

Regulating Fraud in Military Procurement: A Legal Process Model

Patrick J. DeSouza†

This conjunction of an immense Military Establishment and a large arms industry is new in the American experience The potential for the disastrous rise of misplaced power exists and will persist. We must never let the weight of this combination endanger our liberties or democratic processes Only an alert and knowledgeable citizenry can compel the proper meshing of the huge industrial and military machinery of defense with our peaceful methods and goals so that security and liberty may prosper together.

—President Dwight D. Eisenhower*

INTRODUCTION

Waste in military procurement has come to the forefront of public debate.¹ Critics argue convincingly that the current system provides neither the checks nor the incentives necessary to regulate expenditures effectively.² Public debate has focused on the problem of fraud against the government by defense contractors as a primary source of wasted resources.³ However, what is characterized as fraud against the government

† I would like to thank Professors Jan Deutsch, Reinier Kraakman, and Jerry Mashaw for helpful comments on earlier drafts. I would also like to thank Mr. Domingos X. DeSouza for introducing me to these "micro-aspects" of national defense.

* Farewell Address to the Nation by President Eisenhower (Jan. 17, 1961), *reprinted in* DEP'T ST. BULL., Feb. 6, 1961, at 180-81.

1. The purchase of military-related weapons, supplies and equipment cost the federal government \$86.2 billion in 1984. This cost is projected to increase to \$106.8 billion by 1986. OFFICE OF MANAGEMENT & BUDGET, BUDGET OF THE U.S. GOVERNMENT—FISCAL YEAR 1986, at 8-66 (1985). It has been estimated that up to one-half of these procurement expenditures could be eliminated through stricter financial management. Biddle, *New Study Finds Inflated Labor Costs on Weapons*, N.Y. Times, Oct. 11, 1984, at A17, col. 1.

2. See Williams, *Bungling the Military Buildup*, N.Y. Times, Jan. 27, 1985, § 3 (Business), at 1, col. 4. In fact, there is growing consensus among critics of the Department of Defense (DOD) that DOD employs a system of rewards and punishments that creates perverse incentives for all participants in the procurement process. Mohr, *Critics See Key Flaws in Arms Cost Controls*, N.Y. Times, May 18, 1985, at 1, col. 4.

3. See, e.g., Jackson, *Pentagon Blacklists More Suppliers In a Tougher Stance Toward Fraud*, Wall St. J., Aug. 5, 1983, at 23, col. 4; Biddle, *Price of Toilet Seat Is Cut for Navy*, N.Y. Times, Feb. 6, 1985, at D15, col. 2 (Lockheed charged Navy \$640 for aircraft toilet seat but was forced to reduce price to \$100 once public attention was drawn to charges). Although public attention focused on Lockheed's reduction in price, Lockheed was not, however, solely to blame for the overpricing, be-

Fraud in Military Procurement

often may better be understood as fraud *by* the government in the form of mismanagement.⁴ Both fraud against the government and fraud by the government constitute fraud⁵ against a public that believes it is procuring a certain level of military readiness for a given level of spending.⁶ Public policy must recognize and address both types of fraud.

This Note argues that the current regulatory approach used by the Department of Defense (DOD) to deal with fraud in military procurement fails because it does not address the complexities of the military-industrial relationship or DOD's own role in contributing to fraud. Congress and the courts have given DOD broad authority to identify wrongdoers and impose severe sanctions, allowing DOD to shift selectively to defense contractors the risk of its being blamed for excessive and wasteful military spending. As a result, DOD is able to diffuse and divert public pressure on the military to justify its budget.⁷ If waste in military procurement is

cause it relied on standard DOD cost accounting principles in charging DOD for overhead, labor, handling, and 13.4% profit. *Id.* See *infra* notes 10-14 for discussion of the complex nature of fraud.

4. Mismanagement here refers to the misallocation of public resources that results from waste (inefficient use of resources) and abuse (poorly written regulations) in the government's administration of its programs. Mismanagement by the government should be considered a subset of fraud because Congress and ultimately the public are induced to authorize excess defense expenditures for security programs that they are led to believe are absolutely necessary. See *infra* note 6. See Roth, *The "Malmanagement" Problem: Finding the Roots of Government Waste, Fraud, and Abuse*, 58 NOTRE DAME L. REV. 961, 962-66 (1983) (fraud, waste, and abuse in government administration are considered subsets of malmanagement). "Malmanagement," unlike the broader concept of fraud, does not adequately capture the manner in which officials manipulate public opinion in order to legitimize the defense budget. See *infra* notes 5-7.

5. "Fraud [here] may be defined as any behavior by which one person intends to gain a dishonest advantage over another." M. COMER, *CORPORATE FRAUD* 1 (1977) (footnote omitted). There is no standard definition of fraud. See *infra* note 8. In general, studies attempting to define fraud are usually anecdotal, see, e.g., F. OUGHTON, *FRAUD AND WHITE COLLAR CRIME* (1971), or lump fraud together with other publicly inappropriate behavior, see, e.g., R. BLUM, *DECEIVERS AND DECEIVED* (1972); S. ROSE-ACKERMAN, *CORRUPTION: A STUDY IN POLITICAL ECONOMY* (1978) (advocating positive theory of corruption that lumps together behavior such as bribery, influence-peddling, and fraud).

6. Although polls have shown that the majority of voters support the current level of defense spending, which has resulted in a 92% increase in procurement since 1980, analysts cannot agree on whether there has been any improvement in military security. By competing with civilian programs for limited resources, however, the military buildup has called increased attention to waste. See Keller, *As Arms Buildup Eases, U.S. Tries to Take Stock*, N.Y. Times, May 14, 1985, at A1, col. 4, A20, cols. 2-5. The public is defrauded by the government when DOD publicly claims that it requires X dollars to purchase security when there is actually a hidden factor of Y dollars that could have been saved by actions under DOD's control. There are behavioral reasons why the "true price" of the security purchased by the government is unstated. Bureaucrats often seek to maximize their decision-making power by maximizing their budget. See R. ARNOLD, *CONGRESS AND THE BUREAUCRACY* 21 (1979). Another reason for an intentionally inflated price is bureaucratic pressure to enlarge procurement programs. Such pressure arises from a need to justify and perpetuate the institution itself. G. ADAMS, *THE POLITICS OF DEFENSE CONTRACTING* 22 (1981); see also S. MELMAN, *THE PERMANENT WAR ECONOMY* 64 (1974) (explaining DOD managers' tendency to expand programs). The public has a right to choose, free from bureaucratic pressure, whether it wants more defense or increased allocation to other programs; equally important, it has the right to get what it pays for.

7. Evidence suggests that public opinion is often a proximate cause of policy choices. Page & Shapiro, *Effects of Public Opinion on Policy*, 77 AM. POL. SCI. REV. 175, 188-89 (1983) (empirically testing the intuitive relationship). Public pressure and policy preferences regarding the defense budget

to be reduced, the notion of fraud must be redefined to take into account DOD mismanagement. An optimal regulatory policy must not focus exclusively on defense contractors, but should create incentives for both defense contractors and DOD to act efficiently. This Note will explore ways in which legal process can be used to create such incentives.

I. UNDERSTANDING REGULATION OF FRAUD IN MILITARY PROCUREMENT

Any system of regulation must be premised upon a clear and accurate identification of the underlying problem. The nature of military fraud and the complexities inherent in the military-industrial relationship make such identification extremely difficult within the context of military procurement. Difficulties in identification coupled with DOD's broad discretion to deter military procurement fraud allow DOD to mischaracterize its own mismanagement as fraud against the government, leaving the public to bear the cost of such inefficiency.

A. *Identifying Military Fraud and the Problems of Characterization*

An optimal regulatory policy would both punish guilty defense contractors and hold the government accountable for financial mismanagement. In dealing with military procurement problems, however, the government has no standard definition of fraud that captures this policy objective.⁸ Even though three different kinds of misconduct, which can exist simultaneously, may be involved, the current system only recognizes willful wrongdoing by contractors as fraud: falsification of time cards or purchase orders, submission of false claims, intentional misallocation of contract costs, and mischarging of gratuities.⁹ Many situations that DOD cur-

are shaped by the public's perception of whether misallocation of defense resources is due to mismanagement by the government or "rip-off" by the contractor. "What the stories [depicting DOD performance] are determines a lot about his [Secretary of Defense Weinberger's] budget." Alpern, *Now 'Cap the Ladle,'* NEWSWEEK, Feb. 11, 1985, at 20 (statement of Air Force Secretary Verne Orr).

8. See GENERAL ACCOUNTING OFFICE, 2 FRAUD IN GOVERNMENT PROGRAMS: HOW EXTENSIVE IS IT? HOW CAN IT BE CONTROLLED? REPORT TO THE CONGRESS 1 (Sept. 30, 1981) (government has no standard definition of fraud that can be applied across agencies). DOD has defined fraud as: "[A]ny willful or conscious wrongdoing that adversely affects the Government's interests." *Id.* at 2.

9. See DEPARTMENT OF DEFENSE, INDICATORS OF FRAUD IN DEPARTMENT OF DEFENSE PROCUREMENT (June 1, 1984) (listing general categories of fraudulent behavior affecting military procurement) [hereinafter cited as DOD INDICATORS]. Some examples of fraudulent behavior are sensational and relatively easy to detect. For instance, Admiral Hyman G. Rickover, "Father of the Nuclear Navy," was accused by Congressional investigators of having accepted \$75,000 in gifts from General Dynamics during the development of various submarine projects. Williams, *supra* note 2, at 8, col. 6. Under current DOD interpretations of the law, 18 U.S.C. §§ 201-209 (1982), 18 U.S.C.A. § 218(l) (West Supp. 1985), such gratuities are considered to be fraudulent and can trigger suspension and debarment proceedings and perhaps even rescission of contracts. DOD INDICATORS, *supra*, at 9.

Yet the problem of fraud is much more complex than is apparent from the "objective" indicators that DOD has promulgated. Defense is often an "influence business." G. ADAMS, *supra* note 6, at 23.

