UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

02-1105, -1130

Donald H. Rumsfeld, SECRETARY OF DEFENSE,
Appellant,

v.

FREEDOM N.Y., INC.,
Appellee.

FREEDOM N.Y., INC.,
Appellant,

v.

Donald H. Rumsfeld, SECRETARY OF DEFENSE,
Appellee.

Appeals from the Armed Services Board Of Contract Appeals
in No. 43965, Administrative Judge David W. James

REPLY BRIEF FOR THE APPELLANT, Donald H. Rumsfeld, SECRETARY OF DEFENSE

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Dated: August 30, 2002

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STATEMENT OF THE ISSUES

Freedom NY, Inc. (FNY) fails to refute the conclusions set forth by the Secretary of Defense.

ARGUMENT

I. The ASBCA Erred In Finding That Mod. 29, Which Expressly Discharged All Relevant Government Liability, Was Procured By Government Duress

FNY contends that the findings of Administrative Judge David W. James that FNY signed Modification P00029 (Mod. 29) under Government-caused duress should be affirmed under the substantial evidence standard. We disagree.

As the Court of Claims recognized, accord and satisfaction is "'a perfect defense in an action for the enforcement of a previous claim, whether that claim was well founded or not.'" Chesapeake & Potomac Tel. Co. v. United States, 228 Ct. Cl. 101, 108, 654 F.2d 711, 716 (1981)(quoting 6 Corbin on Contracts § 1276 (1962)). The Court of Claims also stated:

> It does not follow that because a claim is by hindsight seen to be even entirely meritorious, an agreement to compromise it was in any way improper. A party who settles his claim may not avoid it by proof that his claim was just. It has long been held that a release for a lawful consideration is binding though the contractor received only what was otherwise due him. United States v. William Cramp & Sons Co., 206 U.S. 118, 27 S. Ct. 676, 51 L. Ed. 983 (1907); Inland Empire Builders, Inc. v. United States, 424 F.2d 1370, 1375, 191 Ct. Cl. 742, 751 (1970).

Johnson, Drake & Piper, Inc. v. United States, 209 Ct. Cl. 313, 324, 531 F.2d 1037, 1044 (1976).

As we demonstrated in our principal brief, the economic duress necessary for FNY to evade the accord and satisfaction defense cannot be implied merely because a party drove a hard bargain. Id. at 321. "Economic pressure and 'even the threat of considerable financial loss' are not duress." Id. (quoting Int'l Tel. & Tel. Corp. v. United States, 206 Ct. Cl. 37, 52 n.11, 509 F.2d 541, 549 n.11 (1975)).

Here, FNY did not have sufficient financial resources to perform the contract. JA125-28. There is no evidence, and the ASBCA made no finding, that the Government misrepresented any facts to FNY's financial backers to create the financial hardship FNY faced. Moreover, withholding progress payments when a contractor's financial condition endangers performance, as was done here, was within the authority of the administrative contracting officer (ACO) under applicable regulations. See 32 C.F.R. § 7-104.35(b), C1 SCA App. E-521 and 524 (1984). The record reflects that FNY's financial condition was a primary focus of concern from the pre-award survey through the performance of the contract. JA125, 128-34, 155-56, 166-68. Initially, a recommendation against an award to FNY was made due to FNY's financial condition. JA128. Ultimately, an award was made, but it specifically was predicated upon the financial commitment made by Dollar Dry Dock. JA130-34. The Government primarily was concerned

about FNY's financial condition at the time progress payments were suspended, not the amount of progress that FNY had made. JA155-56, 166-68, 566-82. Thus, without regard to the audit recommendations challenged by FNY, the ACO was acting within his authority to suspend progress payments as a matter of law. See 32 C.F.R. § 7-104.35(b)(v). Judge Grossbaum recognized this authority. JA74.

Further, contrary to FNY's argument, there was a distinct difference between FNY's condition before and after signing the modification. By signing Mod. 29, FNY was able to extend performance by one month and extricate itself from a default situation,[1] for which it acknowledged that it "may be responsible." JA24, FOF 107; JA347. Thus, the Government did not take any action that it was not entitled to take. FNY's economic duress was a product of its own making, which cannot serve as a basis for actionable duress. See La Crosse Garment Mfg. Co. v. United States, 193 Ct. Cl. 168, 432 F.2d 1377, 1382 (1970); Inland Empire Builders, Inc. v. United States, 424 F.2d at 1377 (citing Fruhauf Southwest Garment Co. v. United States, 126 Ct. Cl. 51, 62, 111 F. Supp. 945, 951 (1953)).

Accordingly, Judge James erred by concluding that the Government created the economic duress to force FNY to sign the modification.

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[1] This is not the same default that was affected by Judge Grossbaum's decision, which was based upon Modification P00030. See JA80-82.

II. The ASBCA Acted Arbitrarily Or Capriciously In Holding The Government Liable Based Upon Factual Findings That, Without Sufficient Explanation, Contradict Findings Made Earlier In The Same Case Upon A Related Claim

FNY misconstrues our argument that the decision by Judge James is arbitrary and capricious by contending that the decision is supported by substantial evidence. Finding substantial evidence to support the decision does not cure the problem because Judge James, without sufficient explanation, made findings that contradict earlier findings made in the same proceeding upon a related claim. Indeed, it appears that Judge James simply ignored the prior findings. We detailed those inconsistent findings in our principal brief at pages 37 to 44.

FNY attempts to evade the clear guidance of Essex Electro Engineers, Inc. v. Danzig, 224 F.3d 1283, 1295 (Fed. Cir. 2000), by implying, if not actually stating, that the two contrary decisions here are based upon two separate proceedings. FNY Brief at 51-52. They are not. As the record reflects, these conflicting decisions arose in consolidated cases and substantially are based upon the same set of facts. As was pointedly stated by Judge Grossbaum:

> The facts and issues appellant raised in its pleadings as excusable delays or other defenses to the Government's default termination of the contract were substantially identical in both ASBCA No. 35671 and ASBCA No. 43965. The parties were given a full and fair opportunity to litigate all these issues.

JA499; Freedom NY, Inc., ASBCA No. 43965, 98-1 BCA ¶ 29,382, at 146040; see also, id. at 146,038; JA496.

