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PRACTITIONER COMMENT

COMPLIANCE WITH MOST FAVORED CUSTOMER CLAUSES: GIVING MEANING TO AMBIGUOUS TERMS WHILE AVOIDING FALSE CLAIMS ACT ALLEGATIONS

*Mitchell S. Ettinger & James C. Altman**

Federal and state contracting authorities more frequently are including Most Favored Customer (MFC) clauses in contracts for procurement of privately manufactured products. These clauses seek to ensure that the contracting authority (typically a federal or state agency) receives at least as favorable pricing as other customers making similar purchases. For example, the government agency may request that the contractor warrant that the prices it charges under the contract will be as favorable as those offered to other parties purchasing similar products of similar quantity under similar terms and conditions. In theory, the request to be treated equally to others making similar purchases is reasonable.

In practice, however, it is challenging to satisfy MFC clauses because they often contain ambiguous comparative terms that make MFC compliance an onerous undertaking. Specifically, in a world of complex products and services, it often is difficult—if not impossible—to identify “similar” products sold pursuant to “similar” terms and conditions. Making compliance even more challenging are those MFC clauses that do not define the subset of purchasers (basis of award customers) who are to be compared for purposes of determining whether a price adjustment is necessary to satisfy the contractor’s MFC obligations. Some MFC clauses are not limited to any subset of purchasers, effectively requiring the

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contractor to search all U.S.-based sales to ensure compliance with the clause.

This Comment will provide examples of MFC clauses, identify the most common problems contractors have in complying with such clauses, and provide recommendations for best practices to achieve compliance with the Clauses and thereby mitigate the potential for liability under the False Claims Act (FCA).¹

I. GOVERNMENT ENFORCEMENT OF MFC CLAUSES

MFC clauses routinely appear in federal and state contracts. Such a requirement reduces the burden on the contracting authority when negotiating pricing for the contract by ensuring that the government agency will receive the best pricing offered to other parties purchasing similar products and quantities. Because these clauses appear in contracts across the country, one would expect that there would be wealth of legal precedent arising in the context of breach of contract claims that could be used to derive best practices for compliance with such clauses. Unfortunately, that is not the case. Rather, the Department of Justice and state attorneys general enforce these clauses in the context of FCA cases, where treble damages and penalties are available. For this reason, best practices must be gleaned from the complaints and settlements in those cases.

A. *The Federal Contracting Regulatory Landscape*

Federal government agencies, such as the General Services Administration (GSA), define the process for the procurement of privately manufactured commercial products.² To facilitate this procurement process, the GSA typically negotiates with private companies to execute Multiple Award Schedule (MAS) contracts governing the sale of goods and services.³ A MAS contract benefits private companies because, once negotiated and executed, the government lists that company's products in a schedule, which is available to all government agencies.⁴ The schedule

¹ 31 U.S.C. §§ 3729–33 (2013). The civil False Claims Act, which Congress enacted during the Civil War era, prohibits the knowing submission of a false claim that is paid in whole or in part from the federal fisc. The statute provides for treble damages and up to \$11,000 penalty for each false claim. In fiscal year 2014, the Department of Justice collected approximately \$6 billion in civil False Claims Act settlements and verdicts. *Id.*; see also Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, Justice Department Recovers Nearly \$6 Billion from False Claims Act Cases in Fiscal Year 2014 (Nov. 20, 2014), available at <http://www.justice.gov/opa/pr/justice-department-recovers-nearly-6-billion-false-claims-act-cases-fiscal-year-2014>.

² See 48 C.F.R. §§ 1.103 (2013); see generally 48 C.F.R. § 1 (2013) (codifying the Federal Acquisition Regulations).

³ See *id.* § 1.102.

⁴ *Id.* § 8.402.

provides a “fair and reasonable” price at which the federal agencies may purchase the listed products or services. A MAS contract thus allows companies direct access to the expansive federal marketplace, where they can sell their products in large volume to clients with substantial buying power.

