

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES OF AMERICA, <i>ex rel.</i>)	
REX A. ROBINSON, and)	
JAMES H. HOLZRICHTER,)	
)	
Plaintiffs,)	No. 89 C 6111
)	
v.)	Judge Guzmán
)	
NORTHROP GRUMMAN CORPORATION,)	
)	
Defendant.)	

RELATORS' COMPLAINT

Dated: October 17, 2001

Table of Contents

Introduction.....	1
Jurisdiction and Venue.....	3
Parties	3
Background.....	4
Northrop Contracts with the United States	4
Northrop’s Billings to the United States.....	6
Northrop’s Cost Accounting and Material Accounting	7
DSD’s Government Programs, Contracts and Subcontracts.....	8
Northrop’s False Statements of Material Costs	12
Relator Holzrichter’s Tenure at Northrop.....	12
Holzrichter’s Audits of Scrap and Attrition Data	15
The False Scrap and Attrition	15
Northrop’s Scheme, Pattern and Practice To Conceal and Misuse Excess and Residual Inventory	18
Northrop’s Fraudulent Financial Reconciliation Scheme.....	19
Fraud in Connection with the SP-3 Program for the B-2 Stealth Bomber	26
Holding Tank Time Charges.....	26
SP-3: Test Stations.....	27
Other False Representations as to Progress	28
Count I - False Claims Act Violation	29
Prayer	30
Count II - Retaliation and Discrimination Under the False Claims Act.....	30

Prayer	30
Count III - Retalitory Discharge of Plaintiff Robinson	31
Prayer	31

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United States of America *ex rel.* Rex A. Robinson and James H. Holzrichter (relators), personally and for the United States Government, complains of defendant Northrop Grumman Corporation as follows:

Introduction

1. This is primarily an action by the United States of America, by and through the relators, to recover treble damages and civil penalties arising from false statements and claims made and/or caused to be made by defendant Northrop Grumman Corporation (Northrop) to the United States, in violation of the False Claims Act (Act), 31 U.S.C. § 3729 *et seq.* The relators also have, individually, rights and claims described below and in the Act.

2. Relators initiated this action on August 10, 1989 under the *qui tam* provisions of the Act, 31 U.S.C. § 3730; the anti-discrimination provisions of the Act, 31 U.S.C. § 3730(h), and; the common law of retaliatory discharge. On June 4, 2001, the United States moved to intervene and file a complaint under 31 U.S.C. § 3730(c)(3). Under that subsection of the Act, “the court, without limiting the status and rights of the person initiating the action, may

nevertheless permit the Government to intervene at a later date upon a showing of good cause.” The primary purpose of this complaint is to preserve and pursue the status, rights and claims of the relators.

3. The False Claims Act provides that any person who knowingly submits a false or fraudulent claim to the United States for payment or approval is liable to the United States for a civil penalty of not less than \$5,000 and not more than \$10,000 for each such claim, plus three times the amount of the damages sustained by the United States because of the false claim. The Act allows any person having knowledge of a false or fraudulent claim made to the United States to bring an action in federal district court for himself and for the United States, and to share in any recovery.

4. Northrop’s false statements and claims primarily encompass two categories of fraudulent acts that were witnessed and reported by relators Holzrichter and Robinson. First, Northrop engaged in a pattern of fraudulently accounting for material purportedly used in performance of government contracts that were billed to the United States and included in contract prices paid by the United States.¹ Second, Northrop fraudulently inflated the cost of the SP-3 program for the B-2 “Stealth Bomber” by charging the United States for unnecessary and non-program related costs, directly inflating the costs of materials and misrepresenting the level of progress to the government.

¹A Glossary of Terms and Acronyms is attached as Exhibit A.

5. Northrop and its employees also violated Section 3730(h) of the Act, which prohibits Northrop from discharging, demoting, suspending, threatening, or harassing any employee who provides information to or cooperates with the Government in relation to an employer's false claims. Northrop harassed both Robinson and Holzrichter for their Government cooperation in violation of Section 3730(h), and Northrop discharged Robinson in violation of both Section 3730(h) and state retaliatory discharge law.

Jurisdiction and Venue

6. The court has jurisdiction over this action pursuant to 28 U.S.C. § 1345 and 31 U.S.C. § 3732.

7. Venue is proper in this district pursuant to 28 U.S.C. § 1391(b) as events giving rise to this cause of action occurred in this district.

8. This suit is not based upon prior public disclosures of allegations or transactions in a criminal, civil or administrative hearing, lawsuit or investigation or in a Government Accounting Office report, hearing, audit or investigation, or from the news media. When the original Complaint was filed in August 1989, plaintiffs provided to the Attorney General of the United States and to the United States Attorney for the Northern District of Illinois a statement summarizing known material evidence and information related to the Complaint, in accordance with the provisions of 31 U.S.C. §3730(b)(2). This disclosure statement is supported by material evidence.

Parties

9. Relator Rex A. Robinson (Robinson) was a resident of the State of Illinois until June, 2001. He brings this action on his own behalf and on behalf of the United States pursuant to 31 U.S.C. § 3730(b)(1). Robinson has direct and independent knowledge of the information on which the allegations are based and, prior to filing this suit, voluntarily provided to

government agents information regarding certain false or fraudulent claims submitted by defendant to the United States. He is an original source as defined by 31 U.S.C. § 3730(e)(4)(B). When Robinson initially contacted Government agents, he was unaware of the incentives in the False Claims Act.

10. Relator James H. Holzrichter (Holzrichter) is a resident of the State of Illinois. He brings this action on his own behalf and on behalf of the United States pursuant to 31 U.S.C. § 3730(b)(1). Holzrichter has direct and independent knowledge of the information on which his allegations are based and, prior to filing this suit, voluntarily provided to government agents information regarding certain false or fraudulent claims submitted by defendant to the United States. He is an original source as defined by 31 U.S.C. § 3730(e)(4)(B). When Holzrichter initially contacted Government agents, he was unaware of the incentives in the False Claims Act.

11. Northrop is a Delaware corporation with its principal place of business in Los Angeles, California. Beginning in approximately 1966, Northrop maintained a Defense Systems Division (DSD), the operations and activities of which are the subject of this complaint, with facilities in Arlington Heights and Elk Grove Village, Illinois and headquarters located at 600 Hicks Road, Rolling Meadows, Illinois. DSD was renamed the Electronic Systems Division in 1990 and is currently known as the Electronic and Systems Integration Division which continues to maintain its headquarters at the Rolling Meadows facility. As used herein, the term Northrop includes DSD.

