorandum of Points and Authorities" attached to the motion to dismiss introduced by General Dynamics, James Beggs, and the other defendants. The subheads in brackets are EIR's.

[Proper jurisdiction]

The Armed Services Board of Contract Appeals ("ASBCA") is the adjudicating board within DOD charged with the responsibility for making determinations as to the propriety of cost allocation decisions in DOD procurement contracts. Pursuant to the doctrine of primary jurisdiction, as well as basic principles of efficient administration of justice, the issues of cost allocation that underlie the indictment should be resolved first by the ASBCA. See *United States v. Yellow Freight System, Inc.*, 762 F.2d 737 (9th Cir. 1985). The doctrine of primary jurisdiction was developed by the United States Supreme Court and has long been recognized as the vehicle by which comity and the expeditious use of limited judicial resources combine to allow a court to defer analyzing difficult or complex issues where an entity has already developed the expertise and ability to undertake such an analysis. . . . The government in this case seeks to sidestep the procedure established to resolve disputes of the kind in this case. Instead of permitting a contracting officer, the ASBCA, and the Federal Circuit to apply their expertise to this case, the prosecution is attempting to "pass [ ] over" those procedures and thrust on this Court and a lay jury the very issues that those administrative bodies were designed to address. . . .

[Unusual nature of DIVAD contract]

The Army's procurement plan for the DIVAD system entailed a compressed schedule that eliminated many years and millions of dollars typically devoted to development and maturation of a prototype prior to its production. Most Army procurement programs include (1) a prototype phase; (2) a full-scale engineering development phase in which maturation, refinement, and testing are performed; and (3) a production phase. In the DIVAD program, however, the full-scale engineering development phase was eliminated. . . .

The Army made clear that the prototypes themselves were not expected to be complete, mature, production-ready DIVAD weapon systems:

> The key to success is a concept of "prototyping for production" where certain system elements will be emphasized, and others will not (in the [Prototype] Development Phase) because of the desire to reduce development time and costs. . . . A maturation of the selected contractor's prototypes will be conducted, if necessary. . . .

The Prototype RFP provided that a Request for Proposal for the initial production contract ("the Production RFP") would be issued to the two competing contractors before the testing scheduled for the prototype phase. Prototype RFP, ¶ A.2.2.2.2. It also provided that the ultimate award of a contract for production of the first 200 units would be based upon the prototypes delivered, the results of the prototype testing, and the production proposals (including an analysis of the life cycle costs presented by each contractor). Id. (Originally, the Prototype RFP required, as part of the effort under the proposed contract, the preparation of a proposal for the Production Contract. This requirement was subsequently deleted from the Prototype RFP prior to the award of the Prototype Contract. This is a significant fact relating to the allowability of the costs in issue here. [In other words, by deleting preparation of the production proposal from the prototype RFP, the Army was directing the contractors to apply B&P funds to develop the production proposal—*EIR*]) The Prototype Contract itself confirmed that "the contractor must be prepared at the end of the Development Phase to embark immediately into the Initial Production Phase." Prototype Contract, Part II, Section F.1.IV.3.

General Dynamics therefore simultaneously had to engage in parallel programs designed to: (1) complete the requirements of the Prototype Contract, and (2) prepare a comprehensive, responsive and persuasive production proposal and bid for a fixed price production contract. Preparation of a production proposal included (a) an analysis of the needs and costs for a fully mature production system, (b) resolution of technical problems associated with the development of any new weapon system, and (c) production cost analysis necessary for preparation of the production bid itself. . . .

The unorthodox procurement strategy employed for the DIVAD program not only complicated the decisions regarding charging of costs because of the need to engage in parallel effort, it employed an equally unorthodox prototype contract.

Typically, a "cost plus" contract or a fixed price incentive contract with a liberal range between target cost and ceiling cost is awarded for the development of a new weapon system. . . .

Unlike the usual development contract, the DIVAD prototype contract was a "Firm Fixed (Best Efforts)" contract. The combination of fixed price and best efforts provisions in a single contract is highly unusual, if not unique. The concept of "Best Efforts" is anathema to the concept of a fixed price contract, which as a predicate assumes a sufficiently precise set of contract requirements to enable a contractor to formulate a fixed price bid and to assess the risks of non-performance. The Armed Services Procurement Regulations ("ASPR") in effect at the time of the prototype contract contained a list of approved contract types and prohibited the use of types not described therein unless a special deviation procedure was followed. ASPR § 3-401(a)(2). A "Firm Fixed Price (Best Efforts)" type of contract is not described in the ASPR. . . .