1. No Requirement to Provide the Federal Government with the Best Price

There are myriad rules and regulations governing the sale of products and services to the federal government. Title 48 of the Code of Federal Regulations (CFR), the Federal Acquisition Regulations (FAR), and various agency supplements, such as the Defense Federal Acquisition Regulation Supplement (DFARS), codify these rules and regulations.⁵ The government designs these regulations to ensure it receives a “fair and reasonable” price for the products it purchases.⁶ However, no regulation requires that the federal government receive the best price available in the marketplace. Indeed, although the federal regulations create an affirmative obligation for the government contracting officer to seek the “best price” available, there is no federal regulatory requirement that the contractor do so. The regulations provide that “[t]he Government will seek to obtain the offeror’s best price (the best price given to the most favored customer).”⁷ Further, “[i]f the best price is not offered to the Government, [the contracting officer] should ask the offeror to identify and explain the reason for any differences.”⁸ Consequently, the government contracting officer is not required by regulation to obtain the actual “best price” available in the marketplace; the federal regulations acknowledge the business reality that “conditions of commercial sales vary and there may be legitimate reasons why the best price is not achieved.”⁹ Rather, the regulations require contracting officers to understand the disparities between the price offered to the government and the actual “best price” available in the commercial sector.¹⁰ As this Comment will discuss below, interchanges with the contracting officer regarding the contractor’s commercial sales data (such as discounts, rebates and special incentives) often serve as the basis for False Claims Act allegations.

⁵ Title 48 of the Code of Federal Regulations codifies both the FAR and DFARS. *See id.* §§ 1.101, 201.104.

⁶ *Id.* § 15.402.

⁷ *Id.* § 538.270(a).

⁸ *Id.* § 538.270(c)(7).

⁹ *Id.* § 538.270(a).

¹⁰ *Id.* § 538.270(c)(7).

2. The Price Reduction Clause

Many government contracts contain a Price Reduction Clause (PRC). The federal PRC governs required price adjustments to federal contracts.¹¹ Through this PRC, the contracting officer establishes a “basis of award” customer as the benchmark by which future discounts to the government will be measured. The basis of award customer can be a class of customers (e.g., educational institutions) or a specified subset of customers.¹² The relationship between the discounts provided to the governmental agency must remain consistent with those offered to the basis of award customer. As the regulations indicate, “[a]ny change in the Contractor’s commercial pricing or discount arrangement applicable to the identified customer (or category of customers)”¹³ triggers the PRC. In addition, the contractor has an affirmative duty to notify the government if there is any change in pricing to a basis of award customer that would trigger the PRC.¹⁴ In addition to liability for breach of contract, a failure to comply with PRC obligations may serve as a basis for FCA allegations.¹⁵ MFC clauses are an analogue to the PRC because they too are designed to ensure that government purchases are subject to the same discounting practices as other customers, including those in the commercial sector.

3. Most Favored Customer Clauses

There is no federal regulatory requirement for the contracting officer to include a “most favored customer” clause in a GSA contract. Indeed, there is no standardized MFC in the FAR. Perhaps it is for this reason that the MFC clauses surfacing in federal contracts vary broadly. Although the concept may appear simple in form (i.e., giving the government at least the best price offered to other customers making similar purchases), in application, compliance with MFC obligations can prove to be quite challenging. The terms of MFC clauses often are broadly constructed without consideration to the burden placed on the contractor to comply with them. Consider the following examples:

- Contractor warrants that the price(s) are not less favorable than those extended to any other customer (whether government or commercial) for the same or similar articles or services in similar quantities;

11 *See id.* § 552.238-75.

12 *See id.* § 552.238-75(a).

13 *Id.*

14 *Id.* § 552.238-75(b) (“the Contractor shall report . . . all price reductions”).

15 *See* 31 U.S.C. §§ 3729–33 (2012).

- The Contractor certifies that the prices, warranties, conditions, benefits and terms are at least equal to or more favorable than the prices, warranties, conditions, benefits and terms quoted by the Contractor to any customers for the same or a substantially similar quantity and type of service; or
- The Contractor warrants that prices of materials, equipment and services set forth herein do not exceed those charged by the Contractor to any other customer purchasing the same goods or services under similar conditions and in like or similar quantities.