Fraud in Military Procurement

rently characterizes as contractor fraud actually reflect a second kind of misconduct—financial mismanagement by Congress or DOD.¹⁰ Sloppy cost accounting standards,¹¹ vague cost indices,¹² and faulty purchase order systems¹³ are at the root of much of what DOD has characterized as

Because bureaucrats and managers in the defense industry often interchange jobs, lower level gratuities such as wining and dining officers and taking trips on corporate jets are particularly pernicious because it is difficult to distinguish expenses necessary for business from those related to future job prospects. See Gelman, *A Giant Under Fire*, NEWSWEEK, Feb. 11, 1985, at 24, 25. In addition, because it is left to the offeree to call attention to this type of fraud, prosecution is often selective and driven by factors such as image-making at budget time. See Gerth, *Pentagon Halts Some Payments Due Contractor*, N.Y. Times, Mar. 6, 1985, at A1, col. 2 (Congressional hearings on improper billing practices of General Dynamics prompts DOD to suspend payments to company); Biddle, *Pentagon Puts a Ripple in Defense Contractor's Cash Flow*, N.Y. Times, Mar. 10, 1985, § E (Week in Review), at 3, col. 1 (Rep. Brooks of Texas calls Pentagon crackdown of General Dynamics "cosmetics").

10. Three examples illustrate the role of government practices in fostering "fraud." First, Ingalls Shipbuilding charged the Navy \$256 for a gravity-timer switch available in a store for approximately \$11. See *Irregularities in Navy Ship Procurement: Hearings Before the Perm. Subcomm. on Investigations of the Senate Comm. on Government Affairs*, 98th Cong., 1st Sess. 93 (1983) [hereinafter cited as *Hearings*]. This 2000% markup was legally possible under a Basic Ordering Agreement system devised by the Navy that allowed the firm to separate out fixed costs and allocate them to specific items irrespective of the cost of the item. *Id.* Second, in 1983, DOD paid Boeing \$1,118.26 for a 26-cent stool cap. Gellman, *Saga of the World's Costliest Plastic Cap*, Washington Post, Aug. 21, 1983, at A1, col. 1. Even if purchased individually instead of by bulk, the cost of production was estimated to be at most \$10. *Id.* at A6, col. 2. Boeing was able to charge the Air Force 100 times this amount by factoring in labor hours, inspection charges, fringe benefits for labor, and manufacturer's overhead. *Id.* at A6, cols. 2-4. The Air Force acknowledged that Boeing used rates in its cost breakdown consistent with approved rates. *Id.* at A6, col. 5. Third, in 1983, the Air Force paid \$38 for a 38-cent screw. Meyer, *Would You Pay \$30 for this Screw?*, ARMED FORCES J. INT'L, Sept. 1983, at 40, reprinted in CONGRESSIONAL RESEARCH SERVICE, DEFENSE SPENDING: WASTE, FRAUD, AND ABUSE (IP0279D) (on file with author). It is possible that lack of competition and choice of high technology materials turned this ordinary screw into a "piece of art." More plausibly, however, it was low levels of monitoring by DOD for errors or waste in contracting that created such unnecessarily high prices. *Id.* at 41.

11. Unlike other government agencies or organizations in the private sector, DOD allows contractors to include the cost of money in the base income from which profit is computed. Gerth, *Pentagon Study Explores Profits for Contractors*, N.Y. Times, Mar. 18, 1985, at A1, col. 1, D6, col. 6. In 1983, a House Appropriations Committee study found a "lack of support in authoritative accounting literature" for the use of a cost of money standard and estimated that such use cost the government between \$1.4 and \$2.1 billion a year in the shipbuilding industry alone. *Id.*

12. Representative Les Aspin, Chairman of the House Armed Services Committee, estimated that over the last four years Congress has appropriated \$18 to \$50 billion more than necessary for DOD procurement programs because the Reagan Administration has used inflation indicators that have overestimated inflation. Mohr, *Military Received \$18 Billion Extra, Aspin Calculates*, N.Y. Times, May 20, 1985, at A1, col. 6. The Reagan Administration applied a special inflation prediction for military procurement that was 30% higher than the general prediction used for the rest of government. *Id.* at B12, col. 2.

13. Purchase order systems are devised by DOD to facilitate contracting. Such systems often allow contractors to charge to each purchase order a fixed amount for overhead, labor, inspection, etc. See *Hearings*, *supra* note 10, at 93. DOD has an incentive to subsidize contractors because it wants to ensure an industrial base for military readiness. However, sloppiness in devising the system, failure to realize the effects of short production runs, and failure to monitor what is being purchased result in billions of dollars in excess subsidies. For example, because the Air Force ordered a short production run of three stool caps, Boeing factored in overhead costs, which were allowable under the purchase order system, resulting in the outrageous price of \$1,118.36 per cap. Boeing explained that if the Air Force had ordered such spare parts in bulk, the unit costs would have been reduced to a price that was expected. See Gellman, *supra* note 10, at A6, col. 2. An audit of seven major military contractors

fraud against the government. Finally, procurement fraud may also consist of collusion between contractors and government.¹⁴ The interaction between these three types of misconduct must be recognized and analyzed before it is possible to construct any reasonable solution to the problem of military procurement fraud.

B. *The Military-Industrial Relationship: "Swindling" or "Selling"?*

Military procurement often involves production of goods, such as tanks and submarines, for which the government is the sole purchaser. As a result, the military-industrial relationship is often a unique one,¹⁵ subject to complexities not found in the normal purchaser-supplier relationship in the civilian economy.¹⁶ The fact that the government and defense industry

by the House Armed Services committee found widespread abuse of overhead charges such as the inclusion of sports tickets for "worker morale" within these charges. Biddle, *Audit Cites Pentagon Contractors*, N.Y. Times, Apr. 29, 1985, at D1, col. 6.

14. Two illustrations demonstrate the complex nature of situations characterized as fraud. First, companies such as General Dynamics often use techniques such as "rubber baseline" and "buy-in" which enable them to secure contracts by bidding for them at unrealistically low prices. After award and start-up, these companies then charge additional amounts as part of renegotiation for design modification in weapons systems. See Williams, *supra* note 2, at 8, col. 5. Second, it has been alleged that the Navy increased profits on ships under construction by General Dynamics in exchange for the company's decision not to file insurance claims against the Navy. *Id.* The critical issue in cases such as these is how to assign blame given the ambiguous relationships among the parties. Often the assignment of blame will depend on who has the decisionmaking power to characterize fraud.

15. There is a circular flow of personnel between DOD and contractors that "create[s] a closed network in a community of shared assumptions [about policy issues]." G. ADAMS, *supra* note 6, at 79. These social networks can lead to facility of contracting given the unique expertise involved. Such networks can also lead, however, to collusion in perpetrating fraud against the public given that defense is considered a unique sector of the economy and usually is not scrutinized by the public. See also S. MELMAN, *supra* note 6, at 59-73 (elaboration of military-industrial complex).

16. Many military goods can be used only by the government and require specialized equipment in order to be produced. In many such cases, both DOD and the contractor are locked into a situation where there is only one buyer and one seller. In the civilian economy, because there are usually many buyers and sellers for each product, if either party is suspected of bad faith in the transaction, the other party can seek out another competitor with whom to do business.

DOD believes that competition in the defense sector will cure inefficiency and poor quality. However, only six percent of contracts, when they reach the production stage, are let competitively. See Williams, *supra* note 2, at 8, col. 2. Some analysts claim that the portion of contracts let competitively has fallen to as low as 4.1% in 1984. Alpern, *supra* note 7, at 20, col. 3. This result is largely due to the fact that there are so few defense contractors.

Even if a larger pool of defense contractors made more competitive bidding possible, it is unlikely that DOD's contracts would automatically become less expensive. Military officials are often swayed more by state-of-the-art technology than by cost-effectiveness. High technology and high cost materials such as tantalum, titanium or cobalt are often needed to sustain high performance weapons. Critics of procurement policy have argued that the functional use of weapons, and not their level of technology, should principally inform the decisionmaking process of what to procure. See J. FALLOWS, NATIONAL DEFENSE 35, 49-55, 173-74 (1981).

Moreover, the "culture of procurement" teaches military officers that the surest path to advancement is not on the battlefield but in being the manager of a large, successful program. *Id.* at 64. Unlike "cost-cutters" in civilian industry who police fraud to ensure a competitive position for the enterprise, managers in DOD have an incentive to "overlook" minor fraud rather than call public attention to waste and risk cut-backs in funding. See Greve, *A Career Cut Short By A Mission Well Done*, in MORE BUCKS, LESS BANG: HOW THE PENTAGON BUYS INEFFECTIVE WEAPONS 284-88

Fraud in Military Procurement

contractors cooperate to produce a specialized product makes it especially hard to distinguish between a legitimate "sale" and a fraudulent "swindle."¹⁷

Professor Leff considered "swindles" to be another way of conceptualizing fraud.¹⁸ Central to any fraud or swindle is the deception employed by the perpetrator to persuade the victim to enter into the bargain.¹⁹ Swindles are, to a greater or lesser extent, consensual crimes—payment is rarely forced.²⁰ In sharp contrast to the image of a perpetrator holding up his victim, swindles work because perpetrators convince the victims to cast themselves as part of a cooperative relationship.²¹ As a consequence, swindles can be difficult to regulate, because the "victim," fully desiring to participate in the transaction, often will not object to the behavior until it is too late, if at all.²²

Because the cooperative aspect of military-industrial relations serves to blur the distinctions among outright theft, mismanagement, and collusion, a narrow conception of military procurement fraud that focuses solely on fraud against the government does not accurately reflect the reality of the problem. A proper definition of procurement fraud must focus on the bargaining positions of the parties and the sociological structure of the procurement transaction.²³ To the extent that the definition rests on an ap-

(D. Razor ed. 1983). See also S. MELMAN, *supra* note 6, at 27-58 (comparing business practices of firms in civilian and military economy).

17. It is often difficult to tell the difference between "selling" and "swindling" because each party entered into the swindle believing that it was getting a bargain in the deal. In order to complete the transaction both parties need each other or at least desire to make it look like they need each other. The most fundamental principle of selling credibility needed to carry out a swindle is that "thou shall not appear to be making a gift." See A. LEFF, *SWINDLING AND SELLING* 9-16 (1976). By the time one of the parties feels swindled, he has engaged in enough questionable activities himself not to want to call attention to the matter.

18. *Id.* at 181-83.

19. Compare *id.* at 182-83 with M. COMER, *supra* note 5, at 1 (conception of fraud based on deception).

20. A. LEFF, *supra* note 17, at 9, 182.

21. *Id.* at 182. Leff points out:

[O]ne reason many swindles may be hard to control is that they work by getting a victim to recast himself as the partner of some other party who is . . . plundering him

Bunco and business . . . have many things in common [O]ne of the fundamental thrusts of all salesmanship . . . [is] the customer's recharacterization of himself.