FNY's argument that these are different proceedings is merely an attempt to distance itself from the adverse findings of the prior opinion. However, this does not change the simple fact that Judge James provided no rationale for disagreeing with the prior findings of fact. For FNY to offer reasons unsupported by any actual reasons by Judge James does not satisfy the requirement for the Board to explain itself. See Essex Electro Engineers, Inc. v. Danzig, 224 F.3d at 1295; cf. Suel v. Secretary of Health and Human Services, 192 F.3d 981, 985 (Fed. Cir. 1999) (different judges may not view same case in same way, but law of case doctrine requires respect for earlier decision by prior judge absent clear showing of error or injustice). Without such explanation, the decision by Judge James violates the principle that a tribunal's action must be measured by what the tribunal did, not by what it might have done. SEC v. Chenery, 318 U.S. 80, 92-94 (1943) (considerations urged by appellant were not expressed by tribunal).

FNY also contends that Judge James properly found that the alleged oral side agreement to Modification P00025 (Mod. 25) created a binding contract. Specifically, Judge James found that Mod. 25 incorporated an oral "side agreement," with which the Government failed to comply, and that FNY would

not have signed the modification but for the incorporation of the side agreement. OP2.FOF94; OP2 at 40. Based upon these findings, Judge James held that there was no accord and satisfaction and, therefore, that the Government was not protected by the explicit and broad release contained in Mod. 25. Judge James is wrong as a matter of law.

Mod. 25, by its express terms, was a written modification to a written contract.[2] It cannot be varied by a contemporaneous oral agreement. See Mil-Spec Contractors, Inc. v. United States, 835 F.2d 865, 867-68 (Fed. Cir. 1987) (citing SCM Corp. v. United States, 595 F.2d 595, 598 (Ct. Cl. 1979)); 31 U.S.C. § 1501(a)(1)(A); 48 C.F.R. § 2-101. In Texas Instruments, Inc. v. United States, 922 F.2d 810, 816 (Fed. Cir. 1990), cited by FNY, the agreement was not oral; it was based upon a signed written price negotiation memorandum.

In addition, the holding by Judge James is contrary to the unambiguous language of the modification. The intent of the parties here was expressed within the four corners of Mod. 25, which clearly stated that "[b]oth parties expressly

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[2] Mod. 25 foreclosed all prior delay claims as a matter of law. The actions of the parties in agreeing to a new delivery schedule eliminates from consideration the causes of delay occurring prior to such agreement. See Johnson, Drake & Piper, Inc. v. United States, 209 Ct. Cl. at 330, 531 F.2d at 1047.

state that the aforesaid recitals are the complete and total terms and conditions of their Agreement and that this Agreement has been entered into free from duress or coercion." JA304-07. FNY was required to make any reservations to Mod. 25 manifest and explicit in the agreement. See, e.g., United States v. William Cramp & Sons Ship & Engine Bldg. Co., 206 U.S. 118, 128 (1907) (parties' intent to leave some things open and unsettled should be made manifest); Cannon Constr. Co. v. United States, 162 Ct. Cl. 94, 101, 319 F.2d 173, 177 (1963) (intention to reserve claim must be made manifest and explicit in written agreement). It did not do so. There is no evidence demonstrating that either party made any notation on the face of the modification to indicate the inclusion of the alleged oral side agreement or otherwise referred to the alleged oral side agreement in writing. As the Court of Claims stated, "as a general rule, there can be no implied contract where there is an express contract between parties covering the same subject." Algonac Mfg. Co. v. United States, 192 Ct. Cl. 649, 673, 428 F.2d 1241, 1255 (1970). Therefore, the ASBCA erred in not holding that any alleged oral side agreement is a nullity.

Moreover, the construction or interpretation of an agreement depends upon the actions of the parties at or near the time of the events and before a controversy arose. Julius Goldman's Egg City v. United States, 697 F.2d 1051, 1058 (Fed.

Cir.), cert. denied 464 U.S. 814 (1983); Blinderman Constr. Co. v. United States, 695 F.2d 552, 558 (Fed. Cir. 1982); Dynamics Corp. v. United States, 182 Ct. Cl. 62, 389 F.2d 424, 430 (1968). As the Federal Circuit stated, "[o]ne may not ignore the interpretation and performance of a contract, whether termed 'mistake' or not, before a dispute arises." Alvin Ltd. v. United States Postal Service, 816 F.2d 1562, 1566 (Fed. Cir. 1987) (emphasis added).

Here, FNY's contemporaneous correspondence negates the determination that the side agreement was made part of Mod. 25. FNY's May 13, 1986 letter to Mr. Chiesa acknowledged that the side agreement was not part of the agreement reached with the Government and that it was not a part of Mod. 25. JA298-300. That letter also acknowledged that the parties agreed to the terms and conditions of the modification, which settled FNY's disputes under the contract. Id. In addition, the letter acknowledged that the alleged side agreement was discussed in connection with FNY's participation in the Meal Ready To Eat (MRE) assembly program, rather than in connection with a contract dispute. Id. Only one day prior to signing Mod. 25, FNY repeated those acknowledgements in a May 28, 1986 letter to Mr. Chiesa. JA301-03. In yet another letter to Mr. Chiesa, dated June 25, 1986, FNY again acknowledged that the alleged oral agreements were not part of Mod. 25, using the exact same words as in the two prior letters. JA316-18.

Accordingly, the finding by Judge James that Mod. 25 incorporated an oral side agreement was arbitrary and capricious, and contrary to the law.

III. The ASBCA Did Not Err For Any Of The Reasons Cited By FNY

A. The ASBCA Properly Found That The Government's Conduct Did Not Amount To Bad Faith

Government officials are presumed to act in good faith. Torncello v. United States, 231 Ct. Cl. 20, 45, 681 F.2d 756, 770 (1982); Knotts v. United States, 128 Ct. Cl. 489, 492, 121 F. Supp. 630, 631 (1954). To overcome this presumption, a party must present "well-nigh irrefragable proof" of bad faith. Id. This standard must be met by clear and convincing evidence. Am-Pro Protective Agency, Inc. v. United States, 281 F.3d 1234, 1239-40 (Fed. Cir. 2002).

FNY's proffered evidence fails to demonstrate bad faith. See, id. at 1240 (bad faith based upon actions motivated by malice, animus, or intent to injure). To the contrary, the record reveals that the ACO's actions were in accordance with the applicable regulations and the governing progress payment clause. See 32 C.F.R. § 7-104.35(b), C1 SCA App. E-521 and 524 (1984); JA155-56, 166-68, 566-82. Moreover, the lack of bad faith was corroborated by Judge Grossbaum's finding that the ACO did not abuse his discretion. JA74; Freedom NY, Inc., ASBCA No. 35671, 96-2 BCA ¶ 28,328, at 141,475.

