IN THE UNITED STATES COURT OF FEDERAL CLAIMS

NORTHROP GRUMMAN CORP.,	**)**	
	)	
Plaintiff,	**)**	
	)	
v.	**)**	**No. 07-482C**
	)	**(Judge Baskir)**
THE UNITED STATES,	**)**	
	)	
Defendant.	**)**	

DEFENDANT'S AMENDED ANSWER AND AFFIRMATIVE DEFENSE TO PLAINTIFF'S COMPLAINT AND DEFENDANT'S COUNTERCLAIMS

For its answer to plaintiff's complaint, defendant admits, denies, and alleges as follows:

The allegations contained in the introductory paragraph to plaintiff's complaint are plaintiffs' characterization of this action, their request for relief and their cause of action, to which no response is required; to the extent that they may be deemed allegations of fact, they are denied.

1. The allegations contained in paragraph 1 are plaintiff's characterization of their action and conclusions of law to which no response is required; to the extent they may be deemed allegations of fact, they are denied.

2. Admits.

3. Admits the allegations that Northrop Grumman Corporation ("Northrop") and the United States are parties to numerous contracts which

are assigned for contract administration purposes to the Defense Contract Management Agency ("DCMA") contained in the first sentence of paragraph 3. The allegations that the contracts are subject to the Contract Disputes Act of 1978, 41 U.S.C. §§ 601-613, recodified as 41 U.S.C. §§ 7101-09, PL 111-350, 124 Stat. 3677 (Jan. 4, 2011), contained in the first sentence of paragraph 3 are conclusions of law to which no response is required; to the extent they may be deemed allegations of fact, they are denied. Denies the remainder of the allegations contained in paragraph 3 of the complaint.

4. Admits the allegations contained in paragraph 4 to the extent supported by the July 7, 2006 contracting officer's final decision issued by DCMA Defense Corporate Executive ("DCE") which is the best evidence of its contents; otherwise denies the allegations contained paragraph 4.

5. The allegations contained in paragraph 5 are conclusions of law to which no response is required; to the extent they may be deemed allegations of fact, they are denied.

6. Admits the allegations that, between 1993 and 1998, Northrop established a Restricted Performance Stock Rights ("RPSR") plan contained in paragraph 6; denies the remainder of the allegations

contained in paragraph 6 for lack of knowledge or information sufficient to form a belief as to the truth of the matters asserted.

7. Admits the allegations contained in the first and second sentences of paragraph 7; admits the remainder of the allegations contained in paragraph 7 to the extent supported by the Northrop's 1993 Long Term Incentive Stock plan which is the best evidence of its contents; otherwise denies the remainder of the allegations contained paragraph 7.

8. Admits.

9. Denies.

10. Admits.

11. Admits the allegations contained in the first, second, and third sentences of paragraph 11 to the extent supported by the Defense Contract Audit Agency ("DCAA") incurred cost and forward pricing audit reports referred to in the first sentence of paragraph 11 to the extent supported by the DCAA audit reports referred to in the first sentence of paragraph 11, which are the best evidence of their contents; otherwise denies the allegations contained in the first, second, and third sentences of paragraph 11; admits the allegations contained in the fourth sentence of paragraph 11 to the extent supported by Federal Acquisition Regulation

("FAR") § 31.206-6(i), which is the best evidence of its contents; otherwise denies the allegations contained in the fourth sentence of paragraph 11.

12. Admits the allegations contained in the first and second sentences of paragraph 12; denies the remainder of the allegations contained in the first sentence of paragraph 12 for lack of knowledge or information sufficient to form a belief as to the truth of the matters asserted.

13. Admits the allegations that DCE is responsible for determining the allowability of Northrop's corporate office expense costs, including deferred compensation costs incurred pursuant to a corporate wide plan, pursuant to FAR §§ 42.301 and 42.603 contained in paragraph 13 of the complaint; denies the remainder of the allegations contained in paragraph 13 of the complaint.

14. Admits.

15. Admits the allegations contained in paragraph 15 to the extent supported by the Settlement Agreement and Mutual Release, dated June 14, 2002 ("2002 Settlement Agreement") cited, which is the best evidence of its contents; otherwise denies the allegations contained in paragraph 15.

16. Admits the allegations contained in paragraph 16 to the extent

supported by the 2002 Settlement Agreement cited, which is the best evidence of its contents; otherwise denies the allegations contained in the fourth sentence of paragraph 16.

17. Admits the allegations contained in paragraph 17 to the extent supported by the 2002 Settlement Agreement cited, which is the best evidence of its contents; otherwise denies the allegations contained in the fourth sentence of paragraph 17.

18. Admits the allegations contained in paragraph 18 to the extent supported by the 2002 Settlement Agreement cited, which is the best evidence of its contents; otherwise denies the allegations contained in paragraph 18.

19. Admits the allegations contained in the first sentence of paragraph 19. Admits the allegations contained in the second sentence of paragraph 19 to the extent supported by the 2002 Settlement Agreement cited, which is the best evidence of its contents; otherwise denies the remainder of the allegations contained in paragraph 19.

20. Admits the allegations contained in the first sentence of paragraph 20 to the extent supported by the 2002 Settlement Agreement cited, which is the best evidence of its contents; otherwise denies the

allegations contained in the first sentence of paragraph 20. Admits the allegations contained in the second sentence of paragraph 20 to the extent supported by Attachment A to the 2002 Settlement Agreement cited, which is the best evidence of its contents; otherwise denies the remainder of the allegations contained in the second sentence of paragraph 20.