Id. See also W. REISMAN, *FOLDED LIES: BRIBERY, CRUSADES, AND REFORMS* 23 (1979) ("deception often is a shared process").

22. See A. LEFF, *supra* note 17, at 182. The procurement technique of using the "rubber-baseline" is an example of the belated realization of the swindle. See *supra* note 14. It is possible that procurement officers—the victims—know that the price bid may be too low for some projects and that the government will have to pay for cost-overruns, but they accept the bid anyway because of the career incentives of managing a weapons program. See J. FALLOWS, *supra* note 16, at 62-69 ("culture of procurement").

23. Economic analysis grounded in rational calculation has limited utility in understanding fraud as it ignores the "microreality of transactions." A. LEFF, *supra* note 17, at 180. Rather than being understood in terms of a coerced choice, swindles are most usefully thought of as studies in people's levels of "ignorance and bondage," and the roles in which they find themselves. *Id.* at 180-81. The

propriate casting of the roles of perpetrator and victim, allocation of the power to characterize those roles becomes crucial. DOD currently enjoys the exclusive power to characterize these roles, and thus it is not surprising that it consistently characterizes itself as the victim and contractors as the perpetrators.

C. *The Current Regulatory Framework*

The current regulatory framework vests DOD with broad regulatory power over the various participants in the weapons acquisition process. Although Congress and especially the courts have raised questions regarding this allocation of power, they have thus far deferred to administrative determinations.

1. *DOD's Regulatory Power*

Congress has granted DOD broad authority to regulate military procurement fraud.²⁴ Pursuant to this grant, DOD has promulgated regulations giving itself largely unlimited discretion to identify fraud, assign blame, and impose sanctions. DOD has absolute discretion to suspend and debar contractors suspected of fraud from receiving any further government contracts,²⁵ defense-related or otherwise.²⁶ Given "adequate evi-

social network of military-industrial relations often has more to do with how deals are made—sales or swindles—than does rational, economic planning. *See supra* note 15. *See also infra* note 89 (DOD official solicits funds from contractors to set up own consulting firm to advise on procurement regulations). Given the limited applicability of cost/benefit analysis in this social system, DOD's choice of a deterrence framework that is based on these calculations is questionable.

By generating information, legal process enables one to understand the intent of the parties to the transaction—a critical feature in this process of casting roles and dealmaking. *See A. LEFF, supra* note 17, at 180, 183. *See also* DOD INDICATORS, *supra* note 9, at 14 (especially in cases involving defective pricing, intent is critical in determining whether criminal act has occurred).

24. On September 19, 1983, a joint document was issued by the General Services Administration, DOD, and the National Aeronautics and Space Administration establishing a new Federal Acquisition Regulation System [hereinafter cited as FAR], 48 Fed. Reg. 42,103 (1983) (codified at 48 C.F.R.); *see also* 50 Fed. Reg. 26,987 (1985) (announcing changed regulatory system). General FAR regulations were codified in chapter 1 of Title 48 while Chapters 2-49 of Title 48 were reserved for individual agency supplements. This FAR system went into effect on April 1, 1984. Defense Acquisition Regulations [hereinafter cited as DAR] (codified at 32 C.F.R.), which formerly governed defense contracts, continue to apply to those contracts preceding April 1, 1984. 50 Fed. Reg. 26,988 (1985). Because most defense contracts are long-term, there exists overlapping regulatory authority. However, between July 1, 1983 and July 1, 1984, when the new system was to become effective, DOD issued numerous amendments to the DAR system which made regulatory power to prosecute fraud basically the same under both sets of governing regulations. In discussing the current regulatory framework, I will illustrate DOD's broad regulatory authority under both systems.

25. FAR, 48 C.F.R. §§ 9-406 to -407 (1984) (contracts effective after Apr. 1, 1984), and DAR, 32 C.F.R. §§ 1-605 to -606 (1984) (contracts effective before Apr. 1, 1984), set the basic penalties for firms "suspected" of fraud. The severity of these penalties in terms of their economic costs to the enterprise are expected to deter defense contractors from deviating from DOD specifications.

26. "A contractor's suspension shall be effective throughout the executive branch of the Government, unless an acquiring agency's head . . . states in writing the compelling reasons justifying continued business dealings between that agency and the contractor." FAR, 48 C.F.R. § 9.407-1(d)

Fraud in Military Procurement

dence," a DOD contracting officer may, for reasons as vague as a lack of business integrity,²⁷ suspend a contractor suspected of fraud for up to eighteen months without initiating legal proceedings.²⁸ Similarly, a DOD official may debar a defense contractor from receiving any new government contracts or from having any existing government contracts renewed or extended for up to three years.²⁹ An official may take such action for any cause "of so serious or compelling a nature that it affects the present responsibility of a Government contractor or subcontractor."³⁰

DOD has chosen a regulatory framework that devotes minimal resources to detection and monitoring,³¹ and that seeks to intimi-

(1984). The same conditions apply to debarment. FAR, 48 C.F.R. § 9.406-1(c) (1984). *Cf.* "A contractor's suspension shall be effective throughout the Executive branch of the Government, unless the Secretary of the Military Department or other Federal agency taking the procurement action . . . states in writing the compelling reason for continued business dealings . . ." DAR, 32 C.F.R. § 1-606.1(d) (1984). The same conditions set forth for suspension apply to debarment. DAR, 32 C.F.R. § 1-605.1(c) (1984).

27. "The suspending official may suspend a contractor suspected, upon adequate evidence, of [c]ommission of any other offense indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a Government contractor or subcontractor." FAR, 48 C.F.R. § 9.407-2(a)(4) (1984). FAR, 48 C.F.R. § 9-407.2(c) (1984) offers even broader discretion to DOD officers in allowing them to "upon adequate evidence also suspend a contractor for any other cause of so serious or compelling a nature that it affects the present responsibility of a Government contractor or subcontractor." *Cf.* DAR, 32 C.F.R. § 1-606.2(a)(4) (1984) which states that "the suspending official may suspend a contractor suspected, upon adequate evidence, of commission of any other offense indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a Government contractor or subcontractor." DAR, 32 C.F.R. § 1-606.2(c) (1984) offers even broader discretion to DOD officers in allowing them to "upon adequate evidence . . . suspend a contractor for any other cause of so serious or compelling a nature that it affects the present responsibility of a Government contractor or subcontractor." Such vague standards for decision give DOD officials power to intimidate contractors and create a risk-averse decisionmaking environment for them.

28. "If legal proceedings are not initiated within 12 months after the date of the suspension notice, the suspension shall be terminated unless an Assistant Attorney General requests its extension, in which case it may be extended for an additional 6 months. In no event may a suspension extend beyond 18 months, unless legal proceedings have been initiated within that period." FAR, 48 C.F.R. § 9.407-4(b) (1984). *Cf.* "If legal proceedings are not initiated within 12 months after the date of suspension notice, the suspension shall be terminated unless an Assistant Attorney General requests its extension, in which case it may be extended for an additional 6 months. In no event may a suspension extend beyond 18 months, unless legal proceedings have been initiated within that period." DAR, 32 C.F.R. § 1-606.4(b) (1984).

29. "Debarment shall be for a period commensurate with the seriousness of the cause(s). Generally, a debarment should not exceed 3 years." FAR, 48 C.F.R. § 9.406-4(a) (1984). *Cf.* "Debarments shall be for a period sufficient to protect the Government's interest. Generally, a debarment should not exceed 3 years." DAR, 32 C.F.R. § 1-605.4(a) (1984).

30. FAR, 48 C.F.R. § 9.406-2(c) (1984). DOD officials also have discretion to debar a contractor for "[v]iolation of the terms of a Government contract or subcontract so serious as to justify debarment, such as [a] history of failure to perform, or of unsatisfactory performance of, *one* or more contracts." FAR, 48 C.F.R. § 9.406-2(b)(2) (1984) (emphasis added). *Cf.* DAR, 32 C.F.R. § 1-605.2(c) (1984). DOD officials also have discretion to debar a contractor for "violation of the terms of a Government contract or subcontract so serious as to justify debarment, such as a history of failure to perform, or of unsatisfactory performance of, *one* or more contracts." DAR, 32 C.F.R. § 1-605.2(b)(2) (1984) (emphasis added).

31. Given the number and the value of its purchases, DOD invests relatively little in monitoring. In 1983, 100 new positions were created for the Office of the Assistant Inspector for Investigations and 140 for the Office of the Assistant Inspector General for Auditing. The small base of auditing

date³² risk-averse contractors through the threat of severe penalties, such as suspension and debarment. This regulatory framework sets up a system of deterrence that threatens contractors with an expected cost of punishment far exceeding any expected gain from committing fraud.³³ The threat facing contractors is even more serious because the current regulatory scheme affords them limited opportunity to challenge administrative determinations of military procurement fraud.³⁴

personnel is illustrated by the fact that these additions increased investigative personnel in the Office of the Inspector General by 100% and auditors by 35%. J. Sherick, *Perspective on Fraud, Waste and Abuse* (statement for the American Bar Association Program on Fraud in Government Contracts and Procurement 1985) (copy on file with author). In 1984, DOD hired only 400 new auditors for its Defense Contract Audit Agency. Department of Defense, *Executive Summary of Memorandum by Department of Defense on Management Improvements in DOD* (1984). Although the DOD has tried to organize its audit groups more effectively, it still has an inadequate number of auditors, especially given the increase in the procurement budget projected over the next few years. *See supra* note 1. This deficiency forces DOD to spot-check only "high priority" items such as wings of airplanes and hulls of ships, with millions of components slipping by the detection system unnoticed. *See Meyer, supra* note 10, at 41; Dunham, *Government Admits Losing Thousands of Items*, *Dallas Times Herald*, Mar. 7, 1985, at A7, col. 1 (auditors for GAO and DOD testify that millions of dollars' worth of government property furnished to contractors for use on contracts has vanished and that DOD "had improperly monitored the whereabouts of more than \$800 million in government property"). DOD has tried to improve its monitoring of contractors by setting up a telephone hotline that it claims has saved \$3.5 million in the last two years. *Callers Help Pentagon To Waste Not Millions*, *N.Y. Times*, Nov. 8, 1984, at B18, col. 2. With a procurement budget of at least \$100 billion and this poor record of monitoring, DOD's mix of minimal monitoring resources and severe penalties seems questionable. A greater allocation of monitoring resources would lead to greater savings from the prevention of fraud. *See infra* note 79. An increase in monitoring is especially important given that "whistle-blowers" have been treated with mixed reactions, especially when they threaten the careers of superiors. *See Rasor & Martin, Protecting Pentagon Whistleblowers*, *N.Y. Times*, Oct. 23, 1984, at A33, col. 1 (rather than encouraging information about mismanagement, DOD often ignores it).

