U. S. Court of Appeals for the Federal Circuit

Freedom N.Y., Inc.

APPELLEE'S REPLY BRIEF

9/17/2002

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INTRODUCTION

The Government's reply brief does not refute the points and arguments raised by Freedom, NY, Inc. ("Freedom") in its principal brief ("Freedom's Brief"). In some instances, the Government's arguments are not even responsive to Freedom's arguments. *See*, *e.g.*, *infra* at 15-16. This brief responds to the Government's reply brief in the order of the arguments made by the Government.

ARGUMENT

I. THE ASBCA'S FINDING THAT MODIFICATION 29 WAS PROCURED BY DURESS IS SUPPORTED BY SUBSTANTIAL EVIDENCE

Freedom's Brief set forth substantial evidence supporting the ASBCA's finding that Mod. 29 was procured by duress, specifically, by the Government's refusal to release Progress Payment 21 until Freedom signed Mod. 29. *See* Freedom's Brief at 48-51. In arguing to the contrary, the Government wrongly assumes that the Government acted within its rights when it withheld Progress Payment 21 and, indeed, when it withheld all progress payments from Freedom from December 1984 until May 1985 and continued throughout the life of the contract to remain delinquent in paying millions of dollars of progress payments. *See* Govt. Reply Brief at 3 (claiming that withholding progress payments when a contractor's financial condition endangers performance was within the ACO's authority). The Government's assumption is wrong for a number of reasons. Firstly, the ACO did *not* act within his authority in withholding progress payments; to the contrary, the ASBCA found that the ACO breached the contract each time he withheld or delayed a progress payment to Freedom. (JA32.) Secondly, the

Government's withholding of Progress Payment 21 until Freedom signed Mod. 29 was not an exercise of the ACO's discretion; to the contrary, the ACO had already exercised his discretion and *approved* Progress Payment 21 before the PCO asked him to withhold that payment as leverage to get Freedom's signature on Mod. 29. (JA438, ¶ 5.) In approving that payment, the ACO considered the factors within his discretion. (*Id.*) Thus, his subsequent withholding of the payment pending Mod. 29 was a breach, and extracting consideration from Freedom to undo the effects of that breach was duress. Also, it was oppressive and constituted bad faith.

Finally, the Government's claim that it was entitled to withhold progress payments, and, therefore, that it was entitled to demand Freedom's signature on Mod. 29, also is dependent upon the Government's claim that Freedom's financial condition was endangered by Freedom's not receiving financing from Dollar Dry Dock ("DDD"). *See* Govt. Reply Brief at 3. The ASBCA found, however, that it was the ACO's breaches that placed Freedom in a poor financial condition. (*See* JA29.) The Government assertion that the award to Freedom was predicated upon DDD's financial commitment is belied by the record. The Government knew that DDD's commitment was "qualified," i.e., it was conditioned on a $21.6 million contract award, which did not come about, because the Government negotiated a lower price. (JA130; JA425.) The original PCO, Mr. Barkewitz, admitted in an internal Defense Department investigation:

> I did not consider the letter to be acceptable. I told Marvin Liebman, who is currently the ACO on Freedom Foods [later Freedom NY], that I didn't think the letter was acceptable and he agreed, but later the letter was considered acceptable by

> the financial services personnel at DCASR NY when they did the preaward survey. My concern was that the letter was qualified. It presupposed that the contract would be awarded at a certain dollar value and that the line of credit was tied to the amount of the contract. It was my concern that if we negotiated a lesser price for the contract, that this would cause Dollar Drydock to drop their commitment.

(JA588.)

Furthermore, the Government knew -- *because the parties negotiated this* -- that Freedom would need only $749,000 in bank financing if the Government kept its promise to make progress payments. (JA523; JA551; JA544-45.) However, the Government did not keep its promise, as the ASBCA correctly found. In short, the Government breached the contract and then tried to avoid liability by forcing Freedom to sign a release under duress. Such behavior cannot be countenanced by this Court.