Accordingly, the ASBCA decision that the Government did not act in bad faith was supported by substantial evidence and should be affirmed. See Erickson Air Crane Co. v. United States, 731 F.2d 810, 814 (Fed. Cir. 1984); 41 U.S.C. § 609(b).

B. There Was No Cardinal Change To The Contract

FNY contends that the ASBCA's findings of multiple breaches created a cardinal change. FNY is wrong.

A cardinal change occurs when the Government alters the work so drastically that it effectively requires the contractor to perform duties materially different from the original duties under the contract. AT&T Communications, Inc. WilTel, Inc., 1 F.3d 1201, 1205 (Fed. Cir. 1993) (quoting Allied Materials & Equip. Co. v United States, 215 Ct. Cl. 406, 569 F.2d 562, 563-65 (1978). Whether a cardinal change has occurred is principally a question of fact. Wunderlich Contracting Co. v. United States, 173 Ct. Cl. 180, 194, 351 F.2d 956, 966 (1965); see also Stone Forest Indus., Inc. v. United States, 973 F.2d 1548, 1550 –51 (Fed Cir. 1992) (determination depends upon nature and effect of violation in light of how contract was viewed, bargained for, entered into, and performed by the parties). Courts addressing a cardinal change issue have considered whether: (i) there is a significant change in the magnitude of the work

to be performed; (ii) the change is designed to procure a totally different item or drastically alter the quality, character, nature or type of work originally contemplated; or (iii) the cost of the changed work greatly exceeds the original contract cost. Alliant Techsystems, Inc. v. United States, 178 F.3d 1260, 1276 (Fed. Cir.), reh'g denied, 186 F.3d 1379 (1999).

None of the above conditions exists here. In the instant case, the parties bargained for a contract that resulted in a $13,000,000 ceiling on progress payments, of which $4,000,000 was tied to delivery of product. JA115, 151. The ceiling later was increased to $15.8 million because FNY already had been paid $12,957,105 by July 1986. JA325, 329-30. Prior to termination, FNY received a total of $14,894,720 in 21 progress payments. JA344-45. Given that 21 progress payments had been made under the contract and FNY received over one million dollars more that the bargained for amount, the ACO's conduct in administering progress payments did not constitute a cardinal change to the contract.

A mere delay in payment is not a material breach. Northern Helex Co. v. United States, 197 Ct. Cl. 118, 124, 455 F.2d 546, 550 (1972). Further, no damages are payable other than interest as a result of a delay in payment. Ramsey v. United States, 121 Ct. Cl. 426, 431, 101 F. Supp. 353 (1951), cert. denied, 343 U.S. 977 (1952).

FNY's citations of authority are misplaced. In Edward R. Marden Corp. v. United States, 194 Ct. Cl. 799, 442 F.2d 364, 369-70 (1971), the Court of Claims addressed a dispute where the contract required a hangar to be framed with 12 precast concrete arches, each weighing over 100 tons and hinged to two concrete buttresses with a steel tie rod. The entire structure collapsed during construction killing two men. The contract specifications directing how the concrete arches were to be erected came into question. The Court of Claims found that there was a cardinal change because of the drastic consequences that followed from defective specifications. Id. (citing Luria Bros. & Co. v. United States, 177 Ct. Cl. 676, 687, 369 F.2d 701, 707 (1966). However, even under those extreme circumstances, the Court of Claims acknowledged that the result was not the usual cardinal change case. Id. (citing Air-A-Plane Corp. v. United States, 187 Ct. Cl. 269, 408 F.2d 1030, 1033 (1969).

In Air-A-Plane, the Court of Claims stated that "there is a cardinal change if the ordered deviations 'altered the nature of the thing to be constructed.'" Id. (quoting Aragona Constr. Co. v. United States, 165 Ct. Cl. 382, 391 (1964) (where contractor was prevented from using building materials that it intended to use to construct a hospital, such as steel, copper, brass, and aluminum, because of World War II). The Court of Claims in Air-A-Plane, however, made no finding that a

cardinal change occurred. Air-A-Plane Corp. v. United States, 408 F.2d at 1035-36.

Here, there was no substantial change in the product to be assembled. Indeed, the product was required to meet standard specifications that were also being assembled by other contractors. JA92-95, 100-24, 139. Further, the Government did not direct FNY to use different equipment to perform the assembly. To the extent that FNY chose to use different equipment to perform the assembly, that was their choice. However, payment for the equipment is not a viable issue. Expenses for equipment was not a part of the progress payment schedule. JA582-84. Only depreciation of capital expenses for the equipment was covered, but FNY would have had to buy the equipment to be reimbursed for the capital expenses. Id.; JA140-41($333,333 approved for depreciation on $1.5 million for capital investment in equipment). It did not.

Accordingly, the ASBCA decision that there was no cardinal change to the contract should be affirmed. See Erickson Air Crane Co. v. United States, 731 F.2d 810, 814 (Fed. Cir. 1984); 41 U.S.C. § 609(b).

C. The ASBCA Properly Found That There Was No Constructive Change To The Contract Because Of Delay

FNY contends that the ASBCA erred by awarding delay damages, but not damages for constructive change and profit because of the delay. This contention is without merit.

FNY's reliance upon J.A. Ross & Company v. United States, 115 F. Supp. 187, 192 (Ct. Cl. 1953), is misplaced. There, the Court of Claims did not hold that a contractor could recover under both clauses for a single event that is both a delay and a change. The case involved two different actions by the Government. One action was the addition of work, which was addressed under the changes clause. Id. at 192. The other action, the delay in deciding what type of additional work was required, was addressed under the delay clause. Id.

The Delay Clause clearly excepted adjustments covered under other provisions of the contract, which included the Changes Clause. JA4. FNY was paid for any constructive changes to the contract. See, e.g., JA277-79.