It appears that the government will contend, in essence, that virtually all work performed to meet a prototype contract requirement, to support an aspect of the production proposal, or to advance generally the technology used by weapon systems, should have been charged to the prototype contract. In the indictment, the government apparently takes the position that items not specifically included in the prototype contract were nonetheless required by the contract. In fact, the government apparently takes this position with respect to items which were specifically and intentionally omitted from the contract by the Army. Based on that premise, the government contends that General Dynamics' decisions to charge such items to B&P and IR&D accounts rather than the prototype contract accounts were fraudulent. . . .

Because the Army demanded that the contractors show their ability to move directly from the development phase into the production phase and because the Army's selection of a contractor for the production contract would depend upon (1) the prototypes delivered, (2) the performance of the prototypes at the shoot-off during DT/OT, and (3) the production proposal, General Dynamics decided to perform a great deal of work not required by the prototype contract. . . .

UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA, Plaintiff, v. GENERAL DYNAMICS CORPORATION, JAMES M. BEGGS, RALPH E. HAWES, JR., DAVID L. McPHERSON, JAMES C. HANSEN, JR., Defendants.	)	No. CR 85-1123-FFF DEFENDANTS' NOTICE OF MOTION AND JOINT MOTION TO DISMISS THE ACTION BASED ON PRIMARY JURISDICTION; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF; EXHIBIT; PROPOSED ORDER Date: March 24, 1986 Time: 2:30 P.M. Courtroom: Hearing Room No. 255 [MOTION NO. 1]

TO: THE UNITED STATES DEPARTMENT OF JUSTICE AND THE UNITED STATES ATTORNEY FOR THE CENTRAL DISTRICT OF CALIFORNIA:

PLEASE TAKE NOTICE that on March 24, 1986, at 2:30 P.M., or as soon thereafter as the matter may be heard, in the courtroom of The Honorable Ferdinand F. Fernandez, United States District Judge, located at 312 North Spring Street, Los Angeles, California, defendants

[Bids & Proposals and Internal R&D funds]

Each year, the DOD enters into agreements with certain contractors, including General Dynamics, which entitle those contractors to include amounts for B&P and IR&D within indirect costs. The amount of such costs that may be charged by the contractor to its contracts is the subject of negotiation between what is called the "Tri-Service Committee," representing DOD, and the contractor. The extent to which these costs may be reimbursed was governed at the time of the DIVAD program by the ASPR. The applicable regulations in effect at the time of the DIVAD program defined B&P costs and IR&D costs as follows:

> Bid and Proposal Costs: Bid and proposal (B&P) costs are the costs incurred in preparing, submitting, and supporting bids-and-proposals (whether or not solicited) on potential Government or non-Government contracts which fall within the following: (A) Administrative costs including the cost of the non-technical effort for the physical preparation of the technical proposal documents and also the cost of the technical and non-technical effort for the preparation and publication of the cost data and other administrative data necessary to support the contractor's bids-and-pro-

posals, and (B) Technical costs incurred to specifically support a contractor's bid or proposal, including the costs of system and concept formulation studies and the development of engineering and production engineering data. ASPR ¶ 15-205.3(a)(1).

Independent Research and Development Costs: A contractor's independent research-and-development (IR&D) is that technical effort which is not sponsored by, or required in performance of a contract or grant and which consists of projects falling within the following three areas: (i) basic and applied research; (ii) development; and (iii) systems and other concept formulation studies. IR&D effort shall not include technical effort expended in the development and preparation of technical data specifically to support the submission of a bid or proposal. ASPR ¶ 15-205.35(a).

The amount that is negotiated by the contractor and the Tri-Service Committee in the Advance Agreement represents a combined ceiling of allowable IR&D and B&P amounts. In performance thereof, one element may be increased or decreased as long as the combined total is within the ceiling amount. Any excess must be absorbed by the contractor. . . .

[Costs were not improperly charged]

A brief examination of a few of the issues in contention will illustrate the importance of the highly specialized procurement regulations.

1. Integrated Logistics Support Items

The Indictment challenges charges to B&P of the cost of certain integrated logistics support items, specifically a formal draft operator's manual, a crew proficiency trainer, and a classroom trainer. The government claims that these items should have been charged to the prototype contract.

Each of these items was specifically identified by the Army as an option in its prototype RFP as to which separate bids were invited. General Dynamics bid on each such option in its prototype proposal. However, the Army never funded the options as part of the prototype contract. The Army did, however, request bids on the same items for production in its production RFP.

General Dynamics worked to develop the unfunded option items during the prototype phase in order (1) to develop cost and technical data for use in the production bid and proposal, and (2) to demonstrate to the Army its ability to produce the items and thereby enhance its competitive position for winning the production contract. General Dynamics charged this pre-production effort to B&P.