21. Admits the allegations that Northrop took steps to maintain the confidentiality of the 2002 Settlement Agreement contained in the first sentence of paragraph 21; admits the allegations that Article 5 of the 2002 Settlement Agreement required the parties to keep the settlement agreement confidential contained in the first sentence of paragraph 21 to the extent supported by the 2002 Settlement Agreement cited, which is the best evidence of its contents; otherwise denies the allegations contained in the first sentence of paragraph 21. Denies the allegations contained in the second and third sentences of paragraph 21 for lack of knowledge or information sufficient to form a belief as to the matters asserted. Denies the allegations contained in the fourth sentence of paragraph 21 for lack of knowledge or information sufficient to form a belief as to the truth of the matters asserted. Admits the allegations contained in the fifth sentence of paragraph 21 that the terms of the Article 1, paragraph c are noted above;

admits the remainder of the allegations contained in the fifth sentence of paragraph 21, to the extent supported by the Article 1 paragraph c, which is the best evidence of its contents; otherwise denies the allegations contained in the fifth sentence of paragraph 21. Admits the allegations contained the sixth sentence of paragraph 21 to the extent supported by Attachment A of the 2002 Settlement Agreement, which is the best evidence of its contents; otherwise denies the allegations contained in the sixth sentence of paragraph 21.

22. Admits the allegations that Attachment A omitted any references to the 75 percent RPSR ceiling contained in the first sentence of paragraph 22 to the extent supported by Attachment A to the 2002 Settlement Agreement; otherwise denies the allegations contained in the first sentence of paragraph 22. Denies the remainder of the allegations contained in the first and second sentences contained in paragraph 22 for lack of knowledge or information sufficient to form a belief as to the matters asserted.

23. Admits the allegations contained in the first sentence of paragraph 23. Denies the allegations contained in the second sentence of paragraph 23 for lack of knowledge or information sufficient to form a belief

as to the matters asserted. Admits the allegations contained in the third sentence of paragraph 23.

24. Denies the allegations contained in the first, second, third, and fourth sentences of paragraph 24 for lack of knowledge or information sufficient to form a belief as to the matters asserted. Admits the allegations contained in the fifth sentence of paragraph 24.

25. Denies the allegations contained in paragraph 25 for lack of knowledge or information sufficient to form a belief as to the matters asserted.

26. Admits the allegations that Plaintiff's 2003 certified final indirect cost proposal was submitted to the Government on June 30, 2004 (the "2003 Cost Proposal") contained in the first sentence of paragraph 26; denies the remainder of the allegations contained in the first, second, and third sentences of paragraph 26 for lack of knowledge or information sufficient to form a belief as to the matters asserted.

27. Admits the allegations contained in the first sentence of paragraph 27. Admits the remainder of the allegations contained in the second and third sentences of paragraph 27 to the extent supported by the draft audit cited, which is the best evidence of its contents; otherwise

denies the allegations contained in the second and third sentences of paragraph 27.

28. Admits.

29. Admits the allegations contained in the first and second sentences of paragraph 29 to the extent supported by the draft audit cited, which is the best evidence of its contents; otherwise denies the allegations contained in the first and second sentences of paragraph 29. Admits the allegations that Northrop denies that the excess RPSR costs included in the 2003 Cost Proposal are allowable and the penalties are appropriate contained in the third sentence of paragraph 29; denies the allegations contained in the third sentence of paragraph 29 that Northrop's excess RPSR costs included in the 2003 Cost Proposal are unallowable and the penalties are not appropriate.

30. Admits the allegations contained in paragraph 30 to the extent supported by the December 22, 2005 letter cited, which is the best evidence of its contents; otherwise denies the allegations contained in paragraph 30.

31. Admits the allegations contained in paragraph 31 to the extent supported by the February 24, 2006 letter cited, which is the best evidence

of its contents; otherwise denies the allegations contained in paragraph 31.

32. Admits the allegations contained in the first and second sentences of paragraph 32 to the extent supported by the March 24, 2006 letter cited, which is the best evidence of its contents; otherwise denies the allegations contained in the first and second sentences of paragraph 32. Denies the allegations contained in the third, fourth, fifth, and sixth sentences of paragraph 32. Admits the remainder of the allegations contained in the seventh sentence of paragraph 32 to the extent supported by the March 24, 2006 letter cited in the first sentence of paragraph 32; otherwise denies the allegations contained in the seventh sentence of paragraph 32.

33. Denies the allegations contained in the first sentence of paragraph 33 that the plaintiff's March 24, 2006 letter demonstrated that Northrop has established policies and personnel training and an internal control and review system that provide assurance that unallowable costs subject to penalties are precluded form being included in the contractor's final indirect costs rate proposals. Denies the allegations contained in the third sentence of paragraph 33 that DCAA's audits have not disclosed recurring instances of expressly unallowable costs. Denies the remainder

of the allegations contained in second and third sentences of paragraph 33 for lack of knowledge or information sufficient to form a belief as to the truth of the matters asserted.