Background

Northrop Contracts with the United States

12. Since at least 1966, Northrop has been engaged in performing work at the DSD facilities on contracts awarded directly or indirectly to Northrop by the United States Department of Defense (DOD). Northrop has directly or indirectly provided various documents to the United

States for the purpose of obtaining, and has obtained, annual payments in excess of hundreds of millions of dollars from the U.S. under those contracts. For example, during the period from 1987 to 1990 alone, Northrop DSD's sales to the U.S. exceeded \$1.5 billion.

13. At all times material to this action, DSD has been engaged primarily in the design, development, testing, and manufacture of defense electronics systems for use in high-technology, state-of-the-art aircraft, including: (a) electronic countermeasure systems for the B-1, B-1B and B-52 Bombers, (b) the AN/ALQ-135 radar jammer deployed on the F-15 fighter aircraft, (c) the AN/ALQ-162 Shadowbox radar jammer, (d) classified "special projects" for the B-2 "Stealth" bomber, and (e) Electro-Optical Infrared ("EO/IR") defense systems.

14. At all times material to this action, DSD's products and services were primarily provided under contracts with the Air Force, Navy, other branches of the United States Armed Forces, and other federal agencies and departments. Virtually all of DSD's business — either as the prime government contractor or as a subcontractor to a prime government contractor — was ultimately for the United States. Thus, virtually all costs incurred by DSD (including overhead and other indirect costs) were charged, directly or indirectly, to the government.

15. During all times material to this action, Northrop submitted cost or pricing data as part of its proposals submitted to obtain contracts with the United States and to justify the prices for those contracts. Typically this data was submitted on a SF 1411 or DD 633 Form, or on an attachment thereto. This data was used by and relied upon by the United States to negotiate the price(s) and other terms of the contract. Accordingly, the submission of inflated cost or pricing data would inflate the price of the contract.

16. As part of each contract proposal, Northrop certified that the cost or pricing data was accurate, complete and current, in accordance with the Truth in Negotiations Act, 10 U.S.C. §2306(a) (TINA). From 1986 to the present, DSD's pricing organization has been responsible

for the preparation, pricing and submittal of proposals, including pricing data to the United States.

17. Northrop's contractual business with the United States included several different types of contracts: (1) firm fixed-price (FFP) contracts which provided a fixed price for Northrop's goods and services; (2) fixed-price incentive (FPI) contracts which provided reimbursement for Northrop's actual costs to complete the contract plus an amount designated as "profit"; and (3) cost-reimbursable (cost-plus) contracts which provided for payment to Northrop of all allowable costs incurred in the performance of the contract to the extent prescribed in the contract plus an amount designated as "profit" or fee.

18. Most of DSD's contracts, including virtually every contract for the F-15 and AN/ALQ-162 programs described below were "sole source" contracts which were not subject to the competitive bidding process.

Northrop's Billings to the United States

19. Progress payments are a form of government-furnished interest-free financing available for firm fixed-price and fixed-price incentive contracts. Progress payments are designed to reimburse contractors for a percentage of the costs actually incurred in performing a contract (between 75-90%). Typically, progress payments are based exclusively on costs incurred and are not tied to any actual performance requirements for the contract. During the performance of FFP and FPI contracts, DSD submitted monthly requests for progress payments to the United States. On each SF 1443 "Request for Progress Payment" form, DSD certified to the United States, among other things, that the cost information was correct, was in accordance with the contract, that the work reflected was actually performed, and that the quantities and amounts involved were consistent with the requirements of the contract.

20. Public vouchers are claims for the reimbursement of costs actually incurred under cost-plus contracts. During the performance of cost-plus contracts, DSD submitted public vouchers monthly to the United States. On each SF 1034 “Public Voucher for Purchases and Services Other Than Personal,” Northrop certified to the United States, among other things, that the voucher was correct and proper for payment.

Northrop’s Cost Accounting and Material Accounting

21. Under government rules, regulations, and practices for negotiating contracts, the prices for contracts between Northrop and the United States depended on the purported actual costs that Northrop incurred in performing previous government contracts. In addition, the final amount paid to Northrop for fixed-price incentive and cost-plus government contracts depended on the actual costs incurred in completing the particular contract. Finally, Northrop’s submissions of public vouchers and requests for progress payments were based on purported actual costs incurred in their performance of government contracts. Therefore, Northrop had to maintain accurate records of the material, labor and other costs that were actually incurred in performing each contract.

22. By contracting with the United States, Northrop agreed to maintain its books and records in a condition and in a manner consistent with the cost accounting standards, contract cost principles, and contract cost procedures in applicable federal regulations.

23. Each government contract required Northrop to maintain records of materials and labor expended on each specific contract. These contracts also required Northrop to maintain records of the actual costs of materials and labor for each contract. DSD established a system of Project Authorization (PA) numbers to account for materials and labor and their cost. DSD represented to the United States that each PA either accumulated costs for a single contract or

accumulated costs which were allocated to multiple contracts in a manner that was identified to and approved by the Defense Logistics Agency (DLA), a branch of the Department of Defense.

24. Federal regulations required Northrop to retain inventory records and other documents relating to costs so that bills and contract proposals could be substantiated when audited by the United States and its agencies, including the Defense Contract Audit Agency (DCAA) and the General Accounting Office (GAO). DSD regularly provided such books and records to the United States for the purpose of substantiating billings and contract proposals, and in response to requests from government auditors and other representatives of the United States. Such books and records were to be retained until three years after final payment under the contract or subcontract except that, for contracts that are the subject of litigation, they are to be maintained until the litigation is completed.

DSD's Government Programs, Contracts and Subcontracts

25. The fraudulent conduct set forth in this complaint affected the proposals and contracts in the following programs at the DSD: the B-1 program, the F-15 program, the SP-3 program, the AN/ALQ 162 program, the B-52 ECM program, the EO/IR program, and the M&O Spares program. These contracts and contract proposals are from time to time collectively referred to in the Complaint as the Programs.