FNY's citations of authority do not support its contention that the ASBCA read the Changes Clause too narrowly. See Melrose Waterproofing Co., ASBCA No. 9058, 1964 BCA ¶ 4119, at 20,080 (involved contract interpretation issue, but not whether delay alone constituted constructive change); Mech-Con Corp.,

GSBCA No. 1373; 65-1 BCA ¶ 4574, at 21881-82 (deferral of air conditioning repair work from Spring to Fall because work could not be completed before Summer "was not in the true sense a delay or suspension of work"); Thomas Electric, Inc., ASBCA No. 30832, 89-1 BCA ¶ 21,516, at 108,370 (remanded to determine whether alleged delay in providing information on cable routing was separable, as a constructive suspension of work, from method or manner of work compensable under Changes Clause).

Accordingly, the ASBCA did not err in finding that FNY was not entitled to any additional damages for any alleged constructive change.

D. The ASBCA Did Not Err In Finding That FNY's Consequential Breach Damages Were Too Speculative

FNY contends that the ASBCA erred in finding that anticipatory profits on post-MRE 5 contracts and other breach damages were unrecoverable because they were remote and speculative. This contention is without merit.

"The general rule in common law breach of contract cases is to award damages that will place the injured party in as good a position as he or she would have been in had the breaching party fully performed." Wells Fargo Bank, N.A. v. United States, 88 F.3d 1012, 1021 (Fed. Cir. 1996), cert. denied, 520 U.S. 1116 (1997) (citing Estate of Berg v. United States, 231 Ct.Cl. 466, 687 F.2d 377, 379

(1982)). However, remote and speculative damages are not recoverable against the United States in a common-law suit for breach of contract. Northern Helex Co. v. United States, 207 Ct. Cl. 862, 524 F.2d 707, 720 (1975), cert. denied, 429 U.S. 866 (1976); see also, Myerle v. United States, 33 Ct. Cl. 1, 26 (1897) (if the profits sought "would have been realized . . . from other independent and collateral undertakings, although entered into in consequence and on the faith of the principal contract, then they are too uncertain and remote to be taken into consideration as a part of the damages occasioned by the breach of the contract in suit.").

Citing Locke v. United States, 283 F.2d 521 (Fed. Cir. 2000), FNY contends that Industrial Preparedness Program (IPP) involved here is akin to the Federal Supply Schedule (FSS) involved in Locke. FNY is wrong. Locke involved a situation in which the contractor was listed on the FSS pursuant to a valid GSA service contract. FNY had no such contract. Under the IPP, FNY's opportunity for receiving work would have been based upon a standard form DD 1519. However, because there is no DD 1519 covering FNY's participation as an MRE assembler in the record, no comparison with Locke can be made.[3] Nevertheless,

3 The only IPP agreement in the record relates to FNY's entrée production during 1983-1985, not MRE assembly. JA564-65.

the standard form reflects that it is not a requirements contract and there is no guarantee that FNY would have received any work as a result of the execution of a standard form DD 1519. See, e.g., JA564-65.

Also, unlike the situation in Locke, FNY seeks anticipatory profits for unawarded future contracts. Such non-direct anticipatory profits historically have been denied in claims against the United States. See, e.g., Olin Jones Sand Co. v. United States, 225 Ct..Cl. 741, 743-44 (1980) (denial of damages to a company that, as a result of alleged Government wrongdoing, lost its bonding capacity and, consequently, was not able to obtain other contracts); Rocky Mountain Constr. Co., 218 Ct. Cl. 665, 666 (1978) (denial of damage claim alleging that, had the Government not delayed contract performance, company would have bid for, been awarded, and profited from other contracts); Ramsey v. United States, 121 Ct. Cl. at 434, 101 F. Supp. at 353 (denial of profits lost from corporation's over-all business activities due to lack of capital that resulted from Government's failure to make timely payments).

FNY's citation to United Technologies Corp., ASBCA No. 46880, 97-1 BCA ¶ 28,818, also is unhelpful because the facts involved there are markedly different than those involved here. United Technologies involved a claim filed pursuant to the "Investment Incentive" clause under a contractual arrangement

with the Navy to become a second source producer of F404 engines to drive down the excessive prices of a sole-source provider. Id. at 143,750-51. Also, the contract clause provided a minimum production limit incentive for the contractor to invest in the program. Id. at 143,763. There was no such investment incentive or minimum production limit here.

Accordingly, the ASBCA properly found that FNY was not entitled to anticipatory profits and other speculative damages.

E. The ASBCA Properly Denied FNY's Claim For Additional Costs

FNY contends that the ASBCA erred in holding it to an inappropriately high standard of proof for its quantum and maintains that it should be awarded $8,830,808, which reflects FNY's overrun of $7,942,739, plus profit of 14.88 percent. FNY's contention is not supported by the record. Other than to express its dissatisfaction with the amount of recovery, FNY has offered no proof that demonstrates that it is entitled to its alleged full overrun. FNY has failed to point to any errors in the ASBCA's computation of quantum and has similarly failed to offer any case law to support its theory that the Government is responsible for all costs regardless of whether they arise from Government fault or not.

The total cost methodology used by FNY to quantify its damages has been approved by this Court only as a theory of last resort. Youngdale & Sons Constr.

Co. v. United States, 27 Fed. Cl. 516, 540 (1993) (citing Servidone Constr. Corp. v. United States, 931 F.2d 860, 861 (Fed. Cir. 1991)). "Use of this method is highly disfavored by the courts, because it blandly assumes – that every penny of the plaintiff's costs are prima facie reasonable, that the bid was accurately and reasonably computed, and that the plaintiff is not responsible for any increases in cost." Youngdale & Sons Constr. Co. v. United States, 27 Fed. Cl. at 541 (emphasis in original.

Because the total cost method is based upon so many assumptions, the courts have required four indicia of reliability to be present. A contractor must demonstrate that: "(1) the nature of the particular losses make it impossible or highly impracticable to determine them with a reasonable degree of accuracy; (2) the plaintiff's bid or estimate was realistic; (3) its actual costs were reasonable; and (4) it was not responsible for the added expenses." WRB Corp. v. United States, 183 Ct. Cl. 409, 426 (1968); see Servidone Constr. Corp. v. United States, 931 F.2d Cl. at 861; Youngdale & Sons Constr. Co. v. United States, 27 Fed. Cl. at 541. The contractor must prove each of these elements by a preponderance of evidence. Teledyne McCormick-Selph v. United States, 218 Ct. Cl. 513, 588 F.2d 808, 810 (1978); Mega Constr. Co. v. United States, 29 Fed. Cl. 396, 444 (1993); Youngdale & Sons Constr. Co. v. United States, 27 Fed. Cl. at 541.

