MRE Contract # DLA13H-85-C-0591 Awarded 15 Nov. 84

10 U.S.C. 2304(a)(16)

-- *Industrial Preparedness Planning & Mobilization*

Exception 16 to Competition in Contracting Act

The contract was awarded under the auspices of Industrial Preparedness Planning and Mobilization.

10 U.S.C. 2304(a)(16).

This method of contracting effectively removed it from open competition, and restricted any award to a limited number of suppliers. The management and administration of a mobilization contract is subject to a different type of scrutiny. As the courts have made note, in considering cases of this sort:

> "Mention should be made of an important difference between an Industrial Mobilization Preparedness contract and an ordinary supply contract. The sole purpose of an ordinary supply contract is to obtain currently needed supplies, and ordinarily there is a close relationship between the delivery schedule of the contract and the time when the supplies are needed. In contrast, the completed supplies to be delivered under an Industrial Mobilization Preparedness contract are not likely to be currently needed at all, and the delivery of such supplies is purely incidental to the main purpose of the contract, which is **to develop** a source of supply to be available in time of national emergency."

Appeal of American Radio Hardware Co., Inc., ASBCA No. 3069, 57-2 BCA 1438.

ARGUMENT: This avowed contracting purpose was intentionally and discriminatory ignored by the Government's agents and officers, who sought not to develop the company, but to destroy it and remove it from the exclusive group of mobilization suppliers.

Government's breach of contract

Wrongful termination of contract

Government's conduct throughout the administration of the contract was repeatedly punctuated by bad faith, deception, arbitrary and capricious behavior, and disparate treatment.

Contract DLA13H-85-C-0591 was awarded on 15 November 1984. It was negotiated and executed and awarded under the authority of the then-existing Defense Acquisition Regulations (DAR), and the Industrial Preparedness Planning Program (10 U.S.C. 2304(a)(16), now known as 10 U.S.C. 2304(c)(3)).

The Contract contained the following Changes clause (Standard Form 32: General Provisions (Supply Contract):

> The Contracting Officer may at any time, by a written order, and without notice . . . make changes, within the general scope of this contract, in . . . specifications, . . . method of shipment or packing . . . and place of delivery. If any such change causes an increase or decrease in the cost of, or the time required for the performance of any part of the work under this contract, . . . an equitable adjustment shall be made in the contract price or delivery schedule, or both, and the contract shall be modified in writing accordingly. . . . [N]othing in this clause shall excuse the Contractor from proceeding with the contract as changed.

The Government Delay of Work clause (DAR 7-104.77(f)) (1968 Sep) was also a part of the Contract:

> If the performance of all or any part of the work is delayed or interrupted by an act of the Contracting Officer in the administration of this contract, which act is not expressly or impliedly authorized by this contract, or by his failure to act within . . . a reasonable time . . . , an adjustment (excluding profit) shall be made for any increase in the cost of performance . . . caused by such delay or interruption and the contract modified in writing accordingly.

The Contract was governed, in part, by application of the Contract Disputes Act of 1978 (P.L. No. 95-563, 41 U.S.C. § 601 et. seq., effective March 1, 1979).

THRESHOLD QUESTIONS FOR BRINGING CLAIM

Modification P00025

Courts and Boards of Contract Appeal have held that "the action of the parties in agreeing upon a new delivery schedule eliminates from consideration the causes of delay occurring prior to such agreement."

> *Orion Electronic Corp., ASBCA No. 18918, 80-1 BCA ¶14,219, at 70,010 and cases cited therein.*

The rationale underlying this view is that such a modification acts as a "substituted contract" that discharges any existing duty or liability the Government may have owed for the consequences of any earlier delays.

> *King Point Mfg. Co., ASBCA No. 27201, 85-2 BCA ¶18,043, n.11 at 90,575-76; REINSTATEMENT 2ND OF CONTRACTS (1981).*

A substituted contract-- like any contract-- must comply with the requisite conditions of any enforceable agreement. It must be voluntarily entered into, be supported by consideration and evidence a meeting of the minds of the parties thereto.

> *Cite to Restatement or other hornbook law or case*

Modification P00025 ("Mod P-25") can be a "substituted contract" only to the extent that it includes the "side agreement" reached between representatives of Freedom and the Government and reduced to writing in the covering letter to the Mod.

> *See Exhibit No. 1: Letter from Freedom to DLA (Raymond Chiesa), dated May 13, 1986. This letter was first directed to PCO Bankoff, but his counsel, Bob Appelian, advised that it should be sent, instead, to Raymond Chiesa, the person responsible for negotiating the agreement. The letter to PCO Bankoff was then withdrawn and resubmitted with the substituted name and office of Ray Chiesa, DLA in place.*

This agreement was first memorialized by Attorney David M.F. Lambert in a letter to Raymond Chiesa, Executive Director of Contracts at DLA, **dated 23 days before Mod P-25 was signed**.