26. The B-1 program: During the approximate period from 1971 through 1995, DSD engineered, designed and produced electronic countermeasure (ECM) systems for the B-1 and B-1B bombers, primarily under subcontracts to and purchase orders from AIL Systems Inc., an operating division or subsidiary of Eaton Corporation (AIL). Much of this work involved Northrop's development and production of Band 6, Band 7, and Band 8 transmitters for the B-1 and B-1B ECM systems as the sole subcontractor for those transmitters. DSD also entered into certain contracts directly with the government concerning the same systems. This series of

contracts was known at DSD, and is referred to herein, as the “B-1 program.” The amount paid by the United States to DSD on contracts under the B-1 program exceeded \$500 million.

27. DSD made one or more submissions of cost or pricing data affecting contracts for the B-1 program each year from approximately 1983 at least through 1992. Each contract proposal that included direct material costs also included attrition costs, as well as indirect costs and profits that were based on direct material costs. During the period from approximately 1980 through at least 1992, Northrop also submitted monthly requests for progress payments and public vouchers on the B-1 program.

28. The B-1 program included FPI and cost-plus government contracts and subcontracts. Northrop’s numerous subcontracts with AIL under the B-1 program included PO596284, PO596282, and a series of subcontracts with the prefix “BP,” including BP0505, BP0509, BP0901, and BP291. The B-1 program also included numerous PAs such as 3344, 4650, 4702, 4743, 4774, 4775 and 4931. The FPI subcontracts included PO596284. While PO596284 was first negotiated in 1983, DSD regularly negotiated subsequent price and cost increases until a final price redetermination was negotiated in approximately 1996. The B-1 program also included cost-plus contracts, such as F09603-89-C-2666, negotiated in approximately 1989, where DSD was the prime contractor to the government. In the course of his duties, relator Holzrichter audited transactions concerning scrap, attrition, and other material attributed to contracts, subcontracts, and/or PAs included in the B-1 program.

29. The F-15 Program: During the period from approximately 1978 to date, DSD engineered, designed, and produced ECM systems for the F-15A, F-15C and F-15E fighter aircraft, primarily under contracts with the Air Force. This work involved Northrop’s development and production of the AN/ALQ 135 jammer, including the AN/ALQ 135(V) Internal Countermeasures Set Pre-Planned Product Improvement (or “P3I”). This series of

contracts was known at DSD as the “F-15 program.” The amount paid by the United States to DSD on contracts under the F-15 program exceeded \$500 million.

30. DSD made one or more submissions of cost or pricing data affecting contracts for the F-15 program each year from approximately 1983 through at least 1992. Each contract proposal that included direct material costs also included attrition costs, as well as indirect costs and profits that were based on direct material costs. During the period from approximately 1983 through at least 1992, Northrop also submitted monthly requests for progress payments and public vouchers on the F-15 program.

31. The F-15 program primarily included contracts F33657-83-C-2149 and F33657-87-C-2029, as well as F33557-78-C-0495 and F33657-79-C-0497. While these contracts were primarily FPI contracts, DSD provided certain products and services on a cost-plus basis under the F-15 program. The F-15 program also included numerous PA's such as 3259, 3843, 4538, 3455, 4884, 4390, 4490, 3239, 4853, and 4713. In the course of his duties, Holzrichter audited transactions concerning scrap, attrition, and other material attributed to contracts, subcontracts, and/or PAs included in the F-15 program.

32. The SP-3 Program: During the period from approximately 1984 through at least 1991, DSD engineered, designed and produced top secret aviation electronic systems for the B-2 Stealth Bomber, primarily under subcontracts to and Interdivisional Work Orders (IWOs) from Northrop's B-2 Division, located in Pico Rivera, California. This series of IWOs and subcontracts was known at DSD, and is referred to below, as the SP-3 program. Northrop is the prime contractor for the Stealth Bomber. The SP-3 program involved the design, development, testing, and manufacture of the ZSR-62 Set (including production test equipment), primarily under IWO 467-76-34055 and PA4816. The SP-3 program included both fixed-price incentive

and cost-plus contracts. The amount paid by the United States to DSD on contracts under the SP-3 program exceeded \$100 million. Relator Robinson worked on the SP-3 program.

33. Northrop made one or more submissions of cost or pricing data affecting contracts for the SP-3 program each year from approximately 1984 through at least 1991. Each contract proposal that included direct material costs also included attrition costs, as well as indirect costs that were based on direct material costs. During the period from approximately 1984 through at least 1991, Northrop also submitted monthly requests for progress payments and public vouchers on the SP-3 program, either directly or indirectly, under the Stealth Bomber prime contract. In the course of his duties, Holzrichter audited transactions concerning scrap, attrition, and other material attributed to contracts, subcontracts, and/or PAs included in the SP-3 program.

34. The AN/ALQ 162 Program: During the period from at least 1988 to date, DSD engineered, designed and produced the AN/ALQ-162 Shadowbox radar jammer for the Navy. This series of contracts was known at DSD as the "AN/ALQ-162 program." The amount paid by the United States to DSD on contracts under the AN/ALQ-162 program exceeded \$100 million.

35. DSD made one or more submissions of cost or pricing data affecting contracts for the AN/ALQ-162 program each year from approximately 1988 to date. Each contract proposal that included direct material costs also included attrition costs as well as indirect costs that were based on direct material costs. During the period from at least 1988 to date, Northrop also submitted monthly requests for progress payments and public vouchers on the AN/ALQ-162 program.

36. The AN/ALQ-162 program primarily included contract N00019-80-C-0147, which was a cost-plus contract. The AN/ALQ-162 program also included numerous PA's such as 3041, 3042, 3043 and 4970. In the course of his duties, Holzrichter audited transactions concerning scrap, attrition, and other material attributed to the AN/ALQ-162 program.

37. Other Programs: During the period from 1980 to date, DSD performed work under government contracts for the B-52 ECM program (e.g. PA's 3218, 3223), the EO/IR program (e.g. PA's 4936, 4988), and the M&O Spares program (e.g. PA's N005, 3111). DSD regularly submitted cost and pricing data, including attrition, public vouchers and requests for progress payments on these programs. In the course of his duties, Holzrichter audited transactions concerning scrap, attrition, and other material attributed to these other programs.

38. When Northrop falsely inflated, recorded, and presented costs that were not actually incurred, through the fraudulent accounting in the handling of scrap and other inventory as alleged herein, Northrop damaged the Government in billings and through contract proposals on the Programs.