Broad MFC clauses, like those appearing above, are particularly difficult from a compliance perspective. First, there is no limitation with respect to the basis of award customer, thus requiring compliance efforts to include a survey of sales to all customers. Second, defining the scope of products or services covered as being those that are “similar” renders the clause susceptible to competing interpretations as to what the parties intended. Third, additional ambiguity is injected into the analysis where the clause defines the triggering quantity only as being “similar” to the government’s purchase volume. It is axiomatic that the quantity purchased may affect a seller’s willingness to increase the discount offered. Fourth, what constitutes similar terms and conditions (e.g., warranties and benefits) provides yet another layer of complexity that can differentiate transactions and remove them from the purview of a MFC clause.

B. State Regulations

Many state contracting agencies include MFC clauses in their requests for proposals as a required term for any contract award. Like their federal counterparts, these clauses vary significantly. Some include a basis of award customer that is well defined (e.g., other educational institutions within the state), while others contain no limitation on the basis of award customer. We have seen some clauses that include the “similar” quantity provision and others that are broader (e.g., similar quantity or fewer). Moreover, the state MFC clauses—like those seen in GSA contracts—contain no temporal limitations when defining relevant transactions, leaving to the contractor the burden of determining when the price adjustment period for any given transaction begins and ends. Also like their federal counterparts, state MFC clauses are principally enforced through FCA cases.

As of July 2014, thirty states, including the District of Columbia, had enacted iterations of the Federal False Claims Act.¹⁶ Local municipalities enact false claims statutes, as well.¹⁷ As is the case with the Federal FCA, invoices and certifications of contractual compliance, whether express or implied, may form the basis of an FCA allegation. Florida, for example, requires contractors “at least annually” to submit an affidavit that the contractor is in compliance with contractual MFC clauses.¹⁸

II. ENFORCEMENT OF MFC CLAUSES THROUGH FEDERAL AND STATE FCAS

Although there are no reported FCA cases tried to verdict based upon an alleged violation of an MFC Clause, FCA caselaw generally, coupled with complaints filed by the government and relators, provide useful insight to a company formulating its compliance strategy with respect to the MFC clauses. The allegations in the publicly available complaints typically are based on a post hoc evaluation of data relating to commercial sales, and the claim that the government should have been offered the discounts identified during the review. Consider the allegations in the following illustrative, publicly available complaints:

- Ward Diesel Filter Systems “failed to disclose its actual best price . . . Ward submitted false pricing information and falsely disclosed that the prices offered through the GSA were ‘equal to or better’ than the ‘best price’ offered to ‘any’ customer Ward’s failure to report the pricing changes to the GSA is fraud.”¹⁹
- “Corning defrauded the government by[] failing to provide the government with price discounts provided to private customers such that private customers received more favorable pricing[.]”²⁰
- “EMC did not accurately disclose its business practices and discounts . . . as required by federal law The defective

16 See *States with False Claims Acts*, TAXPAYERS AGAINST FRAUD EDUCATION FUND, <http://www.taf.org/states-false-claims-acts> (last visited Dec. 30, 2014).

17 See, e.g., ALLEGHENY COUNTY, PA., FALSE CLAIMS ORDINANCE, ch. 485 (2011).

18 FLA. STAT. § 216.0113(2) (2011).

19 Complaint at ¶¶ 38–40, *United States ex rel. Siska v. Ward Diesel Filter Sys.*, No. 10CV00111 (D.N.H. Mar. 22, 2010).

20 Complaint at 1, *United States ex rel. Jones v. Corning Inc.*, No. 1:10CV01692 (D.D.C. Oct. 5, 2010).

disclosures by EMC led to the government paying significantly higher prices.”²¹

- Oracle “fail[ed] to disclose deep discounts [it] offered to commercial customers when [it] sold software products to federal government agencies through a General Services Administration Multiple Award Schedule.”²²
- Network Appliance (NetApp) “promis[ed] to adhere to the contract provisions regarding . . . price reduction . . . [but] failed to do so. . . . The defendant, during the course of its contract with GSA, gave commercial customers higher discounts than it gave GSA in contravention of the provisions of [the] contract.”²³

Although each of these cases involved unique facts and circumstances, their unifying theme is the purported failure to disclose accurate pricing and discounts—either during negotiations for the underlying contract or in the context of post-award pricing of government transactions.