The Government asserts that Mod. 29 was an accord and satisfaction, which is a "perfect defense" even if the underlying claim was well founded. Govt. Reply Brief at 2. However, it is obvious that an accord and satisfaction is no defense if that accord and satisfaction is void from its inception. That is precisely the case here. Accordingly, the Government's appeal must be denied.

II. JUDGE JAMES' FINDINGS REGARDING MODIFICATION 25 WERE PROPER

A. The ASBCA did not fail to explain its factual findings.

The Government is incorrect when it asserts that Judge James failed to explain those of his factual findings which allegedly differed from the factual findings made by a different ASBCA judge (Judge Grossbaum). Judge James did

not "fail" to provide such an explanation because he had no reason to provide one. Rather, he was free to make his own factual findings based on the evidence before him, and that is what he did.

Freedom's one MRE assembly contract has produced no fewer than *eight* published ASBCA decisions. The decisions that the Government claims are contradictory were written five years apart -- one in an appeal from a default termination and the other in an appeal from the Government's denial of Freedom's breach of contract claim. For this reason alone, the case on which the Government relies, *Essex Electro Engineers, Inc. v. Danzig*, 224 F.3d 1283 (Fed.Cir. 2000), is irrelevant. That case involved inconsistent findings *within one decision*.

For the same reason, the other cases cited by the Government (Govt. Reply Brief at 6) also are inapplicable. The Government's assertion that Judge Grossbaum's and Judge James' allegedly contradictory decisions were not the result of two separate proceedings is ludicrous. As noted, the decisions resulted from two hearings held approximately five years apart. The default termination case and the breach case even had different docket numbers. It is true, of course, that the two cases arose out of the same contract and some of the same events. However, as Judge Grossbaum himself wrote:

> [T]he Board's determination of the issues concerning the validity of the challenged bilateral modifications was not essential to its holding in ASBCA No. 35671 that the default termination was improper. The decision did not depend on those determinations, which proved irrelevant to the outcome. Since the decision sustaining the appeal from the default termination was favorable to appellant, appellant has no opportunity to appeal the Board's adverse determination of

> ancillary issues which it litigated vigorously. *Therefore, relitigation of those issues in a subsequent action between the parties is not precluded.*

Freedom NY, Inc., ASBCA No. 43965, 98-1 BCA ¶ 29,382, at 146,040 (emphasis added). (JA499.) Consistent with this, Freedom's legal fees and expenses associated with the breach claim issues were excluded from the EAJA award to Freedom for its successfully overturning the default termination. *See Freedom NY*, ASBCA No. 35671, 98-1 BCA ¶ 29,711. Clearly, Judge Grossbaum and his brethren *intended* that a later judge (in this case, Judge James) would make new factual findings. The Government even admits that "Judge James had the benefit of additional factual evidence[.]" Govt. Brief at 36. Significantly, the Government did not object to that new evidence.[1]

B. The ASBCA properly found that a "side agreement" to Mod. 25 existed.

The Government's contention (on page 7 of its reply brief) that the "side agreement" to Mod. 25 was an oral agreement is baffling. The agreement found by the ASBCA was a written one; specifically, it was created by Freedom's letters to Mr. Ray Chiesa of the Defense Logistics Agency dated May 13 and May 28, 1986

[1/] One might justifiably ask why Judge Grossbaum made factual findings that were not necessary to his decision. The answer is simple, as Judge Grossbaum himself wrote: "From the moment ASBCA No. 43965 was docketed there had been confusion as to the scope of the appeal." *Freedom NY, Inc.*, ASBCA No. 35761, 43965, 96-2 BCA ¶ 28,328. (JA86.)

and the Government's acquiescence thereto. The Government's assertion that Freedom's letters "acknowledged that the side agreement was not part of the agreement reached with the Government" (Govt. Reply Brief at 9) likewise is baseless. Freedom's May 13 letter stated expressly:

> Those issues [discussed by the parties], in part, involved a dispute concerning Freedom's performance of DLA Contract DLA13H-85-C-0591 ("the Contract") for the production of 620,304 cases of MREs. By Modification to be designated (the Mod) P00021 [sic], Freedom and DLA under the authority of th[e] Contract Disputes Act, 41 U.S.C. § 601 et seq. have agreed to settle Freedom's claim against DLA for $3,401,760. This settlement is reflected *in part* in the Contract Modification which is attached.