39. Northrop has always primarily charged the costs of scrap, attrition, and other material costs to the United States by including the costs of attrition and other material costs in its proposals. The costs of scrap and attrition have thus been "built into" the contract price. The falsely inflated scrap, attrition, and material costs detailed herein enabled Northrop to overcharge the government by inflating the contract price. In pricing contracts with the United States, Northrop also included indirect costs (such as overhead) and profits that were based on the direct material costs. Thus, when attrition and other direct material costs were inflated, the other costs and profits based on direct material costs were also inflated. The United States was also damaged when Northrop submitted the falsely inflated costs to government auditors and administrators to avoid payments due to the United States for violations of government cost accounting standards and other contractual provisions.

Northrop's False Statements of Material Costs

Relator Holzrichter's Tenure at Northrop

40. Northrop hired relator Holzrichter in August 1984 as a technician and later promoted him to senior technician. From the outset of his employment, Holzrichter received special assignments including designing the Environmental Testing Lab for the SP-3 program and developing statistical analyses for monitoring material received by Northrop from outside suppliers that might be scrapped because it did not conform to government or DSD specifications (non-conforming material).

41. From at least 1987 to 1989, Holzrichter was employed in DSD's Product Assurance (or Quality) Department. Beginning in late 1987 or early 1988, Holzrichter was assigned responsibility for tracking and auditing large scrap and attrition transactions. From the time he received that assignment until his termination in 1989, Holzrichter was responsible for auditing the scrap and attrition transactions for every government contract that Northrop DSD was working on at that time, including the Programs.

42. During Holzrichter's employment, Northrop purported to have a policy encouraging its employees to report to their superiors or designated corporate personnel waste or fraud that employees believed was occurring or had occurred. In 1988, upon discovering that Northrop was engaged in a pattern of making false or fraudulent claims and statements to the United States in connection with various defense contracts, Holzrichter reported such matters to his immediate supervisor, Tom Clyder, and to others, including Dan Quealy, Northrop's director of security. When those efforts failed to lead to appropriate remedial reports to the United States or to cause the fraudulent activities to cease, Holzrichter began disclosing the instances of fraud to government agents.

43. Holzrichter continued to report to his superiors at Northrop various instances of waste and fraud. Among those of his superiors to whom Holzrichter reported fraud were Clyder;

Amy Selen, Clyder's immediate supervisor; and Murray Snow, Selen's immediate supervisor (who reported directly to DSD's General Manager and CEO Wallace Solberg).

44. In May 1989, Northrop learned that Holzrichter had been providing information about Northrop's fraud to government criminal investigators. Because of his cooperation with the government in furtherance of its investigation into violations of the False Claims Act, Eric Howell, an in-house Northrop attorney, and other Northrop employees harassed Holzrichter and questioned him about his cooperation with the government. Howell informed Holzrichter that he would not be allowed to perform his regular duties and responsibilities because Northrop did not want Holzrichter to cause further "damage" to Northrop. Holzrichter took a disability leave of absence in June 1989 because of the stress he suffered from constant inquiries by Northrop personnel concerning his disclosures to the government. Northrop subsequently hindered Holzrichter from finding suitable employment.

Holzrichter's Audits of Scrap and Attrition Data

45. Beginning in late 1987 and early 1988, Holzrichter audited DSD's scrap and attrition data by checking the records and other justification for each transaction that exceeded a certain size. In connection with these duties and responsibilities, Holzrichter designed reports covering scrapped materials called "Hitter Reports." The purpose of these reports was to determine whether the materials reported as scrapped had actually been scrapped. According to a September 1988 revision to the Product Assurance Department Instructions signed by Selen and Snow, Holzrichter's Hitter Reports were "[w]eekly audits . . . to insure the accuracy of collected data" regarding scrap and other attrition costs. The department instructions also stated that the scrap and attrition data audited by Holzrichter was used by DSD's Finance Department to account for the costs of scrap and attrition.

The False Scrap and Attrition

46. In 1989 while performing his duties, Holzrichter reviewed Northrop computer records which purported to summarize Northrop's historic use and current inventory for a particular part or assembly, including a PTPI Program Inventory Screen. Oddly, the computer record Holzrichter reviewed showed that Northrop had scrapped more of a particular part than had been purchased. Holzrichter then reviewed the computer records for other parts, which revealed that the problem was widespread.

47. As a result of further inquiry about Northrop's procedures for charging the United States for parts that had been falsely reported as scrapped, Holzrichter discovered similar inflated scrap numbers for numerous other parts. The United States had been cheated out of tens of millions of dollars by reason of the false or fraudulent charges for scrap, and by reason of Northrop's failure to provide the United States with proper credits for scrapped parts that had been salvaged and reused. When Holzrichter reported these facts to his immediate superior,

Clyder, Clyder estimated that the overcharges to the United States as a result of improper scrap and salvage practices exceeded \$100 million. Part of that figure related to the cost of component parts supposedly included in delivered product for which the United States was charged full price, including charges for component parts that were not delivered.

48. In 1989, DSD's General Manager Solberg had established an Attrition Committee to dispose of problems. The Committee was directed to act autonomously. The members of the Attrition Committee included Chapman, Selen, Sue Licata, Debbie Taylor, Petra Schiller² (Schiller), Bob Mergener, and others. Holzrichter attended an April 1989 meeting of the committee at which it was decided to provide credits for the excess scrap charges caused by the inflated bill of material for the Band 8 TWTs that had been billed during the first quarter of 1989, but not to provide the United States with credits due for excess scrap billed prior to 1989. Holzrichter provided documents to the meeting attendees which showed some of the overcharges to the United States for the excess Band 8 TWT scrap. Despite Holzrichter's demonstration that the United States had been overcharged, the Attrition Committee decided to provide proper accounting to the United States for 1989 scrap transactions only, and not for prior years.

²She is now known as Petra Schiller Bayer.

49. At this April 1989 meeting, Holzrichter heard the Attrition Committee decide that Northrop would hide and continue to hide from the United States that it was (a) using inflated bills of material, (b) failing to provide credits to the United States for scrapped parts that had been salvaged, and (c) failing to properly disclose residual inventory to the United States and use it appropriately.

50. When Holzrichter apprised Clyder of the facts pertaining to the inflated scrap, he learned that Clyder was already aware of the practice. Northrop employee Don Mazurkiewicz also was aware of it, and Clyder's boss Selen informed another Northrop employee, Doug Powell, of the practice. After the April 1989 Attrition Committee meeting, Selen admitted in Holzrichter's presence that Northrop had provided false scrap reports to the United States.