34. Denies.

35. Admits the allegations contained in the first sentence of paragraph 35. Admits the allegations contained in the second, third, and fourth sentences of paragraph 35 to the extent supported by DCAA's May 9, 2006 letter, which is the best evidence of its contents; otherwise denies the allegations contained in the second, third, and fourth sentences of paragraph 35.

36. Admits the allegations contained in paragraph 36 that Northrop's March 24, 2006 response was a detailed response. The allegations contained in paragraph 36 that FAR § 42.709-5 required DCMA to waive the penalty are conclusions of law to which no response is required; to the extent that they are an allegation of fact, they are denied. Admits the remainder of the allegations contained in paragraph 36 to the extent supported by DCAA's July 7, 2006 letter, which is the best evidence of its contents; otherwise denies the remainder of the allegations contained in paragraph 36.

37. Admits the allegations contained in paragraph 37 to the extent supported by Northrop's December 2006 analysis which is the best evidence of its contents; otherwise denies the allegations contained in paragraph 37.

COUNT I

38. The United States avers and incorporates by reference its responses to paragraphs 1 through 37 as though set forth in full.

39. Denies.

40. Admits.

41. Admits.

42. Denies the allegations contained in the first sentence of paragraph 42 that FAR § 42.709(a)(2) provides, "If the indirect cost was determined to be unallowable for *that contract* before proposal submission, the penalty is two times the amount in paragraph (a)(1)(I) of this section." (Emphasis added). Defendant avers that FAR § 42.708(a)(2) provides that, "If the indirect cost was determined to be unallowable for *that contractor* before proposal submission, the penalty is two times the amount in paragraph (a)(1)(I) of this section." (Emphasis added). Admits the allegations contained in the second sentence of paragraph 42.

43. Denies the allegations contained in the first sentence of paragraph 43. Admits the allegations contained in the second sentence of paragraph 43 to the extent supported by FAR § 31.001 which is the best evidence of its contents; otherwise denies the allegations contained in the second sentence of paragraph 43. Denies the allegations contained in the third sentence of paragraph 3. Defendant avers that the RPSR costs are expressly unallowable pursuant to FAR § 31.205-6(i)(1), which states: "Any compensation which is calculated, or valued, based on changes in the price of corporate securities is unallowable."

44. Denies the allegations contained in the first sentence of paragraph 44. The allegations contained in the second sentence of paragraph 44 are conclusions of law, to which no response is required; to the extent that they are deemed to be allegations of fact, they are denied. Denies the allegations contained in the third sentence of paragraph 44. Defendant avers that the excess RPSR costs were previously determined to be unallowable by the settlement agreement.

45. Admits the allegations contained in the first, second, and third sentences of paragraph 45. Admits the allegations contained in the fourth sentence of paragraph 45 to the extent supported by Recital E of the

settlement agreement, which is the best evidence of its contents; otherwise denies the allegations contained in the fourth sentence of paragraph 45.

46. Admits the allegations contained in the first sentence of paragraph 46 that, pursuant to the terms of the settlement agreement, Northrop agreed to include only a specified percentage of the Settled Costs in its overhead rates for fiscal years 2000-2003; denies the remainder of the allegations contained in the first sentence of paragraph 46 that there was no determination that Settled Costs in excess of the specified percentages were unallowable. Defendant avers that the settlement agreement provides: ". . . the Government agrees to allow Northrop to include Settled Costs in the appropriate overhead rates for fiscal years 1997-2003, ..." Defendant avers that the corollary of this term is that Settled Costs are unallowable. Defendant admits the remainder of the allegations contained in the first, second, third, fourth, and fifth sentences of paragraph 46 to the extent supported by the settlement agreement, which is the best evidence of its contents; otherwise denies the remainder of the allegations contained in paragraph 46. Defendant denies any implication that the cited provisions preclude the imposition of a penalty for inclusion of excess RPSR costs in the 2003 Cost Proposal.

47. Denies.

COUNT II

48. The United States avers and incorporates by reference its responses to paragraphs 1 through 37 and 45 through 46 as though set forth in full.

49. Denies.

50. Admits.

51. Admits the allegations contained in paragraph 51 to the extent supported by Article 2 of the settlement agreement, which is the best evidence of its contents; otherwise denies the allegations contained in paragraph 51.

52. Admits the allegations contained in paragraph 52 to the extent supported by the DCE final decision, which is the best evidence of its contents; otherwise denies the allegations contained in paragraph 52.

53. Denies.

COUNT III

54. The United States avers and incorporates by reference its responses to paragraphs 1 through 37 as though set forth in full.

55. Admits the allegations contained in the first sentence of

paragraph 55 that the United States did not waive the applicable penalties; denies the remainder of the allegations contained in the first sentence of paragraph 55. Admits the allegations contained in the second sentence of paragraph 55 to the extent supported by FAR § 42.709-5(c), which is the best evidence of its contents; otherwise denies the allegations contained in the second sentence of paragraph 55.

56. The allegations contained in paragraph 56 are conclusions of law to which no response is required; to the extent that they are allegations of fact, they are denied.

57. Denies.

58. Denies.

COUNT IV

59. The United States avers and incorporates by reference its responses to paragraphs 1 through 37 as though set forth in full.

60. Denies the allegations that the Government's claim is significantly overstated; admits the allegations that the DCE's final decision asserts a claim to the extent supported by the DCE's final decision contained in paragraph 60, which is the best evidence of its contents; otherwise denies the allegations contained in paragraph 60.

