

APPENDIX F: "Technical Report on Criminal Vulnerability and Fraud," Kenneth M. Pedeleose, David J. Billy, and Henry R. Hagel, Report to Congress, July 26, 2002, pp. 7-14

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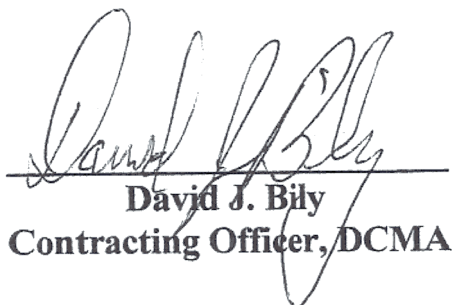
Technical Report on Criminal Vulnerability and Fraud

A Report on Waste, Fraud, Abuse of Discretionary Authority, and
Criminal Vulnerability for the Department of Defense, Defense Contract
Management Agency (DCMA) and Lockheed Martin Aeronautics
Company (LMAC)

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Section 1
C-130J Acquisition Reform Pilot Program
(The Beginning)

In 1994 the C-130J cargo airplane was deemed an Acquisition Reform pilot program where commercial practices were to be used in procurement processes. The intent was to reduce cost and have a military aircraft consisting of parts readily available in the commercial market place.

What this project has turned into is an aircraft that has more than doubled in price with spare parts prices exceeding anything reasonable. In short, the C-130J was a precursor of many future problems to come. To prove this point the C-130J cost escalation history is provided:

C-130H 1995-1996:	\$30.160 Million
C-130J (First aircraft October 1995):	\$33.9 Million
C-130J (First 5 Year Contract) (1995 – 2000):	\$44.2 Million - \$49.9 Million
C-130J (Second 5 Year Contract) (2001 -2005):	\$60.0 Million - \$66.0 Million
C-130J (Rumored prices, 2002)	\$73 Million

The following items outline the C-130J history and are provided to show a failure due to overextending Acquisition Reform from removing the controls necessary to contain cost and ensure ethical conduct. These items will also show the continued trend of excluding technical and financial experts from the process thus allowing further unbridled cost increases, among other issues.

A. 1994 SAF/AQQU Report: On June 3, 1994 there was a Pentagon SAF/AQ report passed to our then Deputy Commander (Mr. Steve Shelley). The report is summarized as follows:

- C-130J development was deemed overly optimistic. Costs over and above the estimates were to be charged to Independent Research & Development (IRAD) thus spreading development cost overruns into an overhead account forcing other programs (F-22, C-5, etc) to burden the cost. I confirmed this trend through a technical review of IRAD programs.

- The development estimate was based on Level of Effort (LOE) support. That is assigning personnel for a specific period of time. In summary, the passage of time took precedence over performance. I have noticed this on recent proposals as well.

- Comparisons were done between the C-130J, C-130H, and C-130E models. Since the C-130Es are significantly older than the C-130Hs, it is understandable that the cost savings of C-130E versus C-130J would be greater than an H versus J model comparison, thus misrepresenting actual savings.

B. Administrative Agreement (June 30, 1995): To avoid debarment as a defense contractor, LMAC agreed to allow access to its records (for a period of 3 years) to prove that they (LMAC) could be dealt with fairly. LMAC during this period continually denied access to records involving the C-130J, thus violating the administrative agreement.

C. C-130J Regulatory Pilot Program Designation (September 19, 1995): In spite of several concerns regarding the C-130J development, and LMAC actions of the June 30, 1995 administrative agreement (Item B) to avoid debarment, the program was designated as a C-130J Regulatory Pilot Program Designation. By doing this the government lost all insight into the C-130 operations.

D. October 21, 1998 (Exclusive Meeting): Pentagon (SAF/AQ) scheduled a visit to LMAC for a C-130J program review. Part of the review was to determine the reason for the cost increase of the C-130J. The local DCMA Divisional Administrative Contracting Officer (DACO) and DCAA were invited for some of the sessions.

It was suspicious when LMAC formerly excluded DCMA and DCAA (via memorandum) from a limited attendance (exclusive meeting) cost session. The LMAC memorandum indicated; *we are not trying to hide anything, only preserve the commerciality of the program.* This began a trend of openly excluding technical and financial personnel who are experts on LMAC operations and thus losing credibility in what should be open dialog conversations. Future actions will involve the exclusion of government personnel who identify LMAC improper business practices (fraud).

E: Letter of Temporary Exception (LOTE): The LOTE is a documentation mechanism that documents the contractual non-compliance of the C-130J. The illusive part of the LOTE is that aircraft are delivered with known shortcomings; however "on paper" the aircraft is "delivered". This is a misrepresentation of data because the C-130J is delivered, with some withholds, and however is not in usable form.