51. On June 1, 1989, little more than a month after Holzrichter reported the inflated scrap at the Attrition Committee meeting, Northrop DSD's top-level management met and discussed the specific problem that Holzrichter had reported — that the computer system was regularly showing that Northrop had scrapped more of a particular part than had been purchased. Present at this meeting were Wallace Solberg, Northrop DSD's CEO, Edward Foley, DSD's vice-president of finance, George Luper, DSD's director of government relations, Kenneth Chapman, Duane Emling, and Russell Bercier. Northrop's management discussed that the inflated scrap problem was widespread across all programs at DSD, and that the problem had existed since at least 1980. The executives were also shown the relationship between inflated scrap, inventory transfers, and anomalous numbers for excess or residual inventory. This internal meeting occurred shortly after Northrop confronted Holzrichter for reporting the inflated scrap to the government, and during the time when Holzrichter was being harassed for this cooperation. At the meeting, Northrop's management determined that they would not fully disclose the inflated scrap to the government.

52. Also at the meeting, top-level management was informed that the inflated scrap numbers were largely undocumented and untraceable. An internal audit revealed that at least 20% of the purported scrap in DSD's inventory system was undocumented. Much of this scrap had "dummy" documentation numbers entered, which did not correspond to any actual, government-required documentation. Participants at the meeting were also shown that the inflated scrap was difficult to detect, since a single part was used on multiple contracts or PAs. The inflated scrap was evident, however, when the inventory records for a single part were accurately consolidated in a single report, as was presented at the meeting. The results of DSD's internal audit were not disclosed to the government. There were multiple causes for the inflated scrap.

Northrop's Scheme, Pattern and Practice To Conceal and Misuse Excess and Residual Inventory

53. At the April or May 1989 meeting of the aforementioned Northrop Attrition Committee attended by Holzrichter, the Committee discussed an ongoing scheme to avoid crediting the Government for \$9 million to \$11 million in excess inventory (also called "residual inventory") that had been ordered and paid for by the Government in connection with completed Government contracts. Members of the Attrition Committee, including Chapman, Mergener, Selen and Licata, planned to establish phony Program Authorization (PA) numbers and phony purchase orders for the excess inventory to create the appearance that the material had been routinely scrapped against completed projects. After the meeting, Holzrichter protested to Selen that the action to be taken by the Committee would be unlawful. She replied in words or substance, "what they don't know won't hurt them." Holzrichter then expressed his concern about the fraudulent conduct to Tom Clyder and urged that the \$9-11 million be returned to the Government. Clyder replied in words or substance that Northrop could not return money that

Northrop had already spent. As of the time of the meeting, the facts regarding this excess inventory had been concealed from the United States and the committee members intended the deception to continue. As of the time of the meeting, according to Chapman, Selen, and Mergener, steps had been taken to accomplish the fraud. Holzrichter reported this matter to Dan Quealy, Northrop's director of security, in May 1989.

Northrop's Fraudulent Financial Reconciliation Scheme

54. In early and mid-1988, Northrop was engaged in a secret effort to alter its inventory history records. This effort was referred to by Northrop personnel as "financial reconciliation." Financial reconciliation was a scheme begun in late 1987 and continuing at least through 1988 that Northrop undertook to mislead and defraud the United States. In furtherance of the scheme, Northrop altered its inventory records to avoid making proper adjustments to its material accounting and financial records which Northrop used to substantiate contract proposals and to bill the United States for material costs. The scheme was specifically designed to hide overcharges resulting from inflated bills of material and scrap, the misuse and non-disclosure of excess and residual inventory and other irregularities. Thus, instead of making financial entries in its computer system to reflect how inventory was actually used and providing credits to the United States, Northrop manipulated its inventory records so that they did not conflict with the records that were the source of the material costs Northrop charged on government contracts.

55. In the course of the financial reconciliation project, Northrop sanitized and fabricated its inventory records by changing the historic inventory records for approximately 500 high value parts used on the Programs. These high value parts constituted more than 75% of the material dollar value of the government contracts for these programs.

56. Holzrichter learned of the financial reconciliation scheme in the regular course of his duties auditing scrap transactions. During these 1988 audits, Holzrichter investigated certain

scrap transactions for contracts on programs including several of the Programs, involving large amounts of scrap of high value parts, including TWTs, that Petra Schiller had entered into Northrop's computer system. Some of these transactions reversed large amounts of scrap previously entered into the system while others added scrap. Schiller explained to Holzrichter that each of these transaction entries had been made pursuant to Northrop's "financial reconciliation" project, and Holzrichter reported these transactions as part of financial reconciliation in his Hitter Reports.

57. Schiller told Holzrichter that the large scrap reversals he had noticed were necessary because the United States was being charged multiple times for these high value parts, due to computer errors known to Northrop management. These computer problems and the multiple charges associated with them were known internally at Northrop as "looping." Schiller was instructed by her superiors to perform a series of inventory transactions as part of a "financial reconciliation" that would allow Northrop to provide some credits for the multiple charges without disclosing to the United States the actual reason for these credits. According to Schiller, the purpose of these instructions was to avoid a comprehensive audit that could uncover the other instances of false and fraudulent claims and acts involved in the larger financial reconciliation cover-up.

58. Looping affected both Northrop's inventory records and its procurement records, including the purchase order history that reflected the material purchases made by Northrop.

The "looping" worked as follows:

- a. After preliminary tests, the TWTs had been transferred to stock, whereupon the inventory was recorded a first time as "accepted" for use in production of products for the United States.
- b. Many of the TWTs and other high value parts failed tests or were otherwise rejected on the production floor, and were designated as scrap. The rejected parts were returned to vendors to be repaired or replaced.

- c. When the repaired or replaced parts came back to Northrop, Northrop's computer system incorrectly identified them as new inventory, and Northrop accounted for their cost a second time.
- d. This practice also resulted in the inflation of scrap costs when TWTs and other parts were scrapped a second time by Northrop. Sometimes parts failed, were returned to vendors, and delivered back to Northrop multiple times, thus falsely inflating scrap two, three, or even more times.