61. Admits the allegations contained in the first sentence of paragraph 61. Denies the allegations contained in the second sentence of paragraph 61 that the penalty amount was significantly overstated; admits the remainder of the allegations contained in the second sentence of paragraph 61.

62. Admits the allegations that DCE did not change the penalty amount based upon DCAA's revised assessment and asserted a Government claim contained in paragraph 62; denies the remainder of the allegations contained in paragraph 62.

63. The allegations contained in the first sentence of paragraph 63 are conclusions of law to which no response is required; to the extent that they may be deemed allegations of fact, they are denied. Denies the allegations contained in the second sentence of paragraph 63.

64. Denies each and every allegation not previously admitted or otherwise qualified.

65. Denies that Northrop is entitled to the relief requested, or to any relief whatsoever.

66. The remainder of the allegations contained in the complaint enumerates prayers for relief to which no response is required.

AFFIRMATIVE DEFENSES

67. Plaintiff's claim is barred by illegality as a result of submitting false claims.

DEFENDANT'S COUNTERCLAIMS

68. These counterclaims arise pursuant to the False Claims Act, 31 U.S.C. § 3729, and the special plea in fraud, 28 U.S.C. § 2514.

69. Defendant and counterclaim plaintiff is the United States.

70. Plaintiff and counterclaim defendant is Northrop.

FACTUAL BACKGROUND

71. DCMA is a component of the Department of Defense ("DoD") that administers contracts awarded by military departments and agencies and certain civilian agencies that do substantial business with DoD contractors.

72. DCMA employs administrative contracting officers ("ACOs") who administer individual contracts and have authority to negotiate indirect rates and determine compliance with Cost Accounting Standards. FAR § 42.302. For defense contractors with multiple operational locations, divisions, or subsidiaries, such as Northorp, DCMA also appoints a DCE (now, called the Corporate Administrative Contracting Officer) who is an

ACO with responsibility for dealing with the corporate management and who administers contract issues on a corporate-wide basis in order to facilitate contract administration activities.

73. As of 2003, Northrop was organized into eight different lines of business, known as "sectors": Electronic Systems, Integrated Systems, Information Technology, Ship Systems, Component Technologies, Newport News, Missions Systems, and Space and Technology. Each Northrop sector is organizationally responsible for a number of business units, known as "segments."

74. Each sector's indirect cost rates (also known as "billing rates") are used for reimbursement of overhead and general and administrative ("G&A") costs on cost-type Government contracts in accordance with FAR § 42.704 and must be approved by the ACO with cognizance over that sector.

75. At Northrop, the typical sequence for establishing and adjusting indirect cost rates is as follows:

(a) Initial billing rates are established based on the prior year-end actual rates.

(b) The negotiated billing rates may be revised based upon the

current year forward pricing rate proposal submitted normally in the second month of the fiscal year.

(c) Actual rate experience is compared to the billing rates during the year to determine if adjustments should be made.

(d) Provisional billing rates are revisited after Northrop submits its final indirect cost claims, usually several months after the end of the fiscal year.

(e) Final indirect cost rates are established for each fiscal year after Northrop submits its final indirect cost proposal to the contracting officer and to the Defense Contract Audit Agency ("DCAA").

76. Once Northrop submits its final indirect cost proposal, DCAA reviews the proposed costs for allowability[1] and allocability and issues an audit report identifying and explaining questionable costs. After reviewing the DCAA audit report, the contracting officer negotiates final indirect costs and/or rates with the contractor. If the contracting officer and Northrop

[1] DCAA examines the proposal to identify unallowable costs, which, if not excluded, can increase the final indirect cost rate. An "unallowable cost" is defined by FAR § 2.101 as "any cost that under the provisions of any pertinent law, regulation, or contract, cannot be included in prices, cost-reimbursements, or settlements under a Government contract to which it is allocable." 48 C.F.R. § 2.101.

cannot reach agreement on the allocability or allowability of final indirect costs, the contracting officer may issue a final decision disallowing specific indirect costs, and Northrop may appeal.

77. At any point in the process described in paragraphs 75 and 76, the ACO for a particular sector or segment may decide to adjust the provisional billing rates. If adjustments are made, Northrop loads the updated rates into the sector's billing rate tables for application on contract billings.

78. If circumstances preclude timely negotiation of final indirect costs or rates as provided for by FAR § 42.708, "quick closeout rates" may be applied to final vouchers so that contracts may be closed. Contracts closed out using the quick closeout process represent a small portion of Northrop's business base. Once a certain contract is closed out using the quick closeout process, Northrop is not able to make further adjustments to the indirect cost rates used for that closed contract.

79. Included in indirect cost rates are G&A expenses that include personnel costs, such as deferred compensation costs. To develop G&A rates, Northrop's corporate office accumulates corporate G&A expenses at the corporate level and it allocates the costs to the benefitting Northrop

sectors. Each sector incorporates G&A costs in its G&A rate.

80. From 1998 through 2001, Northrop made deferred compensation awards to its key employees pursuant to a RPSR plan. The Northrop corporate office accumulated these RPSR costs at the corporate level and allocated the costs to the benefitting Northrop sectors. In this case, the RPSR costs that Northrop specifically identified to a particular sector (for example, those RPSR award recipients that worked under a specific sector) were directly allocated to that sector (hereinafter, referred to as "sector RPSR costs"). RPSR costs that Northrop specifically identified to the corporate office were included in the Corporate Office Expense ("COE") pool, which was allocated to Northrop sectors with other corporate G&A expenses ("COE RPSR costs").