In *Corning*, for instance, the *qui tam* relator alleged that Corning provided more favorable pricing to other customers.²⁴ The more favorable pricing terms included rebates and free laboratory equipment in exchange for purchasing Corning products, which Corning purportedly used “as a way to secure or reward customers for their business.”²⁵ For example, the complaint alleged:

[T]he University of Pennsylvania, a private institution, could purchase a particular type of cell plate for \$131.90 under its . . . Contract. Corning’s GSA contract price for the same plates was \$89.97. When the University of Pennsylvania received a ‘buy 1, get 1 free’ deal on these plates, the price was reduced to \$65.95, which is \$24.02, or approximately 27%, below GSA pricing.²⁶

The relator alleged that this promotion amounted to a “discount” that negated the government’s status as a most favored customer and subsequently became actionable under the FCA when Corning certified

21 Complaint in Intervention at ¶¶ 31–32, *United States ex rel. Rille v. EMC Corp.*, No. 1:09-cv-00628 (E.D. Ark. Jun. 6, 2008).

22 Complaint at 1, *United States ex rel. Frascella v. Oracle USA*, 751 F. Supp. 2d 842 (E.D. Va. 2010) (No. 1:07CV00529 LMB/TRJ).

23 Complaint at ¶¶ 26–27, *United States ex rel. Kapuscinski v. Network Appliance Inc.*, No. 06CV00675 (D.D.C. Apr. 13, 2006).

24 Complaint at ¶ 20, *Corning*, No. 1:10CV01692.

25 *Id.* at ¶ 25.

26 *Id.* at ¶ 31.

compliance with the contract. Ultimately, Corning settled the action for \$5.65 million.²⁷

Recent settlements make clear that FCA cases, based upon purported deficiencies in pricing practices, are likely to be the continued focus of the federal and state agencies, as well as whistleblowers. In 2009, NetApp agreed to pay \$128 million to settle the allegations that it breached its pricing obligations to the federal government.²⁸ In 2011, Oracle paid \$199.5 million to resolve allegations that it “knowingly failed to meet its contractual obligations to provide GSA with current, accurate and complete information about its commercial sales practices, including discounts offered to other customers.”²⁹ Similar allegations in 2012 against hardware company W.W. Grainger resulted in a \$70 million settlement.³⁰ In August 2014, Hewlett-Packard, a manufacturer of IT and other computer products, paid \$32.5 million to settle allegations that it violated an MFC clause by “failing to comply with pricing terms of [its] contract [with USPS], including a requirement that HP provide prices that were no greater than those offered to HP customers with comparable contracts.”³¹

As designed by Congress, the government may not use the FCA as an enforcement tool for mere perceived breaches of contract.³² Yet, because the FCA does not require proof of *scienter*,³³ it is difficult for contractors to establish at the motion to dismiss stage that the action alleges a mere

27 Press Release, Office of Pub. Affairs, U.S. Dep’t of Justice, New York-based Corning Incorporated to Pay US \$5.65 Million to Resolve False Claims Allegations (Mar. 8, 2013), available at <http://www.justice.gov/opa/pr/new-york-based-corning-incorporated-pay-us-565-million-resolve-false-claims-allegations>.

28 Press Release, Office of Pub. Affairs, U.S. Dep’t of Justice, GSA Contractor NetApp Agrees to Pay U.S. \$128 Million to Resolve Contract Fraud Allegations (Apr. 15, 2009), available at <http://www.justice.gov/opa/pr/gsa-contractor-netapp-agrees-pay-us-128-million-resolve-contract-fraud-allegations>.

29 Press Release, Office of Pub. Affairs, U.S. Dep’t of Justice, Oracle Agrees to Pay U.S. \$199.5 Million to Resolve False Claims Act Lawsuit (Oct. 6, 2011), available at <http://www.justice.gov/opa/pr/oracle-agrees-pay-us-1995-million-resolve-false-claims-act-lawsuit>.