59. Northrop's computer system required that quantities received equal quantities ordered for a purchase order to be "closed" and the vendor paid. Thus, Northrop recorded non-conforming materials as "accepted" for use in production in order to close out the purchase orders and pay the vendors. Similarly, Northrop's computer system improperly treated the receipt of incomplete orders as if all of the material ordered had been delivered, and recorded an "accept" for the entire amount of the purchase order so that the purchase order could be closed. This non-existent material, which was recorded as accepted in order to close the purchase order, was later scrapped, thereby inflating the government's scrap and material costs.

60. During looping, when "accepted" non-conforming material was scrapped and returned to the vendor for replacement or repair, a revised purchase order was issued. However, Northrop's computer system could not differentiate between the original purchase order and the "revised purchase order." Consequently, when the replaced or repaired part came back from the vendor, the computer treated the revised purchase order" as if it were the original purchase order for the material, and the material repaired or replaced by the vendor was treated as a new receipt and wrongly counted as an additional "accept" by Northrop's computer system.

61. Northrop employees discovered that looping was occurring in 1987, but instead of immediately reporting the error and issuing credits due the United States, Northrop devised the scheme to conceal the multiple charges caused by looping and other inventory overcharges and problems involved in financial reconciliation. Schiller told Holzrichter the "financial

reconciliation” documents, including the memo authorizing her to enter financial reconciliation transactions, were to be destroyed. Schiller supposedly completed her work in the summer of 1988, but financial reconciliation and similar “reconciliation” projects continued in order to conceal additional overcharges beyond looping. Other Northrop employees who are believed to know about this scheme are Selen, Clyder, Snow, Chapman, Doyle, and Pat Graf.

62. Holzrichter reported these suspicious financial reconciliation program and the adjustments Schiller was performing to the DOD’s Defense Criminal Investigative Service (DCIS) in 1988. The DCIS then interviewed Schiller and protected her identity as a confidential government informant. Schiller became known as government informant CH-05. When questioned by the DCIS agents about financial reconciliation, under the cloak of anonymity, Schiller informed the DCIS that:

- a. “Northrop [was] misrepresenting its true financial position to the Department of Defense”;
- b. “overcharges occurred in every Northrop program”;
- c. “the ‘financial reconciliation’ program has made it extremely difficult for the DOD to discover any cost overcharges”;
- d. "the primary purpose of the program is to fool the DOD when it reviews Northrop’s business records and that Northrop is trying to juggle the books of different programs in an attempt to mislead the government inspectors and auditors”;
- e. “management at Northrop [was] very concerned that the DOD may become aware of the ‘financial reconciliation’ program.”

63. The financial reconciliation scheme primarily hid two types of inventory data problems from the United States. First, the inventory numbers were out of balance. Specifically, the system showed that the amounts of certain parts used on particular contracts exceeded the amounts of those parts that had been purchased. Indeed, parts were scrapped against contracts that never had purchased that part. In fact, Northrop used inventory data records that did not

accurately reflect the quantities of material which had been: accepted to inventory, issued, returned to vendor, returned to stock, scrapped, salvaged, transferred in and transferred out. The causes of these false records included “looping,” as described above, as well as other computer “error modes.” Nevertheless, Northrop had the capability to accurately determine most, if not all, of this information.

64. The second type of false data that financial reconciliation covered up was inventory transactions that removed materials from the stockroom for purposes other than production. These computer transactions, called “adjustments”, were supposed to reflect the temporary removal of parts for various purposes, but often the parts were never returned to the stockroom. Northrop itself characterized these adjustment transactions as “Uncontrolled Inventory.”

65. Financial reconciliation was in part designed to eliminate the problem of uncontrolled inventory. All of the adjustment transactions were simply reversed on the computer system, and the material that was the subject of the adjustment was recorded as scrapped. The reversal did not account for the actual use or movement of the material. This resulted in material being mischarged to contracts on which it was not used. It also resulted in excess and residual and other existing inventory being falsely reported as scrap.

66. Financial reconciliation was also designed to cover-up inaccuracies in the purchase order records. Northrop knew or had reason to believe that the purchase order records were wrong and, in fact, had over-counted certain parts received and that the purchase order records could not be reconciled with the vendor accounts payable or with the job cost ledger and Northrop’s general books of account. Northrop therefore changed the amounts of parts “accepted” in the inventory system to equal the amounts of the parts recorded as bought for particular contracts.

67. The methodology of the financial reconciliation was specifically designed to allow for the deliberate assignment of scrap and the effective transfer of scrap between contracts, to Northrop's best advantage and to the detriment of the United States. For example, scrap transacted by Northrop to conform its inventory records to the amount of material for which it had billed the United States was intentionally and in violation of proper cost accounting practice, assigned to the FPI contracts instead of FFP contracts. Consequently, material costs for this "scrap" was primarily borne by the United States, while Northrop enjoyed an improved profit margin on the FFP contracts. In other instances, material could be used to inflate costs on FFP contracts, for the purpose of inflating the cost of "follow-on" contracts that were based on the price of the original contract.

68. Because its inventory records were false and inaccurate, Northrop knew that scrap and attrition figures it had reported to the United States on ongoing contracts and in new contract proposals were false, as were its reports regarding excess and residual inventory. Northrop also knew that reports which purported to identify when inventory was consumed on particular contracts were also false.

69. Financial reconciliation also concealed past availability, nondisclosure and/or usage of excess and residual inventory, and was designed to minimize credits to the United States for excess and residual inventory due on cost-plus and FPI contracts. Northrop implemented this scheme pursuant to the October 1987 directive that ordered Northrop employees to falsely record excess and residual inventory as scrap transacted on the oldest contracts.

70. During the financial reconciliation project, Northrop expressly misrepresented the origin, scope, duration, intent, and operation of the project to the United States. Specifically, in

response to a government inquiry as to the nature of the project, in June 1988, Northrop falsely represented in writing that:

- a. Northrop undertook financial reconciliation as “an examination of data accuracy” after Eleanor Spector, deputy assistant secretary of Defense, requested all government contractors to review their material accounting systems in December 1987. In reality, and as Northrop well knew, the financial reconciliation scheme had been formulated from August through October 1987 and was initiated because Northrop had to cover-up the inaccuracies in its systems that rendered its data unreliable and inaccurate.
- b. Financial reconciliation was part of cycle counting, an activity described as “[c]ompar[ing the] physical count to on-hand balance reflected in the Inventory System.” Cycle counting was indeed a periodic physical count of selected parts, but in reality, Northrop was performing financial reconciliation on every high value part in most production programs, regardless of whether the physical count matched the quantity shown in the inventory system.