81. In several audit reports of Northrop's 1997-1999 Deferred Compensation and Corporate Office Expense Claims, DCAA questioned the allowability of the variable portion of the RPSR costs pursuant to FAR § 31.205-6 (Compensation Costs).

82. On June 14, 2002, Northrop and the Government settled the question of the allowability of RPSR costs using an Alternative Dispute Resolution ("ADR") process, defined above as "2002 Settlement

Agreement." Pursuant to the 2002 Settlement Agreement, the parties agreed that, "[f]or fiscal years 2000-2003, the Parties shall apply the percentages identified in Attachment A." The 2002 Settlement Agreement also stated that "[t]he Parties further recognize that the 1998 RPSR Grant was, and shall continue to be, accrued at 75% of the initial grant value and Northrop Grumman agrees that there will be no upward adjustment, irrespective of actual performance measurements under the 1998 RPSR plan."

83. On June 30, 2004, Northrop submitted its Fiscal Year 2003 Indirect Cost Proposal for Deferred Compensation ("2003 Cost Proposal"). Northrop posted its 2003 Cost Proposal on its Corporate Government Financial Relations ("GFR") website for access by the Northrop sectors on or about August 6, 2004.

84. Northrop's 2003 Cost Proposal, which was certified by John Young, Vice President Corporate Contracts and Pricing, included amounts for 2003 deferred compensation costs. In its proposal, Northrop stated:

> [t]he fixed portion of an RPSR award has been recognized as allowable by the Defense Contract Audit Agency (DCAA). The variable portion of an RPSR award in the incurred cost claim has been adjusted to reflect the final agreement reached with the Defense Contract Executive (DCE) during the

Alternative Dispute Resolution process on June 14, 2002.

85. Notwithstanding Mr. Young's certification, Northrop claimed payments which included RPSR costs calculated with a performance factor of 150 percent rather than the 75 percent rate to which the parties agreed in the 2002 Settlement Agreement.

86. On August 6, 2004, Mr. Jack Doyle, Manager Electronic Systems Government Compliance, submitted an update to the ES 2003 Sector Overhead Claim based upon estimated amounts for corporate allocations that Northrop's corporate office identified for Electronic Systems in its 2003 Cost Proposal. Given that the 2003 Cost Proposal claimed RPSR costs calculated with a performance factor of 150 percent rather than 75 percent, Electronic Systems' submission also contained RPSR costs in excess of the amount to which the Government agreed in their 2002 Settlement Agreement.

87. In Audit Report No. 4731-2004F10160011, issued on December 23, 2005, DCAA questioned $26,788,302 of Northrop's claimed 1998 RPSR grant costs in Northrop's 2003 Cost Proposal because Northrop utilized the actual performance factor of 150 percent rather than a performance factor of 75 percent as agreed by the parties in the 2002

Settlement Agreement. The regulations in FAR § 42.709 establish conditions under which an agency may assert a penalty against contractors that include unallowable costs in indirect cost proposals. DCAA stated that Northrop's submission subjected Northrop to a level 2 penalty because the 2003 Cost Proposal included costs that had been previously determined to be unallowable, pursuant to FAR § 42.709 and DFARS § 231.7002.

88. In a December 22, 2005 letter, which responded to a draft of DCAA's Audit Report No. 4731-2004F10160011, Northrop "agree[d that] the calculation inadvertently included a 150% rate rather than the agreed to 75% rate but [it did] not concur this inadvertent calculation [fell] within the category of a level two penalty as stated in FAR 42.709-1(a)(2)." Northrop also asserted that any penalties should be waived, claiming that the inclusion of unallowable costs "was inadvertent, notwithstanding the exercise of due care." It asserted: "Northrop Grumman has formal controls in place that involve training, checklist screening, scrubbing, management reviews, etc. to ensure unallowable costs are identified and excluded from its claim."

89. On February 24, 2006, Mr. Donald Springer, the DCMA DCE for Northrop, notified Northrop of his intent to assess a level 2 penalty in

the amount of $33,681,394, plus interest, in accordance with FAR §§ 42.709-1(a)(2) and 42.709-3 ("NOI"). He requested that Northrop provide him with whatever documentation and case law it wanted the Government to consider prior to making his final decision as to whether to impose a level 2 penalty upon Northrop.

90. In its March 24, 2006 response to the NOI, Northrop acknowledged that the 2003 Cost Proposal was prepared "without recognition of a provision of the [2002 Settlement Agreement] that operates to limit to 75% the 'performance factor' that applies to calculation of the 'true-up' of the 1998 Accelerated Fixed and Variable RPSRs." Nevertheless, Northrop asserted that the disputed costs in the 2003 Cost Proposal should not be subject to a penalty, and even if they were, the penalty should be waived.

91. On July 7, 2006, Mr. Springer issued his final decision to impose a penalty in the amount of $33,681,394, plus interest, for unallowable costs. He noted that "[Northrop] has acknowledged that under the Agreement, any amounts in excess of 75% were not to be charged to the Government . . . . and that it was [his] determination that under the [2002] Settlement Agreement, the costs in excess of 75% were agreed to

be unallowable, and that the costs are therefore subject to the level 2 penalty as set forth in FAR 42.709-1(a)(2) and 42.709-3(b)." He also stated that Northrop had not satisfied the requirements for waiver of the penalty set forth in FAR § 42.709-5(c).