30 Press Release, Office of Pub. Affairs, U.S. Dep’t of Justice, Illinois-based Hardware Distributor W.W. Grainger Pays US \$70 Million to Resolve False Claims Act Allegations (Dec. 26, 2012), available at <http://www.justice.gov/opa/pr/illinois-based-hardware-distributor-ww-grainger-pays-us-70-million-resolve-false-claims-act>.

31 Press Release, Office of Pub. Affairs, U.S. Dep’t of Justice, Hewlett-Packard Company Agrees to Pay \$32.5 Million for Alleged Overbilling of the U.S. Postal Service (Aug. 1, 2014), available at <http://www.justice.gov/opa/pr/hewlett-packard-company-agrees-pay-325-million-alleged-overbilling-us-postal-service>.

32 See, e.g., *United States ex rel. Owens v. First Kuwaiti Gen. Trading & Contracting Co.*, 612 F.3d 724, 728 (4th Cir. 2010) (“[The FCA] does not allow a *qui tam* relator to shoehorn what is, in essence, a breach of contract action into a claim that is cognizable under the False Claims Act” (internal quotation marks omitted)).

33 See 1 JOHN T. BOESE, CIVIL FALSE CLAIMS AND QUI TAM ACTIONS § 1.04[B] (4th ed. Supp. 2014).

breach of contract as opposed to a basis upon which FCA liability may be predicated. Indeed, the government and relators frequently contend that a contractor's certification of compliance with the contract, whether express or implied,³⁴ constitutes a knowing violation of the FCA because it was based upon a willful disregard of or a deliberate indifference to the truth.³⁵

A case alleging an FCA violation as a result of the breach of an MFC clause necessarily will force courts to determine the proper interpretation of a contract term and, based on that interpretation, whether there was a knowing violation giving rise to FCA liability. The ambiguous nature of MFC clauses ultimately should inure to the benefit of the contractor, as a number of courts have refused to find FCA liability on the basis of imprecise contract terms.³⁶

The decision in *United States v. Data Translation Inc.*,³⁷ a case involving allegations that the contractor failed to accurately disclose its discount practices, provides a practical approach to disclosure obligations. Data Translation Inc. (DTI) sold computer boards to federal government agencies via a MAS contract at prices negotiated by the GSA. The government brought suit against DTI, alleging it violated the FCA by failing to properly disclose the prices at which it sold the computer boards to other nongovernmental customers. The relevant contract term was as follows:

34 See, e.g., *Shaw v. AAA Engineering & Drafting, Inc.*, 213 F.3d 519, 531 (10th Cir. 2000) (holding that invoices submitted after false certifications of compliance with a contract were cognizable under the "false implied certification theory" of FCA liability).

35 See BOESE, *supra* note 33, at § 1.04[B] (discussing the lowered intent/knowledge requirements of the federal FCA following its amendment in 1986, and stating that "the government need only show that the defendant . . . acted in deliberate indifference . . . or . . . reckless disregard of the truth of the information").

36 See, e.g., *United States ex rel. Thomas v. Siemens AG*, 991 F. Supp. 2d 540, 568 (E.D. Pa. 2014) (granting defendant's motion for summary judgment in a case alleging that the defendant violated the FCA by failing to disclose discounts given to basis of award customers, because "[w]ithout more than a relator's subjective interpretation of an imprecise contractual provision, a defendant's reasonable interpretation of its legal obligation precludes a finding that the defendant had knowledge of its falsity."); see also *United States v. Basin Elec. Power Coop.*, 248 F.3d 781, 805 (8th Cir. 2001) (holding that the relator had failed to prove an FCA violation where the defendant's "interpretation and performance under the contract was reasonable," thereby eliminating the possibility that the defendant "acted with the requisite knowledge."); *United States ex rel. Lamers v. City of Green Bay*, 168 F.3d 1013, 1018, 1020 (7th Cir. 1999) ("[I]mprecise statements or differences in interpretation growing out of a disputed legal question are similarly not false under the FCA . . . [T]he FCA is not an appropriate vehicle for policing technical compliance with administrative regulations."). But see *United States ex rel. Vosika v. Starkey Labs., Inc.*, No. 01-709 (DWF/SRN), 2004 U.S. Dist. LEXIS 18349, at *10-12 (D. Minn. Sept. 8, 2004) (distinguishing *United States v. Data Translation* and denying the defendant's motion to dismiss).