71. Northrop knew its inventory records, which were the basis for billings and contract proposals to the United States, were inaccurate. Northrop did not inform the United States of these data inaccuracies and continued to make representations to government contract negotiators and auditors based on false, inflated and misleading records.

72. Northrop expended thousands of hours of labor on financial reconciliation. Northrop charged the majority of these hours to the cost of its overhead or other indirect costs. Since financial reconciliation was fraudulent, the labor costs incurred to implement the scheme were not allowable costs pursuant to 48 C.F.R. § 31.205–15, and were mischarged to the United States and misrepresented to the United States as allowable costs in an additional fraud.

Fraud in Connection with the SP-3 Program for the B-2 Stealth Bomber

73. From March 1985 until his employment was terminated by Northrop in May 1988, Northrop employed relator Robinson as a “Test Engineer, Test Engineering Group.” Robinson has had extensive experience as a test engineer and electronics technician while in the armed services of the United States and through employment by private contractors who provided his services to the United States. Robinson was a technician at the Kennedy Space Center; Kirkland Air Force Base; the Missile Early Warning Station at Concrete, North Dakota; and Los Alamos, New Mexico. He was initially hired as an engineer associate. In May 1986, he was promoted to engineer.

74. Approximately one year before Northrop terminated his employment, Robinson furnished agents of the FBI with information regarding false or fraudulent claims and statements made by Northrop to the United States. In addition to providing facts and details, Robinson has identified individuals whom he believes have knowledge of false or fraudulent claims submitted by Northrop. Robinson was the original source of the facts contained hereafter.

Holding Tank Time Charges

75. During Robinson’s employment, Northrop frequently engaged in wasteful employment practices, the costs of which were charged or passed on to the United States. Initially, after receiving secret clearance from the DOD in March 1985, Robinson spent several months in a holding tank, waiting for a special access designation. That designation was required by Northrop and/or its customer as a prerequisite for assignment of a Northrop employee to the SP-3 program. During his time in the holding tank, Robinson received work assignments that occupied only about 50% of his time. Other employees assigned to the holding tank similarly had little or no work to do. On information and belief, the down time of Robinson and other employees in the holding tank was charged or passed on to the United States.

76. In addition to improperly charging the United States at all for the unproductive time in the holding tank spent by Robinson and other Northrop employees on the SP-3 program, the method used by Northrop to charge for this time was itself improper. Northrop charged the unproductive time in the holding tank to the SP-3 contract as a direct cost when, in all events, charges for time not directly contributing to the completion of the Project (e.g., overhead) should have only been charged as indirect costs.

77. The charges for unproductive time spent in the holding tank were not authorized under any contractual provisions or applicable regulations. The method of charging this unproductive times as a direct cost of the contract was not authorized under any contractual provisions or applicable regulations.

SP-3: Test Stations

78. In June 1985, after he received special access designation, Robinson was assigned to work on the SP-3 program, which was a classified project. Robinson was assigned to coordinate and design digital test stations and test fixtures for electronic components including printed circuit boards. This required that he work with design engineers to develop test procedures. Dan Watson was the manager of Robinson's unit.

79. In order to design digital test stations and procedures for the SP-3 program, Robinson needed design specifications for the parts and assemblies to be tested. On various occasions between June 1985 and May 1988, Robinson was provided with design specifications that were obsolete in material respects. When Robinson and other employees, including James Howe, complained to Watson that such practices were wasteful and fraudulent, they were ordered to use the outmoded or incomplete design specifications. Watson specifically instructed Robinson and Howe that they were required to build test equipment using only the written design specifications, regardless of whether they had been rendered obsolete by subsequent

modifications that would be forthcoming. Watson also instructed Robinson to refrain from using any updated design specifications that he obtained from design engineers until formal changes in specifications were made. As a result, Robinson and other employees were also required to make many revisions in the SP-3 program test stations and test procedures at a cost of hundreds of thousands of dollars. On various occasions, Robinson and other Northrop employees were instructed to develop test stations and procedures based on incomplete design specifications, and to order test equipment from outside vendors on the basis of outmoded design specifications that had been changed but which changes had not been incorporated in official design drawings. In addition to Robinson, Howe, and Watson, other Northrop employees who have knowledge of facts concerning construction of test equipment using outmoded design specifications are Mark Materna, Mike Tyk, Bill Medlinski, Mike Simaschko, and other test engineers under Watson's supervision. In addition to protesting these wasteful and fraudulent practices to Watson, Robinson also brought these matters to the attention of Bill McConnell, director of engineering for the SP-3 program, Stanley Hanson, a vice president of DSD, and DSD's general manager, Wallace Solberg.

80. On information and belief, Northrop submitted the outmoded and useless test stations and procedures directly or indirectly to the United States to obtain payments. In addition, Northrop directly or indirectly billed the United States for labor and materials purchased in connection with the development of tests and test stations predicated on the outmoded designs.

Other False Representations as to Progress

81. Northrop made other false or fraudulent representations directly or indirectly to the United States regarding progress on the SP-3 program. These false representations extended to and included the progress of work on the prime product. The purpose of these representations

was to obtain payments from the United States. Northrop employees performed work on various stages of the SP-3 program that were previously represented by Northrop directly or indirectly to the United States as having been completed. Conversely, on information and belief, Northrop represented, through SP-3 project management personnel, including Watson, Ed Hecht and Dick Gillette, SP-3 program manager, that test stations and procedures for various RF circuit assemblies were functional when Northrop knew they were not, as well as the prime product, were functional when Northrop knew they were not.

Count I - False Claims Act Violation

82. By virtue of the above-described acts, among others, defendant Northrop knowingly submitted, and possibly continues to submit, directly or indirectly to officers, employees or agents of the United States, false or fraudulent claims for payment or approval on the Programs.

83. By virtue of the above-described acts, among others, defendant Northrop knowingly made, used, or caused to be made or used, and may continue to make, use, or cause to be made or used, false records and statements to obtain payment from the United States for false or fraudulent claims on the Programs.

84. The United States, being unaware of the falsity of the claims and/or statements made by defendant, and in reliance on the accuracy thereof, paid and may continue to pay Northrop for services not rendered and for products and components not used, produced, or delivered.