In this case, FNY failed to meet the standard of proof necessary for the application of the total cost method. First, the particular nature of the losses in this case can and have been determined by the ASBCA with a reasonable degree of accuracy. Second, there was no showing whatsoever that FNY's bid price was reasonable. At the time FNY prepared its bid, FNY had no jobs in-house, no revenue producing potential, and a deficit working capital of $2.6 million. JA129, 134. In brief, there were numerous unknowns associated with FNY's bid price. Third, there has been no showing that FNY's actual costs were reasonable or that the increased costs are totally attributable to the Government.

Accordingly, the ASBCA properly denied FNY's claim for these additional costs.

F. The ASBCA Properly Denied FNY's Claim For Interest

FNY contends that, because Mod. 25 was invalid, the ASBCA should have awarded FNY interest from the date of FNY's original claim. FNY is wrong. Mod. 25 was not invalid for the reasons stated above at pages 6-9.

Further, FNY did not pursue this issue before the ASBCA and, thus, it is not properly before this Court. Singleton v. Wulff, 428 U.S. 106, 120 (1976); Interactive Gift Exp., v. Compuserve, Inc., 256 F.3d 1326, 1344-45 (Fed. Cir. 2001); L.E./A. Dynatech, Inc. v. Allna, 49 F.3d 1527, 1531 (Fed. Cir. 1995).

CONCLUSION

For the foregoing reasons, this Court should vacate the August 28, 2001 decision of the ASBCA and remand the matter to the ASBCA for further proceedings.

Respectfully submitted,

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August 30, 2002

CERTIFICATE OF SERVICE

I certify under penalty of perjury that on the 30th day of August, 2002, I caused to be served by United States mail (first class, postage prepaid) copies of the foregoing "REPLY BRIEF FOR THE APPELLANT, SECRETARY OF DEFENSE" addressed to:

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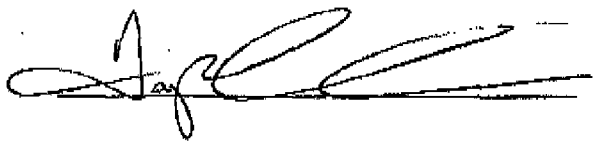
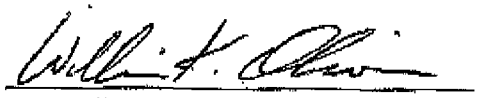


CERTIFICATE OF COMPLIANCE PURSUANT TO RULE 32(a)(7)(B)

Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure ("FRAP"), I hereby certify that the following brief complies with FRAP 32(a)(7)(B) because it contains 4,836 words, excluding the table of contents and table of authorities. To prepare this certificate, I relied upon this information generated by the WordPerfect word processing software used to prepare this brief.



WILLIAM K. OLIVIER

DOD INDUSTRIAL PREPAREDNESS PROGRAM
PRODUCTION PLANNING SCHEDULE

Form Approved
OMB No. 22-R0251

Use of the data entered on this form will be limited to duly accredited officials of the Department of Defense who are subject to penalties for unlawful disclosure. The protection given to data relating to your facility under the Espionage Act and other statutes will confine accessibility within the Government to those responsible for procurement, production preparedness planning, and defense of the United States.

Procuring Activity/Customer Plant Data	Industrial Source (Operating Plant) Data
1. NAME AND ADDRESS (Include ZIP Code) Defense Logistics Agency Defense Personnel Support Center 2800 South 20th Street Philadelphia, PA 19101 DPSC-SPPR	2. NAME AND ADDRESS (Include ZIP Code) Freedom Industries, Inc. One Loop Drive Hunts Point Bronx, NY 10474 PLANT INDEX NUMBER 366996
1a. REPRESENTATIVE AND TELEPHONE NUMBER Mary Adellizzi/Lois Dyduck A/V 444-4477 (215) 952-4477	2a. REPRESENTATIVE AND TELEPHONE NUMBER Mr. Henry Thomas (212) 328-9000
1b. CUSTOMER PLANT ASPPO CODE NO. _____ OFFICE AND ADDRESS	2b. ASPPO CODE NO. 850 OFFICE AND ADDRESS DCASMA-New York, DCRN-NCPI 201 Varick Street New York, NY 10014
1c. REPRESENTATIVE AND TELEPHONE NUMBER —	2c. REPRESENTATIVE AND TELEPHONE NUMBER ALBERT A. SACCHET (212) 807-3161 AV-994-3161
1f. SCHEDULE COVERS: PRIME CONTRACTOR PLANNING SUBCONTRACTOR PLANNING (Tier)	2d. UTM Z-18 N-45177 E-5950 RSAC: 1641 P/V Code: BISADREB

ACCEPTANCE BY INDUSTRIAL MANAGEMENT AND BY GOVERNMENT

The signatures below attest that the information contained herein is true and correct to the judgment of the signatories at the time of signature. Further the signatures indicate (1) an awareness of the Government's dependence upon these data as a basis for appropriate and often costly measures to insure the adequacy of the US industrial base; (2) recognition of the Government's intention to convert production planning schedules to contracts by negotiation on a selective basis as may be required to minimize material shortages during a future Limited War, and (3) recognition that it is also the Government's intention, consistent with such planned production as may be converted to prime contracts by negotiation, to require that planned subcontract support will be similarly converted to subcontracts. Notwithstanding the foregoing basis for acceptance, the signatures herein in no way bind the named firm(s) nor the Government in any contractual relationship, nor is acceptance to be construed as an agreement by industry to maintain production capability as indicated herein. The signature of industry does not obligate the named firm to accept a military contract if one is offered nor is the Government obligated to convert production planning schedules to contracts, to contract with the named firm if procurement of the items specified herein is required, or to convert planned subcontract support to subcontracts if the planned production is converted to prime contracts. It is understood, however, that the named firm(s) may be required to accept such a military contract(s) under applicable laws and regulations as may be in effect at the time.

12 JUL 1983

3. PROCURING ACTIVITY OR CUSTOMER PLANT	4. OPERATING PLANT I.P.R.	5. OPERATING PLANT ASPPO	6. EFFECTIVE PERIOD
SIGNATURE AND DATE JUL 08 1983	SIGNATURE AND DATE 11/28/83	SIGNATURE AND DATE 11/28/83	1 Oct 83 thru 30 Sep 85
1ST RENEWAL (Signature and date) 84-S-14-83-A	1ST RENEWAL (Signature and date)	1ST RENEWAL (Signature and date)	
7. REFERENCE NUMBER	7a. PREPARED BY		7b. DATE

DD FORM 1519 THIS FORM REPLACES DD FORMS 1519 AND 1519-1, 1 DEC 68, WHICH ARE OBSOLETE.