32. DOD has tried to create a risk-averse decisionmaking atmosphere in which contractors are deterred from committing fraud. However, techniques such as "shock and alarm letters" have been used by DOD to modify the behavior of contractors suspected of fraud even when there was "inadequate evidence to warrant a debarment." *See OFFICE OF INSPECTOR GENERAL, DEPARTMENT OF DEFENSE, REVIEW OF SUSPENSION AND DEBARMENT ACTIVITIES WITHIN THE DEPARTMENT OF DEFENSE* 7 (May 1984).

33. The deterring actor manipulates variables such as decisionmaking atmosphere (risk-taking, risk-neutral, or risk-averse), probability of detection, size of penalty, and total enforcement costs to deter decisionmakers from committing the prohibited act. Decisionmakers usually do not act if the expected costs (probability of detection multiplied by the size of the penalty) are greater than the expected benefits (probability of success multiplied by the value of the gain). *See A. POLINSKY, INTRODUCTION TO LAW AND ECONOMICS* 73-84 (1983).

When applied to public policy problems, however, deterrence theory is crude. *See A. GEORGE & R. SMOKE, DETERRENCE IN AMERICAN FOREIGN POLICY: THEORY AND PRACTICE* 503-04 (1974). Certain principles that do not exist in the military procurement context are critical for effective deterrence: (1) each side must be a unitary actor; (2) rational cost/benefit calculations must be made by each actor; and (3) the deterring actor uses threats to ensure the desired outcome. *Id.* at 504-05. In addition, deterrence theory requires some measure of conflict and becomes less effective as common interests become stronger. *See T. SCHELLING, THE STRATEGY OF CONFLICT* 11 (1981). Given the extent to which common interests are shared in the military-industrial network, *see supra* note 15, the usefulness of deterrence as a strategy of regulation is limited. Because of the social network of military-industrial relations, social psychology, rather than the economic rationality upon which deterrence theory relies, provides a better basis for constructing a regulatory framework. A. LEFF, *supra* note 17, at 179-81.

34. Suspension procedures are intended to be "as informal as is practicable, consistent with principles of fundamental fairness." FAR, 48 C.F.R. § 9.407-3(b) (1984). DAR regulations leave out

Fraud in Military Procurement

2. Institutional Incentives to Avoid Responsibility for Fraud

Because it has an overwhelming stake in justifying its budgetary allocation and decisionmaking power, DOD is not well-suited to have absolute authority to characterize fraud and assign blame. The power to characterize fraud, with minimum opportunities for rebuttal, enables DOD to lump mismanagement and "collusion" together with fraud by contractors, thereby diffusing public pressure for budgetary accountability and perpetuating a myth that it is correcting the system.³⁵ The broad discretion af-

"consistent with principles of fundamental fairness" even though this clause still grants DOD broad discretion. DAR, 32 C.F.R. § 1-606.3(b)(1) (1984). A contractor usually makes his opposition to a DOD-imposed sanction known to the contracting officer through a written statement disputing the facts. FAR, 48 C.F.R. § 9.407-3(b) (1984); DAR, 32 C.F.R. § 1-606.3(b)(1) (1984). For an example of problems with the objectivity of review of contractor opposition to suspension, see *infra* note 50. In cases of suspension without formal indictment, the regulations permit DOD to avoid adversarial hearings that the regulations otherwise require. FAR, 48 C.F.R. § 9.407-3(b)(2)(i) (1984); DAR, 32 C.F.R. § 1-606.3(b)(2)(i) (1984).

Before an adversarial hearing is allowed, a contractor must meet certain conditions evaluated by DOD such as "genuine dispute over facts material" and "substantial interests of the Government in pending or contemplated legal proceedings." FAR, 48 C.F.R. § 9.407-3(b)(2) (1984); DAR, 32 C.F.R. § 1-606.3(b)(2) (1984). These conditions limit the opportunities available to contractors to rebut DOD characterizations of fraud. In addition, in actions:

(i) based on an indictment, (ii) in which the contractor's submission does not raise a genuine dispute over material facts, or (iii) in which additional proceedings to determine disputed material facts have been denied on the basis of Department of Justice advice, the suspending official's decision shall be based on all the information in the administrative record, including any submission made by the contractor.

FAR, 48 C.F.R. § 9.407-3(d)(1) (1984); DAR provides instead of (iii) that in actions "in which factfinding to determine disputed material facts has been denied on the basis of Department of Justice advice, the suspending official's decision shall be based on all the information in the administrative record, including any submission made by the contractor." DAR, 32 C.F.R. § 1-606.3(d)(1) (1984). Reliance on the administrative record and lack of an adversarial hearing to challenge such a record, when coupled with judicial reluctance to probe beyond the administrative record, give DOD broad power to characterize fraud so as to avoid blame for mismanagement. See *Transco Sec., Inc. of Ohio v. Freeman*, 639 F.2d 318, 325 (6th Cir. 1981) (judicial review should be confined to whether proper administrative procedures were followed, and it was unnecessary for district court either to review evidence upon which administrative determination to suspend contractor was made or to grant full hearing as to whether suspension was proper); see also Stark & Wald, *Setting No Records: The Failed Attempts to Limit the Record in Review of Administrative Action*, 36 AD. L. REV. 333, 334 (1984) (doctrines of limited substantive review of agency action and of review on the record have their roots in concern that courts should not substitute their judgment for the decisions of administrative agencies).

Although the opportunity for adversarial hearings is greater with respect to debarment proceedings than suspension proceedings, there still remains the problem of DOD determination of a "genuine dispute over facts material" and its implication for the amount of process that is allowed. FAR, 48 C.F.R. § 9.406-3(b)(2) (1984); DAR, 32 C.F.R. § 1-605.3(b)(3) (1984). DOD's attitude toward legal process and opportunities for rebuttal may better be understood in light of Secretary of the Navy Lehman's comment in the context of the Navy's prosecution of General Dynamics for "pervasive" business misconduct. Lehman was reported to have said that business relations would be restored assuming the company did not choose to be "confrontational and litigious." Biddle, *Misconduct Cited As Navy Penalizes General Dynamics*, N.Y. Times, May 22, 1985, at A1, col. 6.

35. The value of government being seen by the people as fulfilling the collective responsibility of rooting out corruption is important as a legitimating symbol. This notion is especially relevant to the American polity, which is constructed to take into account human tendencies toward a privatization of interests. These tendencies have been conceptualized as "economy of virtue" and developed in Ackerman, *The Storrs Lectures: Discovering the Constitution*, 93 YALE L.J. 1013, 1025, 1031 (1984). Self-

forded DOD is especially problematic because other participants in the weapons acquisition process—Congress, courts, individual bureaucrats and the public—have strong incentives to avoid responsibility for identifying and stopping fraud.³⁶ As a result, DOD determinations often go unchallenged, and inefficient practices by the government are perpetuated.

Institutional incentives discouraging the identification of fraud are widespread. Lower-level bureaucrats in DOD, who are personally responsible for the majority of procurement decisions, want to preserve their own decisionmaking powers over weapons projects,³⁷ and naturally do not want to be held liable for abusing budgetary authority. Accordingly, they have strong incentives to shift responsibility for faulty decisionmaking to other actors. Members of Congress do not want to police contractors from their home districts who are an important source of jobs and campaign contributions.³⁸ Contractors seek a low profile in order to avoid liability for fraud and retaliation from the government, which may be a principal

interest makes it difficult to maintain individual interest in a collective goods problem such as rooting out fraud. See M. OLSON, *THE LOGIC OF COLLECTIVE ACTION 2* (1971). Without some incentive to take interest in a collective issue, members of the public tend to look to their own private concerns and to rely on government to take care of the public welfare. Budgetary trade-offs with social programs, however, may offer the public a stake in foregoing the privatization of interests and in scrutinizing allocations for defense.

In every legal order, there are multiple legal systems that shape expectations. Two such systems that shape expectations are "myth" and "operational code." Myth systems present the official picture—the norms that are supposed to apply. Myths affirm values important to society. Operational codes refer to the norms that are actually applied—the way of doing business. See W. REISMAN, *supra* note 21, at 16–17.

It is critical that DOD prosecution of fraud not become a "myth" in which DOD avoids self-scrutiny in order to justify its budget. DOD's suspension of General Dynamics in May, 1985, has been criticized as largely symbolic, especially given the Navy's lifting of sanctions after three months from a company that it had denounced for "pervasive misconduct." Rather, public policy must encourage the self-scrutiny that the Pentagon showed when it admitted that the "pervasive business misconduct" of which General Dynamic had been accused was actually permitted by existing DOD regulations. Biddle, *Dynamics' Brief Stay in Pentagon's Doghouse*, N.Y. Times, Aug. 15, 1985, at D1, col. 1.

36. Participants in the weapons acquisition process behave according to the incentives offered by the system. There is growing consensus among critics of the system that weapons acquisition involves an inverted system of rewards and punishments that reward rather than penalize cost increases. Mohr, *supra* note 2, at A1, col. 4.

37. See *supra* note 16. Uniformed procurement officers seem to place a "far higher priority on gaining Congressional approval to begin a new weapon program, rather than on controlling prices." See Mohr, *supra* note 2, at A1, col. 4.

38. For an excellent treatment of the "pork-barrel" aspects of the military procurement budget, see Roberts, *Political Aims of Lawmakers Bring Military Budget Rises*, N.Y. Times, May 17, 1985, at A1, col. 5 (lawmakers' parochial and political concerns motivate them to treat DOD's budget as public works bill that dispenses money and jobs). See generally D. MAYHEW, *CONGRESS: THE ELECTORAL CONNECTION 5* (1974) (Congresspersons are single-minded seekers of reelection). But see Hiatt & Atkinson, *To Pentagon, Oversight Has Become Overkill*, Washington Post, July 4, 1985, at A1, col. 4 (Congress has not been deterred from oversight because of "pork-barrel politics," but interferes with too much micro-management.). See also Hiatt & Atkinson, *Congress Cleans Up With Acts*, Washington Post, July 4, 1985, at A12, col. 5 (reform legislation such as the Competition in Contracting Act of 1984, the Defense Procurement Reform Act of 1984, the Small Business and Federal Procurement Competition Enhancement Act of 1984 has mainly inflated bureaucracy).