(JA298 (emphasis added).) The May 28th letter contained the identical statement except that it corrected the modification number to P00025. (JA301.) In other words, only *part* of the parties' deal was reflected in Mod. 25. As the ASBCA found, the Government knew that Freedom considered the May 13 and May 28 letters to be an integral part of the deal that included Mod. 25 *and that Mod. 25 was conditional on the total deal*, and the Government did nothing to disabuse Freedom of that notion until after Mod. 25 had been signed.[2] (JA21-22; JA40.)

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[2] The ASBCA specifically *dis*believed the PCO's testimony on the side agreement, finding that he showed "persistently selective recall of facts" and was "evasive." (JA22.) Credibility determinations made by a board of contract appeals in support of its decision are "virtually unreviewable" on appeal. *Statistica, Inc. v. Christopher*, 102 F.3d 1577, 1583 (Fed. Cir. 1986).

Accordingly, a binding contract was formed containing the terms as Freedom believed them to be. (JA40.) *See* Restatement (Second) of Contracts § 201(2)(a).[3]

III. FREEDOM'S APPEAL SHOULD BE SUSTAINED

A. The ASBCA erred as a matter of law in not finding bad faith.

The Government's argument on the issue of bad faith ignores the test of bad faith relied on by Freedom. While "malice, animus, or intent to injure" are *some* of the ways to show bad faith, as the Government argues on page 10 of its reply brief, bad faith may also be shown by a course of oppressive conduct. *Struck Construction Co. v. United States*, 96 Ct. Cl. 186 (1942) (cited with approval in *Am-Pro Protective Agency, Inc. v. United States*, 281 F.3d 1234, 1241 (Fed. Cir. 2002)). According to the Court of Claims in *Struck Construction*, conduct is oppressive when care is taken to appear not to be asking for more than is due under the contract

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[3] The Restatement provides:

> Where the parties have attached different meanings to a promise or agreement or a term thereof, it is interpreted in accordance with the meaning attached by one of them if at the time the agreement was made
>
> (a) that party did not know of any different meaning attached by the other and the other knew the meaning attached by the first party[.]

See Robert K. Adams, ASBCA No. 34519, 92-3 BCA ¶ 25,165 (following Restatement § 201(2) where Government made its understanding known via telex before contract signing and contractor did not respond).

while in fact insisting on more than the contract requires. This is precisely what happened here, and the evidence of that is both clear and convincing. Specifically, the ACO repeatedly placed obstacles in front of Freedom's ability to obtain progress payments and outside financing. All along, he took care to appear not to be asking for more than was due under the contract, claiming that the DAR permitted or required audits and pretending that his hands were tied by DCAA. In fact, however, the ACO was demanding more than the contract required. He knew very well that audits were not appropriate; indeed, his attorneys told him so. (JA10; JA433.) He also knew that he was not bound by DCAA's recommendations (JA526), and that some of DCAA's recommendations were wrong. (JA10) Finally, he knew that financing from DDD was not part of the parties' bargain, but he insisted on it anyway. *See* Freedom Brief at 8. This is a classic case of bad faith such as is described in *Struck Construction, supra*.[4]

In addition, this Court has stated: "[S]ubterfuges and evasions violate the obligation of good faith." *Malone v. United States*, 849 F.2d 1441, 1445 (Fed. Cir. 1988) (quoting Restatement (Second) of Contracts § 205 comment d (1981)). The facts set forth in the preceding paragraph, in Freedom's brief, and even in Judge James' decision, are overwhelming evidence that the ACO was involved in subterfuges and evasions throughout the life of the contract. Moreover, the record

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[4] For the reasons already discussed in Part II above, the Government's reliance on Judge Grossbaum's finding that the ACO did not abuse his discretion is irrelevant.

also reflects Liebman's personal animus towards Freedom's president, Henry Thomas. *See* Appellee's (Freedom's) Brief, pp. 34-36.