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Industrial Preparedness Plan
Reference Number 64-S- N-83 Aftm F

Item: Beef Stew, Thermostabilized, 5 oz. package
NSN: 8940-00-149-1068
Quantity: 50,373,000
Specification: LP/P DES 9-75

Item: Turkey, Diced with Gravy, Thermostabilized, 5 oz. package
NSN: 8940-00-149-1093
Quantity: 50,373,000
Specification: LP/P DES 14-75

Item: Chicken Ala King, Thermostabilized, 5 oz. package
NSN: 8940-00-149-1090
Quantity: 50,373,000
Specification: LP/P DES 10-75

Item: Beef Diced with Gravy, Thermostabilized, 5 oz. package
NSN: 8940-00-149-1086
Quantity: 50,373,000
Specification: LP/P DES 4-75

Item: Ham Slices, Thermostabilized, 5 oz. package
NSN: 8905-00-149-1071
Quantity: 50,373,000
Specification: LP/P DES 13-75

Item: Beef Hash with Spiced Sauce, Thermostabilized, 5 oz. package
NSN: 8940-00-149-1089
Quantity: 25,187,000
Specification: LP/P DES 5-75

Please Note: The above items are essential components of the MRE Combat Ration. It is very important that the information furnished by the Contractor be as accurate and as up to date as possible. I must be sure that the Company has considered all previous committments they have made for mobilization as a subcontractor for similiar items. Since this plan, when completed, will supercede all others in effect for thermostabilized items (except those completed as a vertical producer), any plan for the same or similiar item, such as applesauce or beans with tomato sauce (again except those completed as a vertical producer) should be cancelled, and the capacity made available for this plan.

The industrial base is not adequate to support our mobilization needs. Therefore, anything your office can do to have the contractor voluntarily maximize the shifts and days per week utilized for this plan will help improve the situation. For the same reason, please advise of any additional sources you are able to develop or which you are already aware. If you have any questions at all please call me.

Thank you,

MARY ADELLIZZI
Industrial Specialist

post-award financial surveillance report and after a review of all the documents, the company was still deemed to be in unsatisfactory financial condition without a commitment letter -- a certain amount of -- 3.8 million approximately, in credit. Without that credit --

Q Mr. Liebman, with regard to your January '85 decision to consider progress payments, was that based on all this information from Freedom?

A No, no. In early January 1985, I sent a letter advising the contractor I was considering suspending progress payments, gave the contractor an opportunity to respond before I made any final decision.

After the contractor received my letter of proposed suspension or consideration of suspension -- the contractor submitted various documents.

Q Okay. Now the January 1985 letter, what was the basis for you to consider the suspension of progress payments?

A We were of the -- I was of the opinion that the contractor was in unsatisfactory financial condition because of the withdrawal of Dollar Drydock Savings Bank -- which was the source of Freedom's credit.

Q What led you to believe there was a withdrawal?

A There was a conference call approximately December 17th -- or during the week of December 17, 1985

-- with the bank, our commander, myself, our counsel, and one or two other people -- and the bank categorically advised us that certain conditions had to be met before any money would be forthcoming to Freedom.

Also, there was a post-award conference held at the contractor's facility on December 14, 1984, where the contractor basically indicated that no credit had been forthcoming from that bank up to that point in time and they were seeking alternate sources of credit.

Q Who attended this meeting where that information was given?

A Are you referring to the post-award conference?

Q Yes.

A It was representatives from the government -- specifically the buying command, Defense Personnel Support Center Pennsylvania, the Defense Contract Management Office -- which was my office -- also representatives from Freedom -- and also representatives from the Army Veterinarian Corp.

Q And as a result of that information you decided to consider suspension of progress payments?

A No. We were -- a few days after the post-award conference, at our commander's request, we called the bank to get more information because we were surprised by this development that no monies had been flowing from

Dollar Drydock Savings Bank -- which was the reason we had given the contractor a positive financial pre-award survey several months earlier.

We called the bank, spoke to the vice president. He advised us that unless certain conditions were met, no money would be forthcoming.

Q What were those conditions?

A Specifically, that the government would have to guarantee the loan. That the government would have to provide assurance that progress payments would be paid and also that an arrangement would have to be made to settle Freedom's past creditors -- because Freedom had owed about several million dollars in past debts.

Q And when was this telephone call made?

A This telephone call was made during the week of 17 December 1984.

Q And was Freedom present when the telephone call was made?

A No.

Q Was there any discussion as to getting Freedom involved in the phone call?

A No.

Q So was it based on that information that you sent out the January letter --

A No.

Q Okay. What information -- you would have been very excellent with Mr. Luchansky.

What information was it that caused you to send out the January letter advising that you were considering suspending progress payments?

A Well the conference call with the bank was of course, part of the process. But after the conference call there was an exchange of letters between my office and Freedom, exchange of phone calls, there were some meetings, we gave the contractor every opportunity to discuss this matter.

Q To discuss what matter?

A The matter of the withdrawal or absence of any credit. The -- we were depending that the contractor needed outside financing in order to perform on the contract. With the absence of Dollar Drydock and no replacement for the Dollar Drydock financing, I was of the opinion the contractor could not perform.

Therefore, I sent out a letter. I made a decision that I was going to consider suspending progress payments and so, sent out a letter the first week in January 1985, to the contractor advising the contractor of that opinion.

Q After that letter was sent out, was Freedom given an opportunity to respond to that letter?

A Yes.

Q What was Freedom's response?

A Well we had -- again, there was an exchange of correspondence, phone calls, more meetings, Freedom submitted a lot of documentation to our office for review, there were lines of credit, letters came in regarding possible lines of credit that were being set up. We took everything -- we reviewed everything -- our whole office reviewed it and then our financial analyst issued a post-award surveillance report towards the end January advising that the contractor could not perform without a firm commitment from an outside financial institution. And then I made my decision to suspend progress payments.

Q And again, what was the basis for that decision to suspend?

A Unsatisfactory financial condition that was endangering performance of the contract.

Q Were there other factors mentioned in that letter?