Fraud in Military Procurement

source of income. Furthermore, general contractor reliance on layers of subcontractors in performing defense contracts further diffuses responsibility and accountability. Finally, the fact that the costs of mischaracterization are diffused among all federal taxpayers means that there is little incentive for monitoring by individual members of the public.³⁹

3. Failure of Judicial Oversight

Of all the various participants in the acquisition process, courts are in the best position to review and check DOD characterizations of procurement fraud. Courts have experience in evaluating complex transactions and do not have constituencies to placate. Courts have in the main, however, acquiesced to this regulatory scheme that affords DOD broad discretion to characterize fraud.⁴⁰

Three 1984 cases have been particularly striking in their validation of DOD's control over the procurement process. In *Electro-Methods, Inc. v. United States*,⁴¹ the Claims Court found a defect in DOD regulations⁴² that violated the contractor's property and liberty interests⁴³ and invalidated DOD's suspension of the contractor. Overturning the invalidation on other grounds, the Court of Appeals specifically avoided addressing the

39. See M. OLSON, *supra* note 35.

40. Courts traditionally have hesitated to probe executive decisions concerning foreign policy and national security. See, e.g., *United States v. Reynolds*, 345 U.S. 1, 11 (1953). At least three reasons exist for such deference. First, the U.S. Constitution charges the President, art. II, § 2, and Congress, art. I, § 8, with primary responsibility to provide for national defense. See, e.g., *Concerned About Trident v. Schlesinger*, 400 F. Supp. 454, 482 (D.D.C. 1975) (“[c]ourts are not the proper forum for debate on national security and defense issues”). Second, the political branches are generally thought to be in the best position to make such policy determinations. See, e.g., *Rostker v. Goldberg*, 453 U.S. 57, 69-71 (1981) (in draft registration case, court deferred to congressional choices in making rules and regulations concerning military); *Halkin v. Helms*, 598 F.2d 1, 9 (D.C. Cir. 1978) (narrow standard for judicial review—“utmost deference”—applied in response to executive assertions of privilege upon grounds of military secrets). Third, in the national security area courts have fewer standards upon which they can base a decision. See, e.g., *Trident*, 400 F. Supp. at 482 (national defense not within courts' expertise); see also Note, *The Military and State Secrets Privilege: Protection for the National Security or Immunity for the Executive?*, 91 YALE L.J. 570 (1982) (inappropriate judicial treatment of military and state secrets privilege).

41. 3 Cl. Ct. 500 (1983), *aff'd in part, rev'd in part*, 728 F.2d 1471 (Fed. Cir. 1984) (jet engine parts contractor suspended by Air Force for improprieties in obtaining pricing data of competitors).

42. The Claims Court invalidated the suspension of a “suspected” contractor because it believed the notice of suspension to be inadequate to protect the contractor's property and liberty interests. 3 Cl. Ct. at 510. The applicable regulations, DAR, 32 C.F.R. § 1-606.3(c)(2), (5) & (6) (1984), failed to require that the notice set a fixed time within which contractors would formally be heard. *Id.* This defect allowed DOD to conceal the nature of the suspected fraud. Under the challenged regulations, contractors had no effective rebuttal and were forced, by the opportunity costs of bids foregone during suspension, to settle on DOD's terms. However, the invalidation was later reversed by the Court of Appeals which felt that, based on the facts of the case, the government afforded adequate due process in suspending the contractor. See 728 F.2d 1471, 1475-76 (1984).

43. For an elaboration of recent judicial treatment of property and liberty interests with respect to the administrative state, see Mashaw, “Rights” in the Federal Administrative State, 92 YALE L.J. 1129 (1983).

defect in the regulations.⁴⁴ In *Shermco Industries v. Secretary of the Air Force*,⁴⁵ the district court deferred to DOD discretion in suspending a contractor⁴⁶ even though it had raised questions about DOD's statutory authority to suspend⁴⁷ and about the arbitrary behavior of DOD's agents.⁴⁸ Finally, in *ATL, Inc. v. United States*,⁴⁹ the Federal Circuit went even further and cut off judicial oversight of DOD regulation completely. Decisionmaking power over the procurement process was left entirely to DOD.⁵⁰ The court limited its equitable powers of relief to ensur-

44. *Electro-Methods v. United States*, 728 F.2d at 1476 n.11. Rather than confront a problematic regulatory scheme, the court isolated the particular case and deferred to bureaucratic discretion to manage the process.

45. 584 F. Supp. 76 (N.D. Tex. 1984) (Air Force suspended repair contractor because of concern that it was "nonresponsible" given federal grand jury indictment for false claims on military contracts).

46. The court upheld the suspension despite the Small Business Administration's determination that the contractor was responsible and the court's own recognition that the Air Force had de facto suspended Shermco without affording it the opportunity for rebuttal required by due process. 584 F. Supp. at 82-85, 93-94. The court even noted that formal suspension proceedings came well after the grace period given to DOD by case law. *Id.* at 94. See also *Horne Brothers, Inc. v. Laird*, 463 F.2d 1268, 1272 (D.C. Cir. 1972) (period of de facto suspension while government decides if it has adequate evidence to pursue suspension is limited). Despite Shermco's injury and the problematic nature of DOD's characterization, the court offered no relief to Shermco. 584 F. Supp. at 104-06. Further, the court held that it would be inappropriate to compensate Shermco for lost contracts, even those still unfilled, that resulted from the de facto suspension period. *Id.* at 105-06. The court wanted to avoid "too much judicial interference in the Air Force's decision-making process, specifically relating to defense strategy . . ." *Id.* See *supra* note 40 and *infra* note 51 (judicial deference in national security area).

47. Suspension by DOD in light of a "responsibility" determination by the Small Business Administration presents a problem for allocation of statutory authority. The court in *Shermco*, 584 F. Supp. at 83, pointed out that "15 U.S.C. § 637(b)(7) (1981)" provides: "[W]ith respect to all elements of responsibility . . . of any small business concern . . . [a] Government procurement officer . . . may not . . . preclude any small business concern . . . from being awarded such contract without referring the matter for a final disposition to the [Small Business] Administration." (emphasis added). The court also questioned whether Congress intended to eliminate a governmental agency's power to suspend an indicted contractor, even in light of a validly issued certification of competency. *Id.* at 83-85.

48. 584 F. Supp. at 100. In making a determination not to award Shermco contracts, contracting officer Munch failed to follow the requirements that a procurement contracting officer obtain information from diverse sources and maintain a close relationship with the contract office in making responsibility determinations. *Id.* at 101. These requirements were designed to increase contractor input into such determinations and to check against arbitrary behavior.

49. 736 F.2d 677 (Fed. Cir. 1984). A construction contractor sought to prove that lengthy delays by the Navy in its responsibility review constituted de facto suspension. During this time ATL had made at least four bids in which it was the low bidder but was not awarded the contracts. *Id.* at 680.

50. The court determined that although the Navy should have been more cooperative in furnishing information regarding the suspension, ATL had no right to "confront its accusers and cross-examine witnesses." 736 F.2d at 686. The triple-layer of review within the Navy was found sufficient to prevent "rubber-stamping" of decisions and to eliminate the need for a neutral tribunal. *Id.* at 687.

Judicial deference to DOD evaluation of the evidence is shortsighted given social science's understanding of organizational behavior. In organizational decisionmaking, information adverse to the institution's self-interest usually gets filtered out. In decisionmaking groups, members having the same perspective ratify each other's decisions. This is usually done to preserve friendly intragroup relations and perhaps to validate each one's decisionmaking power. See I. JANIS, VICTIMS OF GROUPTHINK 2-9 (1972). The groupthink phenomenon occurs not only among members of an organization such as DOD who are at the same decisionmaking level, but also among members at different decisionmaking

ing that neither side acted arbitrarily.⁵¹ Such judicial self-limitation results in lost opportunity for record-building, for relatively impartial characterization of fraud, and for effective constraint of DOD's political power.

II. THE ECONOMIC COSTS OF THE CURRENT REGULATORY SYSTEM

The current regulatory approach with its emphasis on the threat of severe penalties, low reliance on monitoring, and unchecked agency discretion is ineffective. Rather than regulating fraud, the current regulatory approach produces hidden costs and creates perverse incentives for both contractors and DOD.

A. *Hidden Costs*

The severe penalties that DOD can impose under the current system generate substantial hidden costs in the form of overdeterrence and distortion of contractors' decisionmaking.⁵² The fact that contractors are afraid to depart from detailed specifications, even if such variations would reduce costs, is a significant hidden opportunity cost that is passed on to the government and the public in the form of missed innovation.⁵³ In addition, the current deterrence approach ignores the fact that DOD can mischaracterize its own mismanagement as contractor fraud against the government. Given the severe penalties that DOD can impose, such error in identifying fraud can threaten the economic life of the contractor's enterprise, which in turn means secondary losses for innocent parties such as stockholders, bondholders, and employees.⁵⁴ Because the potential ramifi-

levels. See also M. HALPERIN, *BUREAUCRATIC POLITICS AND FOREIGN POLICY* (1974) (analyzing decisionmaking on national security issues). In protecting organizational influence in government, participant reactions to issues often reflect "grooved-thinking"—responding to stimulus in a set way. *Id.* at 58. This bureaucratic phenomenon makes it difficult to have any objective review within DOD, even if there is a triple-layer of review. If anything, such a layering of bureaucracy will only serve to reinforce DOD's perspective and not get at the real causes of fraud.

51. 736 F.2d at 688. The court's abdication of responsibility for regulating fraud is striking in its assertion that "it is not our position to judge the merits of this case—*i.e.*, who is right or wrong—but rather to ensure that the procedures which are followed minimize the likelihood of one side or the other acting arbitrarily or improperly." *Id.* (footnote omitted). As in other cases, the court chose not to address the issue of *de facto* suspension. *Id.* at 687 n.52. The court need not have taken this self-limiting path in light of the claim in *Electro-Methods* that the legislative history of the Federal Courts Improvement Act of 1982 reflects the intention that the courts have new equitable powers with respect to government contracts. *Electro-Methods*, 3 Cl. Ct. at 507.