37 984 F.2d 1256 (1st Cir. 1992).

If, subsequent to the award of any contract resulting from this solicitation, it is found that any price negotiated . . . was increased by any significant amount because the prices, data, and facts were not as stated in the offeror's "Certificate of Established Catalog or Market Price," then the contract price(s) shall be reduced by such amount and the contract shall be modified in writing to reflect such adjustment.³⁸

The court characterized the government's 'breach of contract' claim as resting essentially on the proposition that DTI, when it submitting its offer, did not "disclose all the computer board price discounts it gave to its non-governmental customers."³⁹ Justice Breyer, then a member of the First Circuit, opined that "one must examine the relevant provisions, not necessarily as the GSA intended them, but rather from the perspective of a *reasonable person* in DTI's position."⁴⁰ The court emphasized that the contract should be given a practical—as opposed to a literal—interpretation. Justice Breyer observed that "[t]he Government has asked . . . this court to read the contract's 'discount disclosure' language literally, as requiring DTI to reveal *every price discount* it provided *any* of its customers *ever*—a revelation that DTI must concede it did not make."⁴¹ The court held:

No reasonable person, negotiating with [the GSA] could have believed that the Government really wanted the complete and total disclosure for which the language seems to ask. . . . An ordinary business person would not seem likely to interpret the form literally, for, read literally, the form asks a business to shoulder a compliance burden which will often seem inordinately difficult or impossible to carry out.⁴²

The court concluded that a policy requiring the broad disclosure the GSA demanded would create an unreasonable and undesirable compliance situation.⁴³ In attempting to fashion a practical interpretation of the contract clause, the court's explanation focused on *relevant* data. Importantly, the court stated that the contract only required DTI "to disclose *significantly relevant* price discounts that DTI *normally* provided other customers making purchases *roughly comparable* to the agency purchases the Government contemplated would occur under the MAS program."⁴⁴

38 *Id.* at 1258 (alteration in original) (emphasis in original).

39 *Id.*

40 *Id.* at 1259 (emphasis in original).

41 *Id.* at 1260.

42 *Id.* at 1261.

43 *Id.* at 1262 ("[A] system that lays down a literal rule with which compliance is inordinately difficult, turning nearly everyone into a rule violator, and then permits the agency to pick and choose when and where to enforce the rule, is obviously undesirable").

44 *Id.* at 1263 (emphasis in original).

Data Translation supports the contention that MFC contract terms should be interpreted with a practical view toward compliance. The terms of such clauses should be interpreted to ensure commercial viability, fulfilling its purpose of ensuring that the contracting agency is treated fairly in light of other similarly situated purchasers and providing a compliance landscape that is not overly burdensome or expensive to implement.⁴⁵

III. BEST PRACTICES FOR COMPLYING WITH MFC OBLIGATIONS

A. *Define the Basis of Award Customer Narrowly and with Specificity*

When formulating a strategy for complying with MFC obligations, companies need to first analyze their IT systems to understand what data is captured, the form in which it is maintained, and how readily it may be accessed. The answers to these basic questions will inform the negotiating strategy with the contracting agency. For example, one may wish to negotiate the basis of award customer(s) based on how the data is stored in the company's system (e.g., state, local or educational customers). Recognizing the inherent limitations on the ability to access and process sales and pricing data is essential to understanding what the company is able to achieve with respect to MFC compliance. In this regard, limiting the basis of award customer(s) to specific accounts makes compliance with MFC obligations feasible. Whenever possible, identify specific customers (e.g., "entities X, Y and Z") or at least a specific business segment (e.g., educational institutions within the state). Limitations of this kind will enable the company more readily to conduct the necessary comparisons and to establish compliance with the clause.