F. Parts Rotation (Cannibalization): A disturbing issue at LMAC involves rotating parts between Aircraft to accomplish tests and inspections for the C-130J and F-22. There have been investigations which have indicated that since the government about the parts rotations, then no problem exists. Unseen problems include:

- Combat readiness may be affected if parts shortages or field part rotations must occur,
- Constant rotation increases wear of the parts.
- Misrepresentation of commercial part readiness (lack of spare parts)
- Constant rotation may be a sign of high failure rates, thus effecting combat mission success
- Rotating parts takes time and money, increasing end item cost.

To help remedy this situation, a process of pad locking aircraft and documenting serial numbers on certain avionics components has been initiated. The issue of commercialization (readily available anywhere – Commercial Off the Shelf (COTS parts)) may be misrepresented.

G. Contractor Proposal Assessment Report (CPARs): The CPARs is used to evaluate contractor performance for future contractor awards. An event was recorded (March 27, 2000) where the government received training from LMAC on how to correctly fill out these forms. This may represent a conflict of interest, and is provided for information reasons.

H. Disclosures & Current Complaints: On April 5, 2000 I disclosed a significant amount of information including test reports, e-mails, etc., to the DCIS (200000836R-27-MAR-00-20AT-E5) on the regarding the C-130J. This followed my experiences on the C-5PDM project, where LMAC and DCMA management were exhibiting a desensitized response towards waste, fraud, abuse, and safety and simply put I became tired of the situation. Samples of this information are as follows:

- C-130J composite propellers structural integrity issues
- Reduced FAA certification on C-130J baseline (thus reducing commerciality of the C-130J)
- C-130J wiring issues
- Color Multipurpose Display Units (CMDUs) burning out
- Reprisal towards military personnel

Having the benefit of time passage, updates can be provided as follows:

- C-130J composite propellers experiencing structural cracks
- LMAC may further reduce FAA certification thus increasing governments need to test and certify
- The CMDU units may still be burning out. I have heard of field complaints and further investigations in this area.

I will support investigations that develop, however, the commercial nature of the C-130J, and the fluid nature of LMAC management and accounting practices, makes status of any LMAC program difficult to impossible to track.

Foreign Negotiations (Italy C-130J)

In late 1996 through early 1997 our office was requested, and funded, by the Italian Government to independently evaluate an LMAC contract proposal for 18 C-130J cargo Airplanes valued at over \$1 Billion. Italy was the first foreign government that requested DCMA assistance in the evaluation of a C-130J proposal and realized that DCMA could provide an independent cost analysis of the LMAC contract.

The evaluation of the proposal was complicated by the commercial nature of the C-130J and LMAC's extreme intransigence in providing supporting data. This further complicated matters due to fact that the Italian Government had to support their purchases through an independent accounting practice, which required substantiation for purchases of this magnitude. It was our task to provide an independent document and analysis that could be used by the Italian Government.

In short, the LMAC proposed price could not be substantiated based on historical factors and the limited information LMAC provided. Thus the final DCMA evaluation was forced to question the excessive cost and submit the report to the Italian Government for use in negotiations.

Negotiations between the Italian Government and LMAC stalled due to the differences in the LMAC C-130J asking price versus the independent analysis (DCMA recommended price).

Following this incident, LMAC complained that DCMA was interfering with LMAC establishing "commercial pricing" of the C-130J. In short, LMAC wanted to charge as much as they could for the C-130J despite the fact that a commercial price analysis indicated a lesser cost.

One major item of contention was the fact that the Italian Government did not recognize off-set costs that LMAC had included in their proposal. At one point Colonel Boylan (then DCMA Commander prior to Colonel Evans) indicated that he discussed the issue with Mr. Hanson (LMAC Executive Vice President) as to how DCMA could support the off set cost without calling them off set cost. The timeline begins at this point:

January 17, 1997: Mr. Bily reported Colonel Boylan's actions to the agency Fraud, Waste, and Abuse Counsel for corrective action. The following are a list of Mr. Bily's concerns as related to Colonel Boylan's actions:

1. Interfering with official U.S. Government's Pricing Recommendation.
2. Commander working with the contractor to hide costs.
3. Unethical conduct and relationship between Colonel Boylan and Mr. Hanson (LMAC Executive Vice President).
4. Mr. Bily also requested a formal investigation to determine if Mr. Hanson's actions are in violation of the administrative agreement LMAC signed in the fall of 1995 where LMAC expressed interest in demonstrating that, notwithstanding the misconduct for which LMAC was convicted, Lockheed Martin can be trusted to deal fairly and honestly with the U.S. Government and that suspending or debarring Lockheed Martin from future government contracting is not a necessary protection in this case.