92. On January 12, 2007, Ms. Susan L. Cote, Vice President, Corporate Contracts, Pricing and Supply Chain, disputed the DCE's decision to impose a penalty upon Northrop, but, in an alleged effort to resolve the dispute through negotiation rather than litigation, she notified the DCE that, if a penalty were assessed, Northrop believed that the Government overstated the penalty amount and that the amount subject to penalty was $7,647,600, which when doubled pursuant to FAR 42.709-1(1)(2) and 42.709-3(b) amounts to $15,295,200, rather than $16,840,697 in questioned costs, which when doubled amounts to $33,681,394.

93. In the General Dollar Magnitude Penalties Analysis transmitted with Ms. Cote's January 12, 2007 letter, Northrop stated that Long Term Incentive Plan ("LTIP") and deferred compensation costs, such as the RPSR costs, are charged to the Government at the sector level and that Northrop's 2003 Cost Proposal compiled the RPSR and other costs incurred by Northrop's eight sectors and the corporate office. Northrop

further noted that "only the [Electronic Systems Sector] included the allocable true-up costs in its final indirect cost rate proposal." Nevertheless, Northrop represented to the DCE that the 2003 Cost Proposal "did not result in the 'charge' of any RPSR costs to the Government" and that "no Northrop Grumman Government contracts were ever billed for the RPSR true-up costs." Both of these last two statements are untrue. Northrop knew or should have known that both of these assertions were false when it presented them as support for its indirect cost proposal.

94. On June 29, 2007, Northrop filed the complaint in this case.

95. Shortly after Northrop filed its complaint, in January 2008, the parties entered into settlement discussions under the Court of Federal Claims Alternative Dispute Resolution procedures.

96. Prior to entering into settlement discussions, Northrop did not disclose that the statements Northrop made in its General Magnitude Penalties Analysis transmitted with Ms. Cote's January 12, 2007 letter that the 2003 Cost Proposal "did not result in the 'charge' of any RPSR costs to the Government" and that "no Northrop Grumman Government contracts were ever billed for the RPSR true-up costs" were not correct.

97. The Government entered into settlement discussions with Northrop under the mistaken belief that it had not been billed or paid for any excess RPSR costs. Northrop did not inform the Government that Northrop had billed the Government using rates that included unallowable RPSR costs until the end of May 2009 and, even then, Northrop stated that it had reversed out and completely removed such improperly billed costs. In fact, some of those billed costs were not reversed out and removed until as late as November 2009, and others have never been reversed or removed.

NORTHROP'S FALSE OR FRAUDULENT CLAIMS

98. Northrop knowingly presented false claims to the United States to fraudulently obtain payment of unallowable costs. As explained above in Paragraph 75 and footnote 1, the parties established that costs in excess of the percentages of RPSR costs identified in the 2002 Settlement Agreement are unallowable costs. Northrop knew or should have known when it presented its 2003 Cost Proposal to the Government that, pursuant to the definition of "unallowable cost" in FAR § 2.101, these are costs that, under the provisions of the 2002 Settlement Agreement, cannot be included in billing rates or in vouchers presented to the Government for

payment.

99. Further, Northrop fraudulently pursued reimbursement of allocated unallowable RPSR costs in three of its sectors, Electronic Systems, Mission Systems, and Space Technology Sectors.

ELECTRONIC SYSTEMS SECTOR

100. On or about August 6, 2004, the Electronic Systems Sector allocated to its segments both COE and sector RPSR costs from the 2003 Cost Proposal, including RPSR costs which, in the 2002 Settlement Agreement, Northrop and the Government had agreed would not be allowable costs ("unallowable RPSR costs").

101. The Electronic Systems Sector did not remove unallowable RPSR costs from the 2003 Electronic Systems Sector allocations until June 6, 2007, and it did not remove unallowable COE RPSR costs from Electronic Systems Sector allocations until April 23, 2008.

102. Electronic Systems Co. segment ("ESCO") of Northrop's Electronic Systems Sector utilized interim G&A rates, effective June 6, 2007, that included unallowable sector RPSR costs when ESCO issued Rate Release ("RR") 2003-11. Unallowable COE RPSR costs remained in the G&A rates that ESCO used to bill Government contracts until ESCO

issued RR 2003-12, dated July 2, 2008.

103. The Cal Micro segment of the Electronic Systems Sector issued Rate Release CM 03-02, effective April 26, 2005, which was used for interim billing and quick closeout rates. These rates incorporated unallowable COE and sector RPSR costs from the 2003 Cost Proposal. On July 12, 2007, the Cal Micro segment revised its 2003 G&A rates for quick closeouts. Effective November 18, 2009, the Cal Micro segment and the Government entered into a Final Overhead Rate Agreement for 2003.

104. Effective August 18, 2004, the Electronic Business segment ("EBS") of the Electronic Systems sector issued RR 03-11, which utilized the Electronic Systems sector August 6, 2004 rates for 2003 interim final billing and quick closeout purposes and, therefore, included unallowable RPSR costs. Effective March 9, 2007, EBS issued RR 03-14, which rescinded its authority to utilize the RR 03-11 rates for quick closeout purposes. On June 8, 2007, EBS issued RR 03-15 to remove unallowable sector RPSR costs from its billing rates. EBS did not remove the unallowable COE RPSR costs from its interim billing rates until May 20, 2008.