B. *Develop a Written Protocol for Compliance with MFC Clauses*

Recognizing, however, that contracting authorities are not likely to negotiate the scope of their MFC clauses, companies are left to develop a compliance regimen that is practical and will withstand the test of commercial reasonableness. To do so, the contractor must give meaning to most ambiguous of terms, including "similar" or "substantially similar" products or services, quantities, and terms and conditions. To ensure consistency in application and establish the contractor's good faith effort to comply with its MFC obligations, the contractor should (i) develop a

⁴⁵ State caselaw is not well developed as many of the state actions arise in the context of a federal suit. It is reasonable, however, to assume that the state courts will follow the lead of the federal courts that have addressed the same or analogous issues. *See, e.g.*, S.F. Unified Sch. Dist. *ex rel.* Contreras v. Laidlaw Transit Inc., 182 Cal. App. 4th 438, 447 (2010) ("Given the 'very close similarity' of the [California FCA] to the federal False Claims Act . . . 'it is appropriate to turn to federal cases for guidance in interpreting the [California FCA].'" (citations omitted)).

written protocol to be followed by the individuals responsible for compliance with MFC obligations; (ii) train its personnel to that protocol and document completion of the training; (iii) periodically audit compliance with the protocol; and (iv) make appropriate disclosures to the governmental contracting agency at the appropriate time.

When formulating a protocol for compliance with MFC clauses, the contractor must take into account the different clauses within its contracts. In this regard, although it may be possible to develop a single protocol for use with all MFC clauses, the approach must be based on the specific requirements of existing contractual obligations and must be reexamined in the context of future bids for contracts. Although it may be most efficient to develop the compliance protocol on the basis of the broadest MFC clause, that may prove to be too costly. For this reason, the protocol probably should be written on a generic basis with instructions that permit it to be applied to a variety of clauses.

1. Temporal Limitations

The MFC compliance protocol should give definition to the ambiguous terms in the MFC clause. To the extent MFC clauses do not provide for any temporal limitations, the company should adopt a commercially reasonable time frame for comparison of basis of award customer sales. What is commercially reasonable will depend on the volatility of pricing practices in the particular industry—the most volatile the pricing model, the shorter the term of comparison. A solid standard is the current fiscal quarter. In other words, at the end of each quarter, the company could look back to the beginning of the quarter to ensure that the basis of award customers did not receive better pricing on relevant transactions. If no adjustment is necessary, the company should document its analysis, demonstrating its good faith efforts to comply with the MFC clause, and maintain the work product in the contract files. If an adjustment is necessary to comply with the MFC clause, the company should notify the contracting agency that it is entitled to a credit or rebate pursuant to the MFC clause.

2. Give Meaning to Ambiguous Terms

1. Same or similar products

The protocol also must address and give meaning to the inherently ambiguous terms appearing in MFC clauses. In some industries what constitutes the same or similar products may be readily discernable. This is especially true where there is no ability for the consumer to customize the product. Where the product offering includes different options or is susceptible to customization, the protocol should provide a concrete

methodology for isolating potentially relevant sales. It is not possible to provide a one-size fits all approach to this dilemma, but the company should start with the product model and determine what percentage over the list price—due to customization—should be considered within the relevant subset of sales. For example, a model that has a list price for \$100 and options valued at up to \$50 has a ceiling list price of \$150. The company could pick a range of list prices (e.g., +/- 5-7%) for which it would consider purchases of that model to be the “same” or “similar” for purposes of applying the MFC clause. This approach eliminates the need to conduct analysis of what options or customization the purchaser selected. This approach is premised on the principle that the sale of the same model within a specified list price range, although differently equipped, should be discounted similarly. Alternatively, if the company’s IT system facilitates sorting of transactions by model and options, the company could design a more specific protocol that is not price-based.

b. Same or similar quantities

The same approach could be used to define “similar” quantities. Once transactions with “similar products” are identified, it is necessary to identify the subset of those transactions involving the same approximate number of products. Many variables can affect this analysis. If the potentially relevant like-kind transactions involve only the single product at issue, then the analysis is fairly straightforward. The company need only designate a quantity range for inclusion in the analysis (e.g., +/- 5%) (a purchase of 100 units would trigger the same product sales of 95–105 units). Where the potentially like-kind transactions include other products and services, the analysis can (and should) become more complicated. In this regard, the purchase of additional products or services increasing the overall purchase price can affect the overall discount offered to a customer. If the company isolates only one element of the transaction to compare the discount offered on a particular model, it is not truly an apples-to-apples comparison. For this reason, there should be a correlation in aggregate list price between the MFC clause order and the like-kind transaction. This requirement would avoid comparing orders with an aggregate list price valued at \$1,000 with another valued at \$5,000. Again, this can be addressed through a designated relevancy range.