February 12, 1997: Mr. Ryan (DCMA Division Administrative Contracting Officer (DACO)) provided a letter to Colonel Boylan justifying the position of the pricing report submitted to Italy.

March 17, 1997: Mr. Ryan provided a letter to LMAC justifying the position of the pricing report submitted to Italy.

March 28, 1997: Mr. Ryan again writes a letter to Colonel Boylan informing him that the price DCMA recommended was considerably higher than the price paid by the U. S. Air Force and that the DCMA recommended price could be set at the U.S Air Force price and LMAC could be made to justify anything above the Air Force Price. Mr. Ryan also stated that he conferred with legal counsel who conferred that no information should be released to the contractor without securing the permission of the Italian Government.

The questioning of cost and disclosures made to Fraud Counsel may have embarrassed LMAC and DCMA management resulting in reprisal actions. One of these actions was Mr. Bily being removed as a point of contact for the pricing team. Reprisal actions against Mr. Bily are further outlined and explained in Section 6.

For the record, there were never any adverse comments involving the analysis of the Italy report, or any proof that the results/conclusions were faulty or suspect.

Italy Summary: LMAC and Italy agreed on a price which gave LMAC a large production contract, and provided the United States Government a brief respite from having to sustain the C-130 program through military budget add-ons.

This should have been viewed as an Acquisition Reform success story which allowed the American people an additional \$1 Billion to put towards education, health care, infrastructure (roads, bridges), the environment, etc., versus sustaining a military add-on program for C-130 airplanes not needed for several years to come.

The contrary was true, and our efforts were not appreciated by DCMA management as became evident on the follow-on proposal to Norway and future disparate personnel actions.

Foreign Negotiations (Norway C-130J)

In late 1997 the government of Norway requested our assistance in the evaluation of their C-130J proposal, similar to that of Italy. The Norway proposal was for 6 C-130Js and some support equipment.

LMAC applied significant pressure, efforts, and sheer stubbornness to avoid independent review of their proposal. The LMAC stonewalling tactics prolonged the technical analysis, and may have been a contributing factor for LMAC losing the contract. The timeline of events supporting the Norway negotiation are as follows:

August 8, 1997: Received advanced word that Norway will be requesting contract administrative services from our office (DCMA) for the purchase of 6 C-130J aircraft.

September 8, 1997: Colonel Boylan (DCMA commander 1994-1998) informed the government pricing team personnel that the company (LMAC) did not believe that DCMA had the qualified people necessary to do an adequate evaluation of the (LMAC) Norway proposal. Mr. Bily advised Colonel Boylan that he had not looked at the proposal as yet, however similar circumstances with the Italian proposal may occur where DCMA may recommend a price reduction.

September 9, 1997: DCMA received authorization to begin work on the Norway proposal from our DCMA international office.

September 9, 1997: Mr. Ryan (DCMA DACO) sent a letter to Headquarters Defense Command Norway identifying key points of contact for the pricing effort. Mr. Bily was included as a Price Analyst.

September 9, 1997: A meeting was held by Colonel Boylan (attended by Mr. Bill Ryan (DACO), Mr. Tommy Treat (ACO), Mr. Dan Lee (TAG Manager), Major Rob Cooney (C-130 Program Integrator (PI), and Mr. Dave Bily) to discuss the approach used to evaluate the (LMAC) Norway proposal. The thrust of the meeting was Colonel Boylan's attempt to direct the price analysis approach to support the company's catalog price.

Colonel Boylan indicated that the proposal should be evaluated based on the (LMAC) Foreign Military Sale (FMS) price only. In short, Colonel Boylan was attempting to avoid a price reduction recommended on the Italian C-130J purchase by limiting the scope of the evaluation.

Mr. Bily indicated that the FMS price could be used as a fourth alternative price however, should not be the only alternative since better information was available. Mr. Bily indicated that we should decline Norway's request for evaluation of the C-130J proposal if we could not provide them the best possible information. At this time Mr. Dan Lee indicated to Mr. Bily that he (Mr. Bily) was in direct violation of an order by Colonel Boylan, and that he (Mr. Bily) should read his position description to understand what is expected of him (Mr. Bily).

September 9 or 10, 1997: (Whistle blowing) Mr. Bily contacted our local Fraud, Waste, and Abuse Counsel (Ms Leigh Owens or Leslie Cook) and disclosed what he believed to be an illegal order and unethical conduct by Colonel Boylan. (Mr. Bily disagreed with the direction that Colonel Boylan wanted us to evaluate the (LMAC) Norway proposal.) Mr. Bily indicated that this is actually the second time he reported Colonel Boylan to the Fraud, Waste, and Abuse Counsel for unethical conduct involving our attempt to develop a fair and reasonable recommendation to our customers.