85. From 1980 to the date of this Complaint, by reason of the conduct described above, the United States has been damaged in an amount that is believed to be in excess of \$113 million. United States believes that when the initial Complaint was filed in August 1989, Northrop's fraudulent practices were continuing, involved other departments, operations, or

personnel at the Defense Systems Division, and that the United States may have been damaged in a substantially greater amount than alleged in this amended complaint.

Prayer

WHEREFORE, Rex A. Robinson and James H. Holzrichter, personally and for the United States Government, pray for judgment against defendant as follows:

- a. That defendant Northrop be found to have violated and be enjoined from future violations of 31 U.S.C. § 3729.
- b. That this court enter judgment against defendant Northrop in an amount equal to three times the amount of damages the United States has sustained because of defendant's false claims, plus the maximum civil penalty for each false claim.
- c. That relators be awarded the maximum amount allowed pursuant to § 3730(d),
- d. That the United States and the relators be awarded all costs of this action, including expert witness fees, attorneys' fees, and court costs.
- e. That plaintiffs recover such other relief as the court deems just and proper.

Count II - Retaliation and Discrimination Under the False Claims Act

86. Relators incorporate and reallege paragraphs 1-85.

87. By virtue of the above-described acts, among others, Relators have been discharged, demoted, suspended, threatened, harassed and discriminated against in the terms and conditions of their employment by Northrop because of lawful acts done by relators on behalf of themselves and others in furtherance of this action.

Prayer

WHEREFORE, Rex A. Robinson and James H. Holzrichter pray for judgment against defendant as follows:

- a. That defendant Northrop be found to have violated and be enjoined from future violations of 31 U.S.C. § 3730(h).

- b. That relators be awarded all relief to which they are entitled pursuant to § 3730(h) of the False Claims Act.
- c. That relators be awarded all costs of this action, including expert witness fees, attorneys' fees, and court costs.
- d. That relators recover such other relief as the court deems just and proper.

Count III - Retaliatory Discharge of Plaintiff Robinson

88. Plaintiff Robinson incorporates and realleges paragraphs 1-87.

89. The Court has jurisdiction over the claims made in Count III pursuant to its pendent and supplemental jurisdiction over state law claims.

90. The False Claims Act, 31 U.S.C. §§ 3729-32, and decisions of the courts of the State of Illinois, establish a clearly mandated public policy, both nationally and for the State of Illinois, favoring truthfulness and accuracy in representations and claims made by Government contractors to the Government, and encouraging employees of such contractors to object to and report violations of this policy. Further, this policy protects employees from being discharged and retaliated against by employers as a result of such objections. By harassing and discharging plaintiff Robinson, Northrop willfully and in bad faith retaliated against him in violation of the clear public policy mandated by the False Claims Act and state law, causing him in excess of \$50,000 in damages. Punitive damages are necessary to deter others from similar conduct and to punish defendant.

Prayer

WHEREFORE, Rex. A. Robinson prays for judgment against defendant as follows:

- a. That defendant Northrop be found to have retaliated against this plaintiff for objecting to and/or reporting Northrop's misrepresentations and false claims made to the Government.
- b. That this Court enter judgment against defendant Northrop in an amount equal to this plaintiff's actual damages, which are in excess of \$50,000,

including but not limited to lost wages, benefits, seniority and emotional and physical distress.

- c. That this Court enter judgment against defendant Northrop for punitive damages in the amount of \$10,000,000.
- d. That plaintiff be awarded such other relief as this Court deems just and proper, including pre- and post-judgment interest, costs, and attorneys' fees.

Respectfully submitted,

UNITED STATES OF AMERICA, *ex rel.*
REX A. ROBINSON, and
JAMES H. HOLZRICHTER

By: _____
One of their Attorneys

Dated: October 17, 2001

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Exhibit A

Glossary of Terms and Acronyms

Attrition purportedly represented the cost of materials that Northrop bought but which were not actually used as components of the final product purchased by the United States. According to Northrop, attrition is “mainly scrap” and was composed of costs from Production Scrap, “As Required” material, “Engineering Change Order” material, and “Vendor Rework and Repair”.

AN/ALQ 135 is the radar jammer deployed on the F-15 fighter aircraft

AN/ALQ-162 is the Shadowbox radar jammer Northrop manufactured for the Navy.

B-1 is the B-1 and B-1B Bombers.

B-2 is the B-2 Stealth Bomber.

CA362 are computer generated cost accounting reports purported to record how parts and assemblies were used on a particular project, including the number of parts that were issued to the production floor and the number of parts that were scrapped.

Cost-plus contracts provided for payment to Northrop of all allowable costs incurred in the performance of the contract to the extent prescribed in the contract, plus a profit or fee.

DCAA is the Defense Contract Audit Agency.

DD 633 is one of the forms used to submit cost or pricing data as part of a contract proposal to the U.S. government.

DLA is the Defense Logistics Agency, a branch of the U.S. Department of Defense.

DOD is the Department of Defense.

DSD is the Defense Systems Division of defendant Northrop. Plaintiffs worked at DSD’s headquarters located in Rolling Meadows, Illinois.

EBOM is the Engineering Bill of Material.

ECM is the electronic countermeasure system built for the B-1 and B-1B Bomber.

F-15 is the F-15 fighter aircraft.

FFP contracts are firm fixed-price contracts which provide a fixed price for a contractor’s goods and services.

FPI contracts are fixed-price incentive contracts which provide for a target cost, a target profit, a price ceiling, and a “share ratio” formula for establishing final profit and price. At the end of each FPI contract, Northrop submitted to the United States a certified statement of final costs purportedly incurred on the contract for a “redetermination” of the contract price.

Hitter Reports are reports covering scrapped materials that plaintiff Holzrichter designed.

IWO is an Interdivisional Work Order.

MBOM is the Manufacturing Bill of Material.

MIC-Hybrid is the Microwave Integrated Circuit Hybrid.

MIC-Hybrid 040 Sub-Strates are ceramic pieces cut from two-inch stock pieces used in the production of MIC-Hybrids.

PTPI is a Program Inventory Inquiry computer screen used to track the historic use and current inventory of parts.

SF1034 is the standard form Public Voucher for Purchases and Services Other Than Personal.

SF 1443 is the standard form Request for Progress Payment form.

SP-3 is the top secret aviation electronic systems Northrop built for the B-2 Stealth Bomber.

TINA is the federal Truth in Negotiations Act, 10 U.S.C. §2306(a).

TWT is the Traveling Wave Tube, a high value assembly used in the B-1 and F-15.