B. The ASBCA also erred in not finding a cardinal change.

Here, again, the Government ignores Freedom's argument and responds to a "straw man" which it sets up. As explained in Freedom's principal brief (at 22-26), this Court's predecessor has held that a cardinal change can occur even if the final product is unchanged. *Edward R. Marden Corp. v. United States*, 442 F.2d 364 (Ct. Cl. 1971). The Government argues that *Edward R. Marden* was "not the usual case." Govt. Reply Brief at 13. That may be so, but Freedom's experience also was "not the usual case," or so one hopes. No one can seriously doubt that Freedom's "entire undertaking" changed as a result of the Government's breaches. The Government admits that a cardinal changes occurs when the Government drastically alters the quality, character, and nature of work originally contemplated. *See* Govt. Reply Brief at 12. Here, the ASBCA found that:

- Freedom and the Government agreed that Freedom would need to expend $811,002 in direct labor costs. (JA8; JA141.) Instead, because of the Government's breaches, Freedom was forced to expend $2,526,746 on direct labor. (JA537.)
- Freedom's offer specifically proposed utilizing "state-of-the-art, automated equipment to assemble MREs and to track GFM and CFM, namely, Koch Multi-Vac vacuum equipment for bagging crackers and accessories more reliably . . . , Doboy continuous band sealers and double belt conveyors for MRE main assembly, and International Paper

V-2 case-forming and sealing equipment." (JA8.) Freedom's offer also included the use of a "networked, automated, building management and control system." (JA13.) As a result of the Government's breaches, however, Freedom could not finance these systems and this equipment, and was forced instead to purchase older, less efficient equipment with lower production capacity and speed that broke down frequently.[5] (JA15-16; JA34.) And, Freedom could not obtain repair services and spare parts for lack of funds. (JA160.) At times, Freedom had to perform many tasks manually.

- As negotiated, Freedom's contract was to last thirteen months, from November 1984 to December 1985, with deliveries being made in six monthly installments beginning in July. (JA8.) As a result of the Government's actions, the contract was still ongoing in June 1987, 31-½ months after award. (JA29.)

These facts demonstrate that the Government' actions constituted a cardinal change to the contract, and the ASBCA erred in not finding so.

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[5] In an incredible display of gall, the Government asserts: "To the extent that [Freedom] chose to use different equipment to perform the assembly, that was their choice." Govt. Reply Brief at 14. The ASBCA expressly found that the Government's breaches made it impossible for Freedom to obtain equipment financing. (JA13; JA34.)

C. The ASBCA erred in not finding a constructive change to the contract.

Not surprisingly, the Government's actions which constituted a cardinal change also constituted a constructive change to the contract. The Government's reply brief fails to rebut Freedom's demonstration that the same actions that delayed Freedom's performance also constructively changed the *method of performance* spelled out in the contract.[6] As set out in Freedom's Brief, Freedom's offer proposed, and the contract included, a method of performance utilizing "state-of-the-art, automated equipment to assemble MREs and to track GFM and CFM." (JA8.) Freedom's offer, and the contract, also included a "networked, automated, building management and control system[.]" (JA13.) When progress payments were not forthcoming -- which the ASBCA held was a breach -- Freedom attempted to arrange for private financing to cover its equipment acquisition. (JA11-12.) However, the Government interfered with Freedom's private financing also. (JA34.) Thus, as a direct result of the Government's interference, Freedom was prevented from using the state-of-the-art equipment that was included in its offer -- and, hence, in the contract. (JA34.) In its place, Freedom was required "to purchase less efficient equipment" (JA34) -- constructively changing the method of performance under the contract.

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[6] The ASBCA correctly found that Freedom's MRE-5 contract "consisted of the RFP, [Freedom's] offer and the Award/Contract." (JA8, FOF22.)

In denying Freedom relief under the Changes clause, the ASBCA erred by reading that clause too narrowly. *See Melrose Waterproofing Co.*, ASBCA No. 9058, 1964 BCA ¶ 4119 (entire contract is subject to Changes clause, not just the drawings and specifications). Accordingly, the ASBCA should be reversed.