c. Same terms and conditions

Finally, the analysis necessarily must take into account the terms and conditions of the sale. Certain aspects of a transaction (e.g., warranties and credit terms) may affect end pricing. Consider the discounting associated with the purchase of a new car. Dealers often offer 0% financing or, *in the alternative*, cash back of a specified amount. The purchaser is not offered

both; it is a choice because the financing terms affect the final purchase price. Extended payment terms or warranty provisions have associated costs. The MFC review protocol should take into account the specific terms and conditions offered by the company and should eliminate those transactions for which the difference in terms and conditions affects pricing to the customer. This can be accomplished by category (e.g., eliminate all transactions that have extended warranties).

C. Train and Audit to the Written Protocol

Once the company develops and implements a written protocol for compliance with its MFC obligations, it should conduct formal training sessions with the personnel responsible for satisfying those obligations. This could include sales, contracting and compliance personnel. The training session(s) should be documented, including written materials used to present the protocol, attendance sheets and testing, if appropriate. In addition, period updates to the protocol and training may be necessary as the company develops experience and new MFC clauses are added to its contracts.

In addition, the company should audit compliance with the MFC protocol to ensure that it is accurately and consistently applied. The audits should confirm that the required evaluations are being conducted on a timely basis and that adjustments to contract pricing are achieved in accordance with the protocol. Documentation of the audit results is equally important, as it is a further demonstration of the company's good-faith effort to comply with its contractual obligations.

D. Notice to the Government of Pricing Adjustments

Whenever the company determines that a price adjustment is required pursuant to an MFC clause, it should use a standardized letter to inform the customer of the adjustment. The notice should cite the specific provision of the contract and advise that a credit in a specified amount is due to the customer. Although not required, it is prudent to include in the letter the general process followed by the company in arriving at the credit. For example, the notice could advise the customer that the company compared transactions occurring in the same quarter that involved the same model purchased by the customer having a list price within +/- x percent and with an aggregate transaction value within +/- x percent. Those transactions completed under the same or similar terms and conditions (e.g., warranties and financing terms) were compared to the customer's transactions, and it was determined that the customer was entitled to a credit of \$X. Such notice provides transparency with respect to the company's MFC compliance protocol and creates a further hurdle to any subsequent FCA claim premised on noncompliance with the MFC clause. In this regard, the

government knowledge defense prevents the government from claiming fraud related to actions about which the government was aware.⁴⁶

CONCLUSION

MFC clauses are becoming more prevalent in federal and state agency contracts. Contracting officers rely on these clauses to ensure that their customers receive favorable pricing, and generally are not amenable to negotiating changes to their standard clauses. Those clauses are broad in scope, often do not identify a basis of award customer, and contain ambiguous terms that require subjective analysis to implement. Given the litigation landscape, where the government has aggressively sought to enforce pricing provisions, including MFC clauses, through FCA actions, companies need to be vigilant in their compliance efforts.

Compliance with MFC clauses should be achieved through a written protocol that identifies the basis of award customer(s), imputes a commercially reasonable temporal limitation where the clause is silent, and provides definitions for the ambiguous terms consistent with the company's IT capabilities. The company should train and audit to its written protocol to ensure it is implemented accurately and effectively. In addition, the company should provide written notice to its customers when it determines a price adjustment is necessary. That notice should reveal the general parameters of the protocol and the amount of the credit due to the customer. Finally, the company should update its protocol to address new requirements created by MFC clauses in future contracts.

⁴⁶ See, e.g., *United States ex rel. Becker v. Westinghouse Savannah River Co.*, 305 F.3d 284, 289 (4th Cir. 2002) ("Today, we join with our sister circuits and hold that the government's knowledge of the facts underlying an allegedly false record or statement can negate the scienter required for an FCA violation.").