52. See Block & Sidak, *The Cost of Antitrust Deterrence: Why Not Hang A Price Fixer Now and Then?*, 68 GEO. L.J. 1131, 1133-38 (1980) (discussing costs of antitrust enforcement when relying on exorbitant economic penalties and minimal probability of enforcement).

53. The open ended character of FAR, 48 C.F.R. § 9.406-2(b)(1) (1984) and DAR, 32 C.F.R. § 1-605.2(b)(1) (1984)—"Willful failure to perform in accordance with the terms of one or more contracts"—discourages contractors from attempting cost-saving innovation when it would require even minor departures from the terms of the contract.

54. These secondary losses are equivalent to external costs or "spillover." See Coffee, "No Soul to

cations of being "suspect" are so high, contractors often settle disputes with DOD because improperly characterized fraud cannot easily be rebutted under the minimum legal process now afforded.⁵⁵ The hidden costs of settlement cast a shadow of extortion, especially given DOD's nearly unlimited regulatory authority. Taken together, these costs only make the current unmanageable system more inefficient by increasing contractor uncertainty in business planning.⁵⁶

B. *Perverse Incentives*

The current regulatory system also creates perverse incentives for defense contractors and DOD bureaucrats. First, severe penalties deter fraud only up to the point at which the firm's assets equal its expected liabilities.⁵⁷ Beyond that point, firms, especially small contractors, may actually commit *higher* levels of fraud, because they have little to lose if convicted, and know that they may be suspended and debarred for lower levels of fraud, or for no fraud at all. Second, broad administrative discretion coupled with differential bargaining power among contractors, who vary by size and type of product, encourages DOD to engage in selective enforcement.⁵⁸ Selective enforcement based on vague criteria and broad administrative discretion creates obvious inequalities which weaken deterrence and make legal regulation a sham.⁵⁹ Contractors respond to arbitrariness and inequity in the regulatory system by factoring an insurance

Damn: No Body To Kick": An Unscandalized Inquiry Into the Problem of Corporate Punishment, 79 MICH. L. REV. 386, 401 (1981).

55. For an elaboration of the idea that severe penalties and uncertain application can lead to extortion and settlement, see Coffee, *supra* note 54, at 402-03.

56. Certainty in business planning is a primary goal for economic enterprise. A basic financial principle is that a safe dollar is worth more than a risky one. R. BREALY & S. MYERS, *PRINCIPLES OF CORPORATE FINANCE* 12 (2d ed. 1984).

57. The problem of setting an adequate punishment cost that does not exceed the corporation's resources has been conceptualized as the "deterrence trap." See Coffee, *supra* note 54, at 390. This "deterrence trap" has also been referred to as "asset insufficiency" and "sanction insufficiency." Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857, 867-68 (1984).

58. Selective enforcement depends on variables such as size of contractor and type of product. It is more difficult for DOD to exercise leverage over large prime contractors because of the amount of production they control. See Biddle, *supra* note 35 (General Dynamics forgiven within three months of being cited for pervasive business misconduct). Cf. Biddle, *supra* note 9, at 3, col. 1 (DOD discipline of General Dynamics thought to be slap on wrist). It is also difficult for DOD to exercise leverage over companies that are the sole producers of necessary products, such as silicon chips.

59. Selective enforcement may produce a cathartic feeling in the short-run, given some level of enforcement, but over time it threatens the integrity of the legal order by intimidating the opposition and increasing executive power. See W. REISMAN, *supra* note 21, at 160, 171.

Reisman argues persuasively that "[t]he function of sanctions is to maintain or restore public order. No more. No less." *Id.* at 160. When sanctions fail to deter publicly prohibited activities, and serve instead to further a hidden agenda (such as shifting accountability from policymakers to law enforcement officials, or expanding the power of the state), they can weaken the legitimacy of the democratic process. *Id.*

Fraud in Military Procurement

premium into the contract price, forcing the public to absorb the cost of yet another inefficiency.⁶⁰

Most importantly, by using the broad discretionary power afforded them by the present regulatory scheme, DOD bureaucrats can shift the risk of accountability for fraud to contractors as part of the cost of doing business. Readily available targets, defense contractors who the public already perceives as having “dirty hands,” are exploited to absorb pressure for institutional self-scrutiny. DOD can create an atmosphere of “getting tough” with contractors that alleviates public pressure for accountability.⁶¹ The current regulatory scheme thus allows DOD, as well as Congress and the courts, to display public concern while bearing none of the costs of institutional self-scrutiny.⁶²

III. TOWARD A LEGAL PROCESS MODEL

Public policy must more closely examine military-industrial relations and adjust the incentive and power structures of the actors. A reformed regulatory process should draw on the comparative regulatory strengths of Congress, the courts, and DOD and create a system of overlapping checks so that no one institution can thwart efficient regulation.⁶³

60. See generally S. MELMAN, *supra* note 6, at 34 (describing “cost-maximizing” tendencies of “cost-plus” pricing system). This insurance premium can be analyzed using Williamson’s framework of “transactions-cost economics.” The inflated price acts as a “transaction-specific asset” or “hostage” that compensates for the risk of arbitrary behavior by DOD. See Williamson, *Corporate Governance*, 93 YALE L.J. 1197, 1204 (1984); see also Williamson, *Credible Commitments: Using Hostages to Support Exchange*, 73 AM. ECON. REV. 519, 527 (1983) (contract “governance structures” such as “third parties and reciprocal exposure of specialized assets” may be used to facilitate adaptation to complex contracts, such as defense, that are plagued by unforeseen contingencies and incomplete knowledge of production). Efficiency of economic organization is improved by lowering transaction costs and letting prices reflect only the purchased good and not the insurance premium. Thus an enforcement process that uses courts as neutral third parties and trades off inflated prices for decreased risk of arbitrary sanctions by DOD would promote harmonious and efficient exchange relations.

61. For an example of DOD “getting tough” on fraud, see Gerth, *supra* note 9. *But see* Biddle, *supra* note 9.

62. Free-riding is a cost-avoidance technique by which an individual allows others to bear the costs of purchasing a good whose benefits can be shared by all. See generally M. OLSON, *supra* note 35 (theory of collective goods). The concept of free-riding may be used to describe the regulatory process of military procurement. Instead of all affected institutions working to stop fraud, each institution prefers to let the others take on the regulatory burden while accepting the political benefits of reduced public pressure.

63. The principles of Madisonian theory also contain the concept of overlapping and counterbalancing checks. See THE FEDERALIST No. 48, at 308 (J. Madison) (C. Rossiter ed. 1961) (departments of government need to be both separate and blended, and each must have constitutional check against others). See Strauss, *infra* note 95 (analysis of problems of administrative state should focus on separation of functions and checks and balances, not separation of powers).

A. *The Need for Legal Process*

A legal process model of regulation would redistribute regulatory authority to characterize and penalize fraud more effectively. A system of overlapping checks would better protect the public against theft, mismanagement and possible collusion. The model would require courts to take a more active role in characterizing fraud, assigning blame and crafting remedies.⁶⁴ The expanded use of the judicial system would create incentives for other actors to engage in self-scrutiny and monitoring.

The incentives created by a legal process model would address the inefficiencies and perverse incentives produced by the current system. By providing opportunity for timely legal rebuttal and a more neutral forum for sifting the information pertaining to procurement conflicts, each actor would be rationally expected to engage in increased self-monitoring in order to reduce the possibility of being held accountable on a public record.⁶⁵ DOD would have an incentive to root out mismanagement, because it would be less able to shift blame by claiming contractor fraud. Contractors would benefit from the increased certainty in business planning that would result from the elimination of DOD's broad bureaucratic discretion over imposing sanctions. Contractors would also be much more willing to challenge DOD determinations of fraud, thus increasing the chances of exposing DOD mismanagement. Realigning incentives would not only be more efficient in focusing on the actors in the best position to prevent

64. Courts have been thought of as a mediating institution between different power groups and can act as forums for "mini-hearings" that Congress neither has time nor resources to conduct. As a result, legal process can be developed to address the problems of the administrative state. This emerging mode of analysis, developed by Professor Bruce Ackerman, is known as "Legal Constructivism." See B. ACKERMAN, *RECONSTRUCTING AMERICAN LAW* 3, 37 (1984). Central to any attempt to address the problems of the administrative state is the problem of coordinating private and public law. *Id.* at 37. Courts would mediate controversies seeking to resolve five key variables: a) different conceptions of fact; b) different conceptions of values; c) adjudication; d) impact on democracy; and e) finality. Judicial resolution of these variables and coordination of public and private interests constitute the basic framework of Ackerman's model of "activist legal discourse." *Id.* See also Chayes, *The Role of the Judge in Public Law Litigation*, 89 HARV. L. REV. 1281 (1976) (modern federal litigation requires courts to manage complex situations). The proposals in this Note seek to increase the current level of judicial supervision of DOD. Courts should force other administrative agencies to scrutinize more closely DOD by moving beyond techniques such as the "hard look" doctrine. *Kleppe v. Sierra Club*, 427 U.S. 390, 410 n.21 (1976) (court's only role is to ensure that agency has taken "hard look" at consequences of its actions). Cf. *supra* note 51 (courts in military procurement cases need not take such a self-limiting path). Given the the difficulties of characterization of fraud in military procurement, techniques such as "hard look" must be a minimum requirement.

65. Rational conduct is an assumption of most modern analyses of political behavior. See Eulau, *Understanding Political Life in America: The Contribution of Political Science*, 57 SOC. SCI. Q. 112, 122 (1976) (review of research developments in political science). For a classic treatment of such behavioral political science, see A. DOWNS, *AN ECONOMIC THEORY OF DEMOCRACY* 4 (1957) (studying effects of rationality, ordered preferences, and utility maximization on government behavior). See also T. SCHELLING, *supra* note 33, at 16-17 (models of rational behavior must take into account factors leading to irrationality—value systems, communication and information systems, decisionmaking processes, and probability of error).