A Yes. There were other factors -- side factors that were mentioned.

Q What was the purpose of mentioning the side factors if they weren't the basis?

A It -- well they weren't driving engines, but

they were just in the way of some background information.

MR. LUCHANSKY: I'm sorry, I didn't hear.

THE WITNESS: It wasn't -- the other factors were not the driving engines as to why I suspended progress payments. It was made quite clear in the suspension letter that it was suspended because of an unsatisfactory financial condition.

The others were just mentioned as side issues which would not have caused me to suspend progress payments on their own.

BY MS. HALLAM:

Q Are there certain procedural steps that are required before doing a suspension of progress payments?

A Yes.

Q Could you tell us what those procedural steps are?

A Okay. Again, as I mentioned before -- there must be an intensive dialogue between the contractor and the government. Then once the ACO makes his decision to suspend progress payments -- or not to suspend progress payments -- the ACO must go before an internal contract management review board -- which is what I did.

Both times when I proposed suspending progress payments, I convened a contract management board of review meeting and then -- this was in early January

1985, regarding proposed suspension -- then when I actually made my decision to suspend, I also had a board of review convened. And in both cases they sustained my position.

Q Now, who's on this board of review?

A Board of review consists of multi-functional people, the chief of our contracts division, there's a chief of production, there's a quality assurance manager there, there's the chief of pricing, there are other -- there's a small business representative from our office, legal sits in in an advisory capacity -- they don't vote.

There may be one or two others -- but it's a multi-functional board consisting of contractual, financial, production, quality, sometimes engineering, small business with legal -- with a legal representative as an advisor.

Q Sir, you said something about voting -- is there actually a vote?

A No. The lawyer doesn't have a vote but he's there to advise.

Q But is there a voting procedure?

A Yes.

Q Oh, okay. What steps or what did Freedom have to do in order to get the suspension lifted?

A Freedom -- as the suspension letter indicated

-- Freedom would have to demonstrate financial capability in performing on the contract and then I would consider resuming progress payments.

Q And Freedom eventually did do this, or --

A Yes.

Q And how did they do this or how did it do this?

A They obtained financing from a company called Bankers Leasing from Illinois. They had a five or a five and a half million dollar financing arrangement.

Q Do you remember attending a meeting at headquarters, I believe, February 14th?

A Yes.

Q Could you tell us what your recollection of that meeting is?

A Yes. The government and the contractor discussed various scenarios that would enable Freedom to obtain financing, which would enable me to resume progress payments.

There was a consensus among the attendees that we wanted Freedom, if at all possible to perform on the contract. We wanted Freedom to be successful and I think it was a very positive meeting and various -- as a result of the meeting, it was agreed that -- we advised Freedom that we feel they would need about $3.8 million in credit from a verifiable, reliable financial source -- that they

believe 17 April 1985.

Q And after that period of time who had the contract?

A H.T. Food Products, Incorporated.

Q Do you remember any discussion among government officials with regard to the propriety of novating in general?

A Well, in this case, yes. There was a lot of discussion at Headquarters at the 14 February meeting and subsequent to that meeting because there was -- the government was concerned that we could be -- the government could be accused of shielding Freedom from its creditors because H.T. Food Products was owned by Mr. Thomas -- he was the president of H.T. Foods. He was an officer of both companies, meaning Freedom Industries as well as H.T. Food Products.

So there was a lot of discussion about this. We called it piercing the corporate veil. Even if we novated, we were concerned the creditors could pierce the corporate veil -- the government perhaps could be liable for novating and be accused of shielding Freedom from its creditors.

Q But none the less, it was approved?

A It was approved, yes.

Q Were Freedom Industries and its successors

progress payments subjected to pre-payment reviews?

A In most cases, yes.

Q What does a prepayment review consist of?

A Well the -- a full prepayment review would involve pricing, audit, and technical. It could be a limited prepayment just involving one of the elements I just mentioned.

Q Could you tell us why these requests were for the most part, subjected to the prepayment review?

A Well the first one was -- I conducted a prepayment because it's -- the contract was a brand new contractor, never had progress payments before and it's standard operating procedure to review the first progress payment on a prepayment basis when a company was in such a mode as this -- as Freedom was -- meaning a new contractor, never had progress payments before. We had to test the accounting system.

Regarding progress payments after number one, I had to do prepayment reviews on most of the progress payments because I could not place reliance on their accounting system and controls.

The audits that were done by the Defense Contract Audit Agency -- or DCAA revealed numerous deficiencies in their accounting system and controls that caused me to be -- to take the position that I couldn't

rely on Freedom's accounting system.

Q Could you explain to us what it was that you felt was questioned or what you felt was there to make you believe that you couldn't have any reliance on their requests?

A Yes. I'll just mention a few areas. There were costs that were -- in the beginning there were costs that were not booked. There were costs that were not Freedom's liability. They were costs really that were liabilities -- the liability of other contractors. There were pre-contract costs included. There were excessive costs included. There were costs that should be capitalized and depreciated. There were costs that should be amortized. There were costs that violated the defense contract -- I'm sorry -- that violated the Defense Acquisition Regulation Chapter 15, Contract Cost Principles. There were duplicative costs. There were costs that Freedom did not pay in the ordinary course of business which it was required to do. These include vendor costs, subcontractor costs, the payment of taxes -- and these are just some examples.

Q Where did the information with regard to these problems come from? Were you doing a review of the progress payment request and did you discover these problems?

A No. The review -- the organization that reviewed Freedom's books and records regarding the progress payment requests was the Defense Contract Audit Agency, or DCAA. They sent auditors out to Freedom, performed the reviews in accordance with the Defense Acquisition Regulation.

Q So you were relying on their findings with regard to these problems?

A Yes.

Q With regard to those examples that you gave, were those examples all found during the first progress payment?

A No. These were pervasive -- at various times -- they occurred at various times throughout the life of the contract. There were twenty-two progress payments and they occurred at various times.

Q I'd like to talk to you now about the second time you considered suspending progress payments, in August of '85. Could you tell us what the basis for that decision to or determination to consider suspending progress payment was based on?

A The Defense Contract Audit Agency issued a report for progress payment number five deeming Freedom's accounting system unacceptable for progress payment purposes. The deficiencies in the system had mushroomed

to such an extent that DCAA made the determination that it was unacceptable. Per the Defense Acquisition Regulation which has the full force and effect of law, I cannot as a contracting officer, pay progress payments without an approved accounting system.