D. The ASBCA erred in not awarding Freedom its lost profits and other consequential damages.

After Freedom submitted its principal brief, this Court issued an important decision that supports Freedom's claim for lost profits and other consequential damages. In *Energy Capital Corp. v. United States,* -- F.3d --, No. 01-5018, 2002 WL 1868983 (Fed. Cir. Aug. 14, 2002), this Court reaffirmed the well-established principle that:

> Lost profits are 'a recognized measure of damages where their loss is the proximate result of the breach and the fact that there would have been a profit is definitely established, and there is some basis on which a reasonable estimate of the amount of the profit can be made.'

2002 WL 1868983, at *9 (quoting *Neely v. United States,* 285 F.2d 438, 443 (Ct. Cl. 1961)). Furthermore, this Court emphasized in *Energy Capital* that even a new enterprise with no history of profits can prove entitlement to profits using the *Neely* criteria. 2002 WL 1868983, at *11 (new venture is required to demonstrate its entitlement to lost profits by showing the same elements that any business must show: (1) causation, (2) foreseeability, and (3) reasonable certainty). Freedom *has* shown those elements.

The Government *caused* Freedom's lost profits and consequential damages. But for the Government's breaches of MRE-5, Freedom *would have* received

follow-on contracts (MRE-6, MRE-7, etc.). The ASBCA found that Freedom submitted the lowest offer for the portion of MRE-7 for which it was eligible (JA26), and Freedom's contracting officer has stated in a sworn affidavit filed in United States District Court that "[i]f a bidder responding to a given [MRE] solicitation is determined to be eligible, and responsible, and has submitted the low bid for supply of the solicited item or items, *he will receive the award*." (JA440 (emphasis added).) The ASBCA also found that a pre-award survey for the MRE-7 procurement recommended a complete award to Freedom of an MRE-7 contract. (JA23.) Thus, as the low responsible bidder, Freedom should have received an MRE-7 award. The Government itself has acknowledged in internal documents that Freedom, as the low bidder, would have received an MRE-7 award no matter how many awards the Government chose to make. (JA441.) Only after the Government caused Freedom to "run out of financial resources and [to] shut down production" did the pre-award survey team reverse itself and recommend that no award be made. (*See* JA26.)

Freedom's lost profits and consequential damages were the *foreseeable* result of the Government's breach. The ASBCA found that MRE producers had no non-MRE business. (JA2.) In fact, Freedom's complete dedication to the MRE program was *required* by the Government. (JA514; JA517.) And, the Government knew that "Freedom was a new facility self-established solely for the manufacture of MRE for the Government[,]" (JA407; JA408), and that "the existing ration assemblers exist only to satisfy military requirements." (JA449). Thus, the Government knew that its actions would put Freedom out of business. (JA586.)

Finally, Freedom's lost profits and consequential damages were *reasonably certain* at the time of the breach. Aside from the certainty that Freedom would have received an MRE-7 contract but for the Government's breaches, there is overwhelming evidence in the record that should have led the ASBCA to find that Freedom had "reasonable expectations" of future awards. Only MRE IPP participants are even permitted to offer in response to MRE solicitations, and Freedom had the largest capability of any contractor. (JA506; JA511.) Moreover, Freedom was included in the D&F for MRE-8 (the last D&F before Freedom closed its doors as a result of the Government's breaches). (JA26.) And, clearly the Government's intention in awarding the MRE-5 contract was to create a long-term supplier, not simply to award a one- or two-time contract. (*See, e.g.*, JA531.) Indeed, in the past 15 years, every MRE Planned Producer has received a contract every year. (JA504.) Finally, Freedom was expressly told by the Government during MRE-5 negotiations that it should lower its price in the expectation of recovering some of its costs on future MRE contracts. (JA427-28.)

In the words of the court in *Locke v. United States*, 283 F.2d 524 (Ct. Cl. 1960), Freedom's "chance for profit . . . is fairly measurable by calculable odds and by evidence bearing specifically on the probabilities[.]" That evidence includes the ASBCA's implicit finding that Freedom's anticipated profit rate for MRE-5, i.e., 14.88%, was reasonable. (*See* JA43, JA142.) It also includes DOD documents in the record showing that MRE assemblers have historically averaged profit rates of 9% or higher, and in all cases, higher than the profit rates realized by commercial food producers. (JA446.)