105. On October 11, 2004, the Marine Systems segment of the

Electronic Systems Sector incorporated the August 6, 2004 allocation of unallowable RPSR costs in Rate Release 04FPC-048. The Marine Systems segment did not remove unallowable sector or COE RPSR costs from its billing rates until August 20, 2009.

106. The Advanced Technical Support Program segment ("ATSPS/DMEA") of the Electronic Systems sector incorporated the August 6, 2004 allocations of RPSR costs in a rate release effective September 17, 2004, and did not remove unallowable RPSR costs until March 27, 2009.

107. The Xetron segment of the Electronic Systems sector utilized the August 6, 2004 allocations of unallowable sector and COE RPSR costs in its billings on Government contracts beginning on August 9, 2004. Northrop has not removed the unallowable sector or COE RPSR costs from its billing rates for the Xetron segment up to this point in time.

108. For a portion of the time period from August 2004 through at least December 2009, the ESCO, Cal Micro, EBS, Marine Systems, ATSPS/DMEA, and Xetron segments of Northrop's Electronic Systems Sector included unallowable RPSR costs in interim billing rates. During this period of time, the ESCO, Cal Micro, EBS, Marine Systems,

ATSPS/DMEA, and Xetron segments of Northrop's Electronic Systems Sector submitted invoices and vouchers to the Government that included unallowable RPSR costs, and the Government paid these invoices.

109. For a portion of the time period from August 2004 through at least December 2009, the ESCO, EBS, and Xetron segments of Northrop's Electronic Systems Section submitted final invoices to the Government that used quick closeout rates which included unallowable RPSR costs, and the Government paid these invoices. Northrop has not reimbursed the Government for unallowable RPSR costs that were included in final invoices that used these quick closeout rates.

MISSION SYSTEMS SECTOR

110. For accounting and billing purposes, the segments of the Mission Systems Sector of Northrop were divided into West Coast and East Coast divisions. The West Coast division includes the Systems Support & Integration ("HC/HD") and Engineering & Systems Support Services ("HE/HH") segments. The East Coast division includes the Information Systems Management Support Systems ("HF/KA"), Information Systems Value Services ("HQ"), Information Systems Support Systems ("HW"), and Information Systems Management Support Services ("KB")

segments.

111. The quick closeout rates for the West Coast segments of the Missions System's Sector's 2003 COE claim included unallowable RPSR costs which were incorporated into quick closeout rates beginning on November 18, 2004, until March 26, 2009. The Government paid these invoices. Northrop has not reimbursed the Government for unallowable RPSR costs that were included in its quick closeout rates.

112. The quick closeout rates for the East Coast segments of the Missions Systems Sector's 2003 COE claim included unallowable RPSR costs which were incorporated into quick closeout rates beginning on December 2, 2004, until July 14, 2009. During this period of time, the HF/KA, HQ, HW, and KB segments billed the Government for costs based upon quick closeout rates that included unallowable RPSR costs, and the Government paid these invoices. Northrop has not reimbursed the Government for unallowable RPSR costs that were included in its quick closeout rates.

SPACE TECHNOLOGY SECTOR

113. The Radio Systems Segment of the Space Technology Sector 2003 COE claim included unallowable RPSR costs which were

incorporated into quick closeout rates beginning on May 30, 2007, until July 16, 2009, the date upon which the ACO was advised of the potential impact of the unallowable RPSR costs and other adjustments on the quick closeout rates. During this period of time, the Radio Systems Division billed the Government for costs based upon quick closeout rates that included unallowable RPSR costs, and the Government paid these invoices. Northrop has not reimbursed the Government for unallowable RPSR costs that were included in its quick closeout rates.

COUNT I

(False Claims Act – 31 U.S.C. § 3729 *et seq.*)

114. The United States incorporates by reference the allegations set forth in paragraphs 68 through 113 above.

115. Despite the fact that Northrop agreed in the 2002 Settlement Agreement that it would not charge the Government for RPSR costs in excess of RPSR costs based on a 75 percent performance factor, Northrop repeatedly presented false claims and misrepresentations to the Government to fraudulently obtain payment of the costs it specifically promised it would not charge the Government.

116. Northrop billed the Government for RPSR costs based upon a

150 percent performance factor.

117. In its December 22, 2005 response to DCAA's audit of its 2003 Cost Proposal, Northrop admitted that its 2003 Cost Proposal "included RPSR costs calculated using a 150% rate rather than the agreed to 75% rate".

118. In its January 12, 2007 letter to the DCE, Northrop represented that the 2003 Cost Proposal "did not result in the 'charge' of any RPSR [true-up] costs to the Government" and that "no Northrop Grumman Government contracts were ever billed for the RPSR true-up costs."

119. During the period of time from July 2004 through December 2009, Northrop submitted thousands of interim and quick closeout billings for G&A costs based upon rates that included unallowable RPSR costs.

120. The Government paid Northrop's Electronic Systems Sector at least $1,974,900 in unallowable RPSR costs.

121. The Government paid Northrop's Electronic Systems Sector at least $1,000 for unallowable RPSR costs which Northrop included on final invoices using quick closeout rates.