Q Could you tell me what you mean by, "the deficiencies had mushroomed to such an extent?"

A Right. The -- there were just so many deficiencies that we couldn't place reliance on the system. DCAA made the determination that the system was so flawed that the system was deemed inadequate.

Q Could you give me an example of some of these deficiencies, do you recall any?

A Yes. Well, I mentioned a whole bunch of them before but I can just add in some more.

One of the areas was a reduction in contract costs. Specifically, about -- approximately $400,000 in rental payments and New York City occupancy tax that I had paid progress payments for but had not been passed on to the landlord. That was picked up by the DCAA auditors. And again, there were numerous other -- basically I can repeat what I said before. It's --

Q Okay. What is the impact of this determination by DCAA that the accounting system is inadequate?

A I'm sorry. I missed the first part of the

question.

Q What is the impact of that?

A Well, it prevents me from paying progress payments. The system must be deemed adequate and DCAA is or the Defense Contract Audit Agency is the government office that performs the reviews of the contractor's accounting system for the Defense Acquisition Regulation.

Q You're the ACO. Don't you have authority to overrule their findings?

A Again, no. I don't believe so, no. I'm not a lawyer but it's -- it's quite clear in the Defense Acquisition Regulation that it is DCAA that makes the determination of acceptability of the accounting system. They're acting for the ACO. They are a service organization servicing the ACO. They are the experts. I'm not an accountant. I'm not an auditor. But it's -- they make the determination concerning acceptability of the system per the DAR.

Q Could you explain how Freedom's system could be found inadequate after or as a result of progress payment request number five when it was considered adequate prior to the award of this contract?

A Well prior to award of the contract, the contractor had no -- did not have any progress payments, didn't have any contracts -- there basically would have

been very little to look at when DCAA did a review during the pre-award process concerning acceptability of the system.

Once the contract was awarded -- which was Freedom's first contract for progress payments -- in fact the company had been really out of business for about two years and didn't have any contracts -- the system had to be tested. So there was really -- probably nothing to look at or very little to look at when the contract -- when DCAA went out there during the pre-award phase.

It was only after the contract was awarded that costs were being incurred and recorded on their books and records for this contract that gave the auditing agency something really to look at and to test the system -- that formed as a basis to test the system.

Q How and when was this matter ultimately resolved?

A Okay. It was ultimately resolved as a result of a meeting at headquarters in late -- I think -- September 25, 1985, with government personnel, Freedom personnel, and the DCAA or Defense Contracting Audit Agency review of progress payment number seven.

Freedom's system showed improvement as a result of a review of number seven. The documentation had been improved. The paper trail was better. Its system had

been set up to capitalize costs. So there was improvement and that -- as a result, DCAA took away the statement that the system was not acceptable for progress payments.

Q And at that time were progress payments reinstated?

A Yes. Actually, it was reinstated on an emergency basis before that meeting to pay an -- to pay some electrical bills. On progress payments five and six, we paid electrical bills in the amount of about $10 or $11,000 in order to protect our property that was out there.

But I reinstated progress payments of -- really for number seven as a result of the DCAA findings.

Q I'd like to go through H.T. Foods and Freedom N.Y.'s progress payment submissions starting with H.T. Foods progress payment number one. Could you briefly describe what if any costs were questioned, what was withheld?

A Yes. The request was submitted for roughly $1,700,060 whatever. There was only about $60,000 questioned. I paid $1,700,000 and questioned about $60,000 as a result of a DCAA review.

Most of the costs questioned were -- forty of the sixty some thousand had to do with capital type

costs. These costs should have been capitalized. Specifically, for computers -- office equipment. There were some small deductions for guard service, accounting -- there was an adjustment for one of Freedom's subcontractors, Star Foods, in the approximate amount of seventeen thousand.

So I paid basically, the bulk of the progress payment -- one million seven, out of one million, seven hundred sixty thousand.

Q Could you tell us what the problem was with the capital equipment -- why the DCAA found that questionable?

A Well, when it's capital equipment you must -- you only can submit progress payments for the depreciated value of that equipment. You can't submit progress payments for the full value of that equipment.

Q Wasn't Freedom at this particular point in time telling you that that was the way they negotiated the contract?

A Yes.

Q Why didn't you pay the progress payments then if that was the way it was negotiated?

A The contract price was negotiated that way. I'm not -- I was not going to interfere with the contract price. However, when you're talking about progress

payments you're talking about a different venue and I'm prohibited by government regulations to pay progress payments for capital equipment at a hundred percent -- or 95 percent. I only can pay for the depreciated value.

Q Did you check with anybody at the DPSC, with the PCO or check with anybody with regard to the propriety of not paying the costs, the progress payments on those capital type equipment?

A Yes. Yes, I spoke to the PCO, Mr. Thomas Barkewitz, I spoke to his procurement agent, Mr. Keith Ford. My counsel, Mr. Carl Herringer spoke to the DPSC counsel, Mr. Chuck Wright. I was also in touch with Mr. Chuck Wright with Mr. Herringer present.

The PCO, Mr. Barkewitz said the issue with progress payments only came up during the negotiation of the contract at the very end. But there was no discussion concerning progress payments for capital equipment.

The PCO allowed certain items of capital equipment at a hundred percent in the contract price because they wanted Freedom as a -- or they hoped Freedom would be a prospective supplier or an assembler down the road -- so they figured they would pay for it in terms of contract price now. But it was only selected items of capital equipment.

However, in order to pay progress payments I would have -- a DAR deviation would have to be obtained -- it would be to pay progress payments for this capital equipment. The PCO basically -- the PCO's position was -- and Mr. Ford's position was that -- the progress payments were something within the purview of the DCAS contracting officer, myself. I administer the progress payments. I'm responsible for progress payments and that was my call.

Q Was a DAR deviation pursued?

A Yes.

Q Did you have any -- did you participate in that in any way?

A Yes. I recommended approval to higher headquarters. I recommended that it be approved.

Q What was the ultimate outcome of that request?

A Well I never saw the ultimate outcome but it's my understanding it was never approved. I know there were letters going back and forth and correspondence and discussions for months -- up until February 1986. I know in the government Rule 4 there's a document from signed -- well, anyway -- I know it was disapproved at the assistant secretary of defense level -- undersecretary of defense level, Dr. Wade.

Q I'd like to move on to H.T. Foods progress