Because Freedom easily meets all of the criteria set forth in *Energy Capital, supra*, the ASBCA erred in not awarding Freedom lost profits.

E. The ASBCA erred in denying Freedom's additional costs.

In its principal brief, Freedom demonstrated that it is entitled to recover its "full additional costs resulting from the combined effects of the Government's misconduct" and that the additional costs to which Freedom is entitled are to be "measured by the difference between what it cost Freedom to perform and what *it would-have* cost Freedom to perform but for the Government's misconduct." *See* Freedom's Brief, at 38-43. That measure is the fundamental and proper measure of an equitable adjustment under the Changes clause for changes, actual or constructive. *Bruce Construction Corp. v. United States*, 324 F.2d 576 (Ct. Cl. 1963). It is also the proper measure for the equitable adjustment to which a contractor is entitled for its additional costs attributable to multiple changes or other events for which the Government has cost responsibility. *See* Freedom's Brief, *id.*

There is no mention in Freedom's brief, let alone a discussion, of the so-called "total cost" method of measuring an equitable adjustment. Thus, Freedom was astounded by the Government's characterization of Freedom's measure of the equitable adjustment to which it is entitled as being on the ill-favored "total cost" basis. *See* Govt. Reply Brief, at 19: "The total cost methodology *used by FNY to quantify its damages* has been approved by this Court only as a theory of last resort." (Emphasis supplied.) Freedom is unable to understand why the Government wastes over a page and a half of its brief discussing what is wrong with the "total cost"

method and the narrow conditions under which it has been permitted to be used by courts, when Freedom never mentioned, let alone claimed under, that method.

Apparently the Government does not understand the difference between the "total cost" method and the "would-have-cost" method, which is the *correct* method for pricing equitable adjustments. In any case, the Government's comments on this point are totally irrelevant to Freedom's argument. Freedom is entitled to be compensated for the full amount of its additional costs caused by acts of the Government, as measured by the difference between Freedom's actual costs and what it *would have cost* Freedom to perform the contract *but for* the events for which the Government had cost responsibility. These costs to which Freedom is entitled include the loss of efficiency suffered by Freedom resulting from the Government's breaches and other acts and omissions. *See* Freedom's Brief, at 41-43.

F. The ASBCA erred in not awarding additional interest.

The Government admits that Freedom's entitlement to additional interest is inextricably linked with the validity of Mod. 25. Govt. Reply Brief at 21. For the reasons discussed above, the ASBCA correctly held that the Government breached Mod. 25, and that Freedom's release of its certified claim was not valid. Accordingly, the ASBCA should have awarded Freedom interest from the date of its original claim.

As for the Government's claim that Freedom should have pursued this issue at the ASBCA, the fact is that Freedom did do so, requesting the Board to award "appropriate amount of Contract Disputes Act interest." (JA589-90.) It never occurred to Freedom that the ASBCA would err in calculating that interest. But

even if Freedom had not raised the issue below, the Supreme Court has stated, in the very case relied on by the Government, that there are circumstances in which a federal appellate court is justified in resolving an issue not passed on below, as where the proper resolution is beyond any doubt. *Singleton v. Wulff*, 428 U.S. 106, 120 (1976). Since the Government admits that Freedom's entitlement to interest is dependent upon the validity of Mod. 25, the interest issue is one where the proper resolution is beyond any doubt. Accordingly, this Court may rule on the issue.

CONCLUSION

For the reasons set forth in Freedom's Brief, and as further expounded herein, this Court should grant Freedom the relief requested in its initial brief.

September 17, 2002

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 17th day of September, 2002, he caused two copies of the foregoing APPELLEE'S REPLY BRIEF to be served by hand and two copies to be served by United States first class mail, postage prepaid, on the following:

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CERTIFICATE OF COMPLIANCE
WITH TYPE-VOLUME LIMITATION

Pursuant to F.R.A.P. 32 and Fed.Cir. R. 32, Appellee's counsel certifies that this brief, including footnotes, contains 4,339 words.

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