The government contends that the items should have been charged to the prototype contract, presumably relying on ambiguous language in the prototype contract requiring the use—although not the delivery—of a draft operator's manual and "training hardware" in the training of Army crews to operate the prototypes for testing after their delivery to the Army. General Dynamics contends that the work could not have lawfully been charged to the contract because the Army explicitly refused to fund these options under the prototype contract. . . .

2. Software Development

Another example of the complex issues raised by the indictment concerns the allegation that defendants improperly charged costs incurred in the design and development of DIVAD computer software to IR&D. As noted, IR&D is defined, in part, as "technical effort which is not sponsored by, or required in performance of a contract." ASPR ¶ 15-205.35(a). The difficulty here lies in determining whether the computer software work in question was "sponsored by, or required in performance of" the prototype contract.

The government apparently contends that all software development generally applicable to DIVAD should have been charged to the prototype contract, regardless of whether it was specifically "required in performance of" the prototype contract and regardless of whether the purpose of the development was to advance software technology generally. However, the prototype contract's software requirements were extremely vague and relatively minimal compared to those which were envisioned by General Dynamics for the production model DIVAD. The challenged IR&D projects were initiated to expand software technology far beyond that which existed. This technology also had application to gun systems other than DIVAD. Defendants content that this effort fell within the scope of ASPR ¶ 15-205.35(a). . . .

[Past DOD contract precedents]

The ASBCA routinely rules upon issues of the very kind presented in this case. . . .

For example, in *In re North American Rockwell Corp.*, 69-2 BCA (CCH), ¶ 7812 (July 22, 1969), government auditors argued that B&P expenses incurred in connection with preparation of an unsuccessful bid on a contract should have been charged to an earlier contract because the work performed was useful in the earlier contract. This contention is remarkably similar to allegations in this case involving charges to B&P for the unsuccessful bid on the production contract, which the prosecution contends should have been charged to the earlier prototype contract. In *Rockwell,* the ASBCA rejected the auditor's argument, holding:

> It is apparent . . . that bid and proposal costs are chargeable to current overhead accounts unless they are incurred solely by reason of the terms of a particular contract, to which they are chargeable. The fact that they may be useful to or equally applicable to a preliminary study contract does not impeach their character as bid and proposal costs.

Similarly, in *In re General Dynamics Corp.*, 65-2 BCA (CCH) ¶ 5067 (August 31, 1965), the contractor appealed to the ASBCA the disallowances of certain B&P costs expended primarily in connection with a mock-up, where the contractor had simultaneously performed work on a preliminary study contract and a proposal for a development contract. The ASBCA ruled that expenses incurred in connection with a mock-up not required for the preliminary design study were reimbursable B&P costs, noting that the "preparation of a proposal, whether for the preliminary design study or the development contract, is essentially distinct from the preparation of the preliminary design study itself."

General Dynamics Corp., Convair Div., ASBCA No. 15394, 15858, 72-2 BCA ¶ 9533, is also similar to the facts of this case. Although the government in that case did not argue that B&P costs should have been charged to the contract (the government argued that the costs were not allowable as B&P), the analysis of the facts and law by the ASBCA is particularly germane here. The government's argument in that case was that costs incurred by the contractor in connection with a development contract to enhance the contractor's effort to win the follow-on production contract were excessive and not appropriately related to the bid and proposal effort for the production contract.

The Armed Services Board sustained the contractor's appeal, finding that the contractor's parallel engineering effort, which included the construction of a mock-up of the planned aircraft and extensive test bed work, was well within the efforts appropriate for B&P for the production contract. The ASBCA further noted that there was a significant interrelationship between IR&D and B&P expenses and that the contractor was to be accorded substantial flexibility in determining which of these accounts was appropriate for its proposal support costs.

D. Deferral Is appropriate in an criminal case

The doctrine of primary jurisdiction applies with equal force in criminal proceeding. For example, in *United States v. Alaska S.S. Co.*, 110 F. Supp. 104 (W.D. Wash. 1952), the court dismissed a criminal indictment alleging breach of federal antitrust statutes by a shipper, holding that the primary jurisdiction doctrine compelled deference to the Federal Maritime Board. In rejecting arguments that the doctrine did not apply to criminal cases, the court stated:

> All arguments in favor of letting an experienced administrative board exercise its primary jurisdiction applies [sic] with the equal force in a criminal case as in a civil case. The rationale applicable to the two types of action is the same.

The Ninth Circuit recently affirmed this position in *United States v. Yellow Freight System, Inc.*, 762 F.2d 737 (9th Cir. 1985), a criminal case in which a motor carrier was convicted of violating certain tariff regulations. . . .