Fraud in Military Procurement

fraud, but it would also expose, to a greater degree than at present, the true way in which the military procurement system operates.⁶⁶

B. *Reforming the Regulation of Fraud in Military Procurement*

1. *The Courts*

An enhanced role for the courts is crucial to a process framework of regulation. First, as an information gathering and processing institution, courts are well-suited to characterize fraud situations. Courts do not have the self-interest incentives, such as budgetary allocation, to avoid accountability and to shift blame for fraud. Second, courts are accustomed to examining factual information and assessing whether and where liability should be imposed. Third, as more cases are brought and more information about the causes of fraud becomes known, courts will be better able than either Congress or DOD to adjust and improve the regulatory scheme.⁶⁷

In order for courts to assume a more active role in addressing fraud, DOD regulations must be amended to require pre-suspension and pre-debarment adversarial hearings and to allow judicial review of administrative evidence. These steps are required if legal process is to expose a clearer picture of the nature of military fraud. In addition, for jurisdictional purposes, Congress must make it clear on the legislative record that it intends for courts to take a more active role in mediating between DOD and defense contractors.⁶⁸

If courts are to assume a more central role in regulating military procurement fraud, they must overcome their reluctance to act in matters relating to national security.⁶⁹ The national security area presents particular problems due to governmental restrictions on information.⁷⁰ Courts, however, can and must distinguish between two sorts of procurement cases.

66. Legal process would generate information about the military-industrial relationship so that "neutral" third parties such as courts could properly structure responses to the problem of fraud. For a theoretical elaboration of the relationship between the structure of legal discourse and the generation of information, see *THE STRUCTURE OF PROCEDURE* 376-419 (R. Cover & O. Fiss eds. 1979). See also McDougal & Reisman, *The Prescribing Function in the World Constitutive Process: How International Law is Made*, in *INTERNATIONAL LAW ESSAYS* 355 (M. McDougal & W. Reisman eds. 1981) (law is process of communication).

67. See generally G. CALABRESI, *A COMMON LAW FOR THE AGE OF STATUTES* 44-58 (1982) (courts are often in best position to fine-tune regulatory framework because of their common law method of incremental adjudication and their lack of self-interest motivations).

68. See *supra* notes 51 & 64.

69. See *supra* note 40.

70. See *Farnsworth Cannon, Inc. v. Grimes*, 635 F.2d 268, 281 (4th Cir. 1980) (en banc) (per curiam) (in military contracts case, litigation was precluded where attempt to establish prima facie case conflicted with U.S. invocation of military and state secrets privilege). The exemption for national security under the Freedom of Information Act, 5 U.S.C. § 552b(c)(1) (1982), has been interpreted broadly by courts to restrict the release of information. See Note, *supra* note 40, at 585-88.

On the one hand, courts have limited authority and expertise to decide fraud cases involving technical violations with serious security implications.⁷¹ On the other hand, courts do have the authority and expertise to review the transactions aspects of procurement, which involve pricing data that is "central to the integrity of the procurement process."⁷² Where the transactions and security issues are intermixed or difficult to distinguish, courts have available an array of techniques, including *in camera* proceedings,⁷³ the creation of summaries of classified data,⁷⁴ protective orders,⁷⁵ and employing special masters with security clearances.⁷⁶ These techniques can help overcome national security objections, better enable courts to participate in the regulatory process, and allow courts to provide an institutional check against DOD discretion.

Allowing courts greater power to characterize procurement fraud still allows DOD to bring as many cases as it wants and to make initial determinations of fraud. Redistribution of regulatory power merely deprives DOD of the power to use *de facto* suspensions and restricted rebuttal opportunities to shift blame for its own mismanagement.

2. *The Defense Department*

Proposals for reforming the current regulatory approach must focus on DOD's powerful role as the key actor in the procurement process. DOD must craft for itself checks that increase the possibilities for self-scrutiny and restraint on wielding its preponderant bargaining power. In addition, self-regulation must be coupled with attempts by other actors such as Congress to restructure DOD's role in the procurement process.

Effective self-regulation may be achieved by studying decisionmaking patterns of DOD administrators to determine if there is an "internal law"

71. See *supra* note 40.

72. See *Shermco Industries, Inc. v. Secretary of the Air Force*, 584 F. Supp. 76, 96 (N.D. Tex. 1984).

73. See Note, *Discovery Of Government Documents and the Official Information Privilege*, 76 COLUM. L. REV. 142, 168-69 (1976) (courts have liberally construed showing of need prerequisite for *in camera* proceedings).

74. A Vaughn index, first developed in *Vaughn v. Rosen*, 484 F.2d 820 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 977 (1974), enables a court to demand from an agency that is claiming privilege an index containing a detailed analysis of each claim of privilege along with a specific listing of every document and the relevant subdivision within the document for which a privilege is claimed. See McMillan & Peterson, *The Permissible Scope of Hearings, Discovery, and Additional Fact-Finding During Judicial Review Of Informal Agency Action*, 1982 DUKE L.J. 333, 388 (discussing development of Vaughn index doctrine).

75. See Note, *supra* note 73, at 170-71. Protective orders serve as a compromise between an order requiring unrestricted disclosure and a finding of privilege.

76. See *Loral Corp. v. McDonnell Douglas Corp.*, 558 F.2d 1130, 1132-33 (2d Cir. 1977) (affirming order appointing special master with security clearance to hear contract dispute involving confidential and secret equipment for Air Force; court retained control over case, ensuring neutral forum).

Fraud in Military Procurement

of administration guiding their conduct.⁷⁷ A better understanding of how bureaucrats behave would be the first step in enabling DOD and other actors such as Congress and the courts to move toward a better structuring of responsibility.⁷⁸ Instead of relying on large contractor penalties to deter fraud, DOD should invest more resources in self-monitoring. Reallocation of resources would produce greater savings,⁷⁹ increase the accountability of both contractors and DOD to the public, and enable DOD to construct various penalties that have equivalent deterrent effects.⁸⁰ Flexibility in constructing penalties will also allow DOD to improve the efficiency of its enforcement efforts by seeking marginal deterrence.⁸¹ Such an approach would eliminate perverse incentives for defense contractors, such as “asset insufficiency,”⁸² whereby firms may actually commit higher levels of fraud because they have little more to lose if they are convicted of defrauding the government of a very large amount rather than a small one.

Congress can also help redistribute DOD’s institutional power and create incentives for the effective regulation of fraud. First, changes must be

77. See J. MASHAW, *BUREAUCRATIC JUSTICE* 15 (1983). Mashaw advances the idea that the challenge of administrative law is to admit the limitations of an external orientation—a law oriented toward justiciable rights enforceable against administrators in court—and to look inside bureaucracy for an internal law of administration that guides the conduct of administrators. *Id.* at 14–15. In this way, citizens may better understand bureaucratic action and hold administrators accountable for administrative discretion available to them within the “gigantic policy space, invisible to the legal order because devoid of justiciable rights” that is circumscribed by the “loose requirements of clear statutory language, procedural regularity, and substantive rationality.” *Id.* at 9. For an attempt to test empirically for such an “internal law,” see McFadden, *The Revealed Preferences of a Government Bureaucracy: Empirical Evidence*, 7 *BELL J. ECON.* 55 (1976).

78. J. MASHAW, *supra* note 77, at 15.

79. Assuming that the probability of detection varies with monitoring resources, the optimal tradeoff between such probability and the magnitude of fines is not to set the probability of detection as low as possible and the fine as high as possible, because such a mix does not address the reality that actors are risk-averse. See *supra* note 32 (DOD cultivates risk-aversion). Factoring in risk-aversion, the optimal tradeoff should be weighted toward the probability of detection, especially if the costs of detection are low. See Polinsky & Shavell, *The Optimal Tradeoff Between the Probability and Magnitude of Fines*, 69 *AM. ECON. REV.* 880, 881 (1979).

[The] general point regarding optimal deterrence when individuals are risk averse: Given the probability of detection, it is always possible to set the level of the fine so that the certainty equivalent of the fine—how much a person would be willing to pay with certainty to avoid the risk of being fined—equals the cost to others of that person’s harmful activity.

A. POLINSKY, *supra* note 33, at 78 (footnote omitted). Although such optimal deterrence does not apply to situations in which the probability of detection is very low, *id.* at 78 n.49, this situation is unlikely to occur with respect to military procurement because the cost of fraud detection (salaries and computer time of auditors) is sufficiently low relative to the procurement budget that it is always possible to have the minimum level of monitoring. The search for the optimal tradeoff thus argues for increased monitoring rather than for reliance on severe penalties.

80. Different sanctions that have equivalent effects are said to achieve the same “expected penalty.” An “expected penalty” is equal to the penalty multiplied by the probability of detection. If detection varies positively with monitoring, then more monitoring means a higher probability of detection and a less severe sanction required for the same “expected penalty.” See A. POLINSKY, *supra* note 33, at 73–84.

81. Marginal deterrence shapes behavioral incentives more efficiently by helping to avoid the perverse incentive of a “deterrence trap.” See *supra* note 57.

82. Kraakman, *supra* note 57, at 867.

made in the ways in which DOD and defense contractors do business.⁸³ For example, stricter limits are needed on Congressional lobbying by defense contractors.⁸⁴ Furthermore, Congress should force DOD to accelerate recent trends toward a more competitive bidding process.⁸⁵ However, careful scrutiny of DOD allocation of profit margins on contracts is also required so that incentives for increased competition in bidding do not become incentives for firms to shift out of production of civilian goods. Diversification of the defense industry should be encouraged,⁸⁶ because it instills in managers efficiency goals that are required in the competitive sectors of the economy. Further, in transacting business, DOD should be made to require contractors to post a bond as insurance against fraud.⁸⁷ Such a "hostage"⁸⁸ would protect the government's interest in avoiding fraud and would lessen the need for de facto suspensions. The risk that a contractor might lose his bond would be a significant deterrent to any attempt to defraud the government. Finally, Congress should consider the more radical alternative of taking the uniformed services out of the acquisition process. This step would alleviate potential conflict of interest difficulties that arise when the lure of post-retirement jobs in the defense industry leads some DOD procurement personnel to treat some contractors more sympathetically than others.⁸⁹

83. See Adams, *Undoing the Iron Triangle: Conversion and the "Black Box" of Politics*, in *ECONOMIC CONVERSION: REVITALIZING AMERICA'S ECONOMY* 147, 158-59 (S. Gordon & D. McFadden eds. 1984) (suggesting variety of proposals to keep procurement process open to change and to ensure that political actors are not beholden to defense spending).

84. *Id.* at 158.