September 10, 1997: Mr. Dan Lee e-mailed Mr. Bily and stated the following guidelines for evaluation of the LMAC Norway proposal:

1. Tommy Treat is the ACO. All Correspondence, both ways will go through him.
2. The ASC (*Aeronautical Systems Center*) Contract FMS price is the Official U. S. Government price for the basic Aircraft. (Tommy will research the price and determine what it should be and what it includes.)
3. We will not request clarification of any information from LMASC. All requests will be made to the Norwegian government.
4. We can make recommendations based on experience, except for the FMS price of the basic aircraft.
5. All reports to Norway will be released by the Commander's Office.

This e-mail limited the involvement of Mr. Bily and Mr. Ryan (financial and pricing experts) from the process.

It can be further noted that the established Government FMS price is for a different aircraft. In short attempts were underway to ensure that LMAC's price would not be challenged as occurred on the Italy negotiation. These actions substantiate a trend of not challenging the contractor (LMAC).

September 15, 1997: A draft memorandum of record was issued describing what events have taken place to date concerning the Norway proposal. Mr. Bily had questions involving the accuracy of the letter.

September 16 or 17, 1997: DCMC legal counsel Ms. Leigh Owens and Leslie Cook discussed concerns that the DCMC pricing team had with the Norwegian proposal. Both Ms. Cook and Ms. Owens supported our position and advised we could and should use any method we felt was required in our analysis for the Norwegians. As a result of this meeting, Colonel Boylan reversed his directions provided on September 9, 1997.

September 16, 1997: Mr. Ryan sent an e-mail to Mr. Dan Lee indicating that he disagrees with the results of the meeting as reported (by Mr. Lee). Mr. Ryan questioned the following items:

1. FMS price, except when used as historical data,
2. The need to go through Norway prior to contacting LMAC,
3. The involvement of Mr. Tommy Treat versus himself (whom Norway has been dealing with all along), and
4. The involvement of the commander in the pricing recommendation process.

September 17 – November 7, 1997 (exact date unknown): Mr. Bily contacted the local Office of Special Investigation (OSI) (Mr. Frank Clemmer) to report problems encountered with the contractor's pricing of the C-130J program under Acquisition Reform and the fact that the Government and Foreign Governments are expected to pay for contractor mismanagement.

Mr. Bily disclosed how the contractor changes data points in their regression analysis to support the commercial price, and the fact that Colonel Boylan was involved in the pricing process of Italy and Norway to support the catalog price. Mr. Bily advised the OSI that he believes Colonel Boylan's conduct was unethical and that Colonel Boylan's involvement was interfering with the pricing recommendation being made to a foreign government who is paying for our services.

October 23, 1997: Mr. Bily submitted his official pricing report of Norway's purchase of six (6) C-130J aircraft to the Contracting Officer, Mr. Tommy Treat.

November 6, 1997: Mr. Bily was aware that the report he submitted was being revised by Colonel Boylan. Mr. Bily informed the Contracting Officer (Mr. Treat) that he could not concur with the rewrite of the original report submitted on October 23, 1997. Mr. Bily believed that the revisions removed the information necessary for Norway to negotiate, and the fact that the presentation of the numbers changed the content and recommendations made by the original report.

November 7, 1997: The Contracting Officer (Mr. Treat) sent out Colonel Boylan's final revision as the U.S. Government's position without identifying any reasons or justifications to the changes made to the original report submitted by the Price Analyst (Mr. Bily).

This Document Contains Sensitive Data

In summary, this pricing exercise depicted an event where the commander (Colonel Boylan) interjected himself into negotiations (to the point of re-writing technical reports) to ensure LMAC wishes over the objections of his own personnel, and despite the fact that the Government of Norway paid for an independent pricing report.

Italy/Norway Summary. The Italy and Norway projects verified that LMAC could not support C-130J cost in a commercial market place. This is evidenced by the fact that LMAC international sales have been abysmal. The attitude of LMAC in negotiations and the strenuous nature to which they protect their "proprietary" data for an unjustifiable price is a contributing factor to the poor sales of the C-130J.

The C-130J also clarified the involvement of DCMA management to effect positive outcome in favor of LMAC. When subtle attempts (such as restricting the technical information and analysis) failed, DCMA management resorted to a more direct approach of rewriting the technical report. The following section will show that the C-130J was not an anomaly but was a forerunner of more blatant fraudulent acts yet to come.