122. The Government paid Northrop's Mission Systems Sector at least $8,700 for unallowable RPSR costs which Northrop had included on

final invoices including quick closeout rates.

123. The Government paid Northrop's Space Technology Sector at least $3,300 for unallowable RPSR costs which Northrop had included on final invoices using quick closeout rates.

124. Northrop's Electronic Systems Sector included unallowable RPSR costs in over 4,525 interim billing invoices that it submitted to the Government.

125. Northrop's Electronic Systems Sector included unallowable RPSR costs in at least 15 quick closeout billings that it submitted to the Government.

126. Northrop's Mission Systems Sector included unallowable RPSR costs in at least 592 quick closeout billings it submitted to the Government.

127. Northrop's Space Technology Sector included unallowable RPSR costs in at least 28 quick closeout billings it submitted to the Government.

128. In each instance of the above described billings by Northrop, it presented or caused to be presented claims for payment to the Government in the form of vouchers and invoices that included indirect rates that included RPSR costs which the parties had agreed in their 2002

Settlement Agreement would not be allowable costs.

129. The claims referred to in paragraph 115 through 128 were fraudulent because, in signing their 2002 Settlement Agreement, Northrop and the Government had agreed that, in the future, (1) "[f]or fiscal years 2002-2003, the Parties shall apply the percentages identified in Attachment A;" and (2) "[t]he Parties further recognize that the 1998 RPSR Grant was, and shall continue to be, accrued at 75 [percent] of the initial grant value and Northrop Grumman agrees that there will be no upward adjustment, irrespective of actual performance measures under the 1998 RPSR plan." Northrop knew or should have known that its claims were based upon indirect rates which included RPSR costs calculated with a performance factor of 150 percent rather 75 percent.

130. Based upon the parties' 2002 Settlement Agreement, Northrop knew or should have known that submission of invoices and vouchers for payment which included indirect rates that included unallowable RPSR costs was fraudulent.

131. The United States suffered damages as a result of the false or fraudulent claims because: (1) the Government overpaid Northrop in excess of $1.9 million based upon Northrop's fraudulent inclusion of

unallowable RPSR costs in its indirect rates; (2) notwithstanding Northrop's later repayment of some of the excess $1.9 million the Government overpaid Northrop, the Government was damaged because it did not have use and benefit of the money the Government overpaid Northrop between the extended period of time that Northrop received the payments and it repaid the Government; (3) the Government was and continues to be damaged by the significant administrative and investigative costs expended to pursue the extensive and complicated unraveling of Northrop's billing the Government for unallowable RPSR costs from 2003 through at least 2009; and (4) the amount of actual damages incurred by the Government will be determined at trial because Northrop has not repaid all of the money the Government paid to Northrop based upon its fraudulent invoices and vouchers.

132. In the alternative, in entering into the 2002 Settlement Agreement, Northrop promised not to charge the Government for unallowable RPSR costs. The Government was induced by the 2002 Settlement Agreement to pay subsequent invoices and vouchers from Northrop that included unallowable RPSR costs in its indirect rates. When Northrop failed to act to insure implementation of the terms of the 2002

Settlement Agreement in its submission of cost proposals and in its billing practices, Northrop knowingly and recklessly disregarded its obligation to comply with the terms of the 2002 Settlement Agreement. As a result, the Government was damaged in the manner described in paragraph 126.

133. Further, by representing in the General Dollar Magnitude Penalties Analysis transmitted with Ms. Cote's January 12, 2007 letter that "no Northrop Grumman contracts were ever billed for the RPSR true-up costs," Northrop knowingly made a false statement to improperly avoid or decrease its obligation to repay unallowable RPSR costs to the Government.

134. Therefore, Northrop is liable pursuant to the False Claims Act, 31 U.S.C. § 3729, for treble damages for all unallowable RPSR costs paid by the Government, less amounts previously reimbursed to the Government, plus a civil penalty of not less than $5,500 and not more than $11,000 for each claim presented.

COUNT II

(Forfeiture of Fraudulent Claims – 28 U.S.C. § 2514)

135. The United States incorporates by reference the allegations set forth in paragraphs 71 through 97.

136. Northrop practiced or attempted to practice fraud against the United States in the proof, statement, establishment, or allowance of the submissions referenced in paragraphs 71 through 97. In particular, Northrop made false claims and practiced fraud against the United States when it presented its 2003 Cost Proposal to the DCE and its certified claims to the contracting officers with the intent to cause the Government to pay Northrop amounts to which it knows it is not entitled.

137. Northrop made false claims and practiced fraud against the United States when it falsely represented that "no Northrop Grumman Government contracts were ever billed for the RPSR true-up costs" in connection with its claim that the penalty assessment was improper.

138. Therefore, Northrop is liable for the forfeiture of its claim, in its entirety, pursuant to 28 U.S.C. § 2514.

PRAYER FOR RELIEF

WHEREFORE, defendant, the United States, requests that the Court enter judgment in its favor, and against Northrop as follows:

a. On Count I (False Claims Act – Presentation of False Claims), for such damages and civil penalties as are allowable by law;

b. On Count II (Forfeiture of Fraudulent Claims), for forfeiture of

plaintiff's entire claim;

c. for such other and further relief as the Court may deem appropriate.

Respectfully submitted,

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