85. Mohr, *supra* note 2, at 8, cols. 4-5. In 1985, the Army, Air Force, and Defense Logistics Agency joined the Navy by each appointing a "Competition Advocate General" whose job is to encourage competitive bidding. Keller, *Competition: A Pentagon Battlefield*, N.Y. Times, May 12, 1985, § 3 (Business), at 1, col. 2. There is considerable skepticism, however, over whether DOD's push for competitive bidding will actually create change. In 1984, the ten largest contractors held \$133.6 billion in defense contracts. This share represented 34.4% of all defense contracts, up from 29.8% in 1980. *Id.* at col. 3 (graph). Critics of procurement policy argue that the cost of weapons can be cut by one-third through increased competition. "[Critics] argue that high costs stem not so much from such contractor abuses as entertainment expenses billed to the Government as from excessive labor and management costs that the Pentagon knowingly allows and sometimes even initiates." Gerth, *Pentagon Buying: Need for Businesslike Business*, N.Y. Times, May 15, 1985, at A1, col. 1.

86. Adams, *supra* note 83, at 159.

87. Bonds are not required but are left to the discretion of DOD. Performance bonds, FAR, 48 C.F.R. § 228.103-2(a)(1) (1984), and fidelity and forgery bonds, FAR, 48 C.F.R. § 228.105-70 (1984), would be especially useful given the widespread incidence of product substitution and false claims by contractors. See generally DOD INDICATORS, *supra* note 9, at 21-29 (indicators of cost mischarging and product substitution).

88. See Williamson, *Credible Commitments: Using Hostages to Support Exchange*, *supra* note 60, at 527 (arguing that transactions assets also have "hostage" value).

89. Mohr, *supra* note 2, at 8, col. 4. The dangers of the so-called "revolving door" can be seen by contrasting the experiences of two civil servants who work in DOD. See *Whistle-Blower; Horn-Blower*, N.Y. Times, Aug. 13, 1985, at 26, col. 1 (comparing experiences of two officials). Ernest Fitzgerald, a management analyst who had won public notice as a "whistle-blower" of DOD mismanagement, was recently given an unfavorable performance report by DOD. See *Harlow v. Fitzgerald*, 457 U.S. 800, 802-05 (1982) (factual background of Fitzgerald's past conduct and subsequent

Fraud in Military Procurement

In addition to restructuring the way business is done, Congress can introduce other incentives that promote efficiency. At a minimum, Congress should temporarily freeze the military budget at its current level, thereby forcing DOD to use its money more efficiently.⁹⁰ Congress should also require DOD to use work-measurement standards as a check against inflated labor costs.⁹¹ Finally, a reward system should be introduced permitting the military to retain part of any savings from fraud prosecution or cost reduction in military procurement programs. Such retained savings could be used by DOD to boost pay for those officers monitoring the system, an incentive which would enable DOD both to recruit and to reward better monitors. These incentives would reform the current system of rewards that contributes to the incidence of fraud and helps to bury its causes.

C. *Overlapping Checks*

Critics of the regulatory process approach may argue that such a scheme would result in many fewer prosecutions. Although the current framework produces inefficiencies and mischaracterizations, it also produces some prosecutions. Even when applied selectively, unchecked bureaucratic power does punish some wrongdoers and deter others. Some argue that if decisionmaking power is redistributed away from DOD, cases alleging military fraud might not be brought at all. Furthermore, they argue, fear of being held accountable on a public record for misman-

dismissal before eventual reinstatement). Such treatment creates disincentives for career officers to monitor DOD management. *See supra* notes 16 & 31. In contrast, Mary Ann Gilleece, until recently DOD's top procurement regulator, decided to play the "revolving-door" game. Upon deciding to leave DOD, Ms. Gilleece solicited \$30,000 a year from each of 29 military contractors to set up a consulting company that "would represent the concerns of the corporation to the appropriate officials." *See Whistle-Blower; Horn-Blower, supra*. A Pentagon inquiry found that she was not guilty of wrongdoing. *Id.* Such a finding creates an incentive for retiring military officers, many of whom are still in their 40's after 20 years in the military, to remain on good terms with the contractors they are to regulate. *See also* Carrington, *Official's Tough Defense of Military Purchasing Is Criticized by Both Democrats and Republicans*, *Wall St. J.*, June 25, 1985, at 64, col. 1 (criticism of Ms. Gilleece and military-industrial social network).

90. *See* Mohr, *supra* note 2, at 8, col. 2. *See also* Moynihan, *Reagan's Inflate-the-Deficit Game*, *N.Y. Times*, July 21, 1985, § E (Week in Review), at 21, col. 1 (budget deficit deemed political strategy to dismantle welfare state). Moynihan focused on President Reagan's anecdote that parents cure their children's extravagance by reducing their allowance. Similarly, to force DOD to become more efficient, we should fix its allowance.

91. Mohr, *supra* note 2, at 8, col. 5. Data measuring labor hours used by ten contractors showed that workers took at least twice the amount of time that their own experts estimated was required and that the contractors had an average efficiency rate (ratio of time company estimates a project should take over time it actually takes) of 30%. *See* Greenberger, *Defense Contractors Exceeded Estimates For Labor on Some Projects, Data Show*, *Wall St. J.*, June 24, 1985, at 10, col. 3; Gerth, *Inefficiency Laid To Weapon Makers*, *N.Y. Times*, Mar. 31, 1985, at A1, col. 1 (major military contractors take "2 to 10 times longer to complete a particular task than their own engineers projected as necessary").

agement may lead DOD to forswear "gray-area" cases entirely instead of scrutinizing its own conduct.

A series of overlapping checks can ensure an appropriate level of prosecutions even under a process framework of regulation. First, public pressure, especially at budget time, will force DOD to bring some fraud cases. There is much evidence to indicate that the fraud issue has been a powerful spur behind recent congressional attempts to limit DOD's budget.⁹² Second, Congress should establish an independent enforcement commission whose specific function would be to root out fraud in military procurement.⁹³ Such an agency would create competition for DOD that would prevent DOD from either bringing only cases of "clear" fraud by contractors or bringing no cases at all. If DOD knew that the new commission could prosecute "gray-area" cases of possible mismanagement, and that the courts' enhanced role would diminish opportunity for "accountability-shifting," DOD would be forced to scrutinize itself more carefully to avoid public embarrassment. Even if DOD did not self-regulate, the accumulated public record would allow other institutions such as Congress and public-interest organizations to understand better the nature of military procurement fraud and to craft more efficient remedies.

CONCLUSION

Military procurement involves a section of the economy that is shielded from public scrutiny. The public's perception⁹⁴ of fraud and waste in mil-

92. See *supra* note 7.

93. An independent agency would be better at rooting out fraud than any agency operating under DOD. Independence will help insulate the agency from the "procurement culture." See *supra* note 16. If organizational theorists are correct that bureaucrats seek to maximize decisionmaking power, see R. ARNOLD, *supra* note 6, at 20-23, then career rewards for such an independent agency could be structured so as to compete with the bureaucrats in DOD who are part of the military-industrial network.

With at least an estimated \$30 billion being wasted annually through financial mismanagement, see Biddle, *supra* note 1, at A17, col. 1, col. 5, the increased administrative costs of a system of overlapping checks would be more than paid for through savings. A reduction in waste of only one percent through increased monitoring of both DOD and contractors would produce a savings of \$300 million—far in excess of the administrative costs of a process framework.

94. See M. EDELMAN, *THE SYMBOLIC USES OF POLITICS* 56-57 (1977) (successful administration as symbol of stability for the public). DOD, by projecting an image of "managing" the system and "getting tough with contractors," diffuses public concern for fraud. See also *supra* note 7 (public opinion influences DOD's budget demands). Reich points out that the traditional view of accountability in public administration is inaccurate because it leaves out a critical aspect of governance in a democracy—public deliberation of issues. Reich, *Public Administration and Public Deliberation: An Interpretive Essay*, 94 *YALE L.J.* 1617, 1625 (1985). Public preferences are often predetermined by both the process and substance of administrative decisionmaking. *Id.* Public administrators, such as those in DOD, should not merely make decisions for the public in trying to project an image of "managing" the system, but should also help the public deliberate over decisions such as regulating fraud. *Id.* at 1637. For this view of accountability to be implemented, public information is required. "Rather than view debate and controversy as managerial failures that make policymaking and imple-

Fraud in Military Procurement

itary procurement suggests that the problem is only one of fraud against the government, not one of fraud by the government. This perception lends support to the current regulatory scheme that allows DOD full discretion to regulate. However, because military procurement fraud actually involves a combination of theft, mismanagement, and collusion among actors in the military-industrial network, broad DOD discretionary power leads to “accountability-shifting” that not only inefficiently attacks fraud, but also buries its causes.

Redistribution of regulatory authority through a framework of overlapping checks,⁹⁵ mediated by legal process, would deal more effectively with how the weapons acquisition system actually operates. Military “fraud” could then be accurately identified and accountability properly assigned. The public interest is not served by a morality play⁹⁶ of DOD “getting tough” while simultaneously papering over its own irresponsibility in spending the public’s money.

mentation more difficult, [DOD] should see them as natural and desirable aspects of the formation of public values, contributing to society’s self-understanding.” *Id.* Legal process helps generate information necessary for public deliberation by creating a public record. *See supra* notes 64–66 and accompanying text.

95. This system of overlapping checks is in keeping with our political theory tradition of factions checking themselves. *See supra* note 63; *see also* P. Strauss, *The Place of Agencies in Government: Separation of Powers and the Fourth Branch*, 84 COLUM. L. REV. 573, 578 (1984) (in addressing problems of administrative state, analysis should focus on separation of functions and checks and balances, not on rigid separation of powers). In contrast, the current regulatory framework relies on a more statist approach in which elements of the state have preponderant decisionmaking power. There is an emerging political science literature on the rise of the “autonomous state” and its threatening implications for democratic theory. *See generally* E. NORDLINGER, *ON THE AUTONOMY OF THE DEMOCRATIC STATE* (1981) (state might not be responsive even to society’s politically powerful groups). *Cf.* Jaffe, *The Illusion of Ideal Administration*, 86 HARV. L. REV. 1183 (1973) (elaboration of deficiencies of broad delegation model of administration).

96. Crusades of rooting out fraud often merely validate the myth system so as to allow operational codes to continue. W. REISMAN, *supra* note 21, at 105–07. Crusade enforcement takes a number of forms such as “sound and fury” and “scapegoating,” which are “aimed at the perspectives of the audience rather than the operations of the violators . . .” *Id.* at 105–06. There are dangers to democratic responsiveness and the legitimacy of legal order when the information given to the public and the actual way of doing business diverge.