> *Exhibit No. 2: Letter from Attorney David M.F. Lambert to Raymond Chiesa, Executive Director of Contracts at DLA, dated May 6, 1986.*

Lambert notes in his letter that he is enclosing a draft copy of

*"**the Freedom letter** which will be sent to the Contracting Officer tomorrow **along with a draft of the Mod** with some minor changes in schedules. **I understand they have been discussed with Frank Bankoff**."*

He goes on to say, "Col. Francois and I appreciated the manner in which you and Karl worked with us."

Argument: It is clear from Lambert's letter that 1) the substance of the side agreement was being reduced to writing, and 2) that it had been referred to and fully discussed with the Contracting Officer prior to execution of the contract modification. It is also clear that the substance of this side agreement was being kept within the context of a "Freedom letter," and separate from the actual modification itself.

So, without the side agreement in place, the "substituted contract" clearly fails for lack of mutuality. Without a meeting of the minds, the modification is invalid, and all pre-existing claims would be immediately revived.

Modification P00028

On July 11, 1986, the Contracting Officer issued a "cure notice" for anticipated failure to meet the required July 31 delivery increment.

Exhibit No. 3: Letter from PCO Bankoff to Freedom, dated July 11, 1986.

The company responded in writing on July 23, pointing out that the failure was due to Government delay in providing Government Furnished Material (GFM):

"Freedom has been shut down since 17 July for lack of GFM jelly * * *. [O]ur GFM report to you of 30 June clearly showed that we were short of jelly, and other GFM items, and constituted sufficient notice to you to obtain the needed items to maintain our production. Further, on July 15, we called to remind you of said

> critical shortages. * * * Had we had GFM jelly from 17 July on, we would have produced an additional 49,500 cases, thereby exceeding our July requirement, thus putting us ahead of schedule on production."

ARGUMENT: Modification P00028 grew out of this exchange. It represented an attempt to fix a specific problem caused by a specific condition. It was signed by Freedom on August 6, 1986. Like Mod P-25, it contained an extension in date of delivery. But where Mod P-25 contained broad and sweeping language of release, Mod P-28 was intended to have a much narrower and limited scope. It addressed only the time lost by the company as a result of the Government's failure to timely deliver needed GFM. The modification itself contains restrictive language:

> "WHEREAS, Contractor's delinquency or anticipated delinquency is partially excusable due to lack of Government Furnished Material jellies for eight production days; * * *
>
> The Contractor hereby acknowledges that it has no claim whatsoever for any consideration or damages, monetary or otherwise, **resulting from lack of Government Furnished Material jellies during the period 16-28 July 86."** (Emphasis added.)

Mod P-28 was clearly intended by both parties to have a very specific application and should therefore operate as a bar only to the claim for late delivery of GFM jelly. No other pre-existing claims are affected. To characterize this agreement as having a wider and more far-reaching application would not be consonant with the intent of the parties at the time of the accord.

The determination of whether a modification acts as a substituted contract (or accord and satisfaction) rests on the intention of the parties. 6 Corbin on Contracts, Sec... 1293, at 190, 199.

ARGUMENT: 1) Adjustment of the delivery schedule was required by the Contracting Officer under threat of termination for default; 2) the action threatened was not lawful, in the sense that the company's anticipated inability to deliver the subject increment was directly attributable to a lack of Government Furnished Material; and 3) had the company not signed, the threatened termination for default would have caused it irreparable harm.

These three elements embody the approach used by the Court in Systems Technology Associates, Inc. v. United States, 699 F.2d 1383 (1983). So that to the extent Mod P-28 can be deemed to constitute an accord and satisfaction, it is voidable on the grounds of duress.

Modification P00029

Mod P-29 was also intended to have limited application. It, too, resulted from the failure of the Government to timely deliver GFM. As noted by the ACO:

> "Modification P00029 was faxed to Freedom for signature 2 Oct. 86. The modification revises the delivery schedule as a result of delays encountered in receipt of GFM."

Exhibit No. 5-A, Internal Memorandum by ACO Liebman dated 26 Sep 86.
Exhibit No. 5-B, Internal Memorandum by ACO Liebman dated 3 Oct 86.

ARGUMENT: Since both parties assumed Mod P-25 to be valid, the only time period within the contemplation of the parties to which the company's waiver of rights under Mod P-29 could apply was the time period between execution of the two modifications P-25 and P-29. And would not therefore apply to any prior claims that might be revived as a result of Mod P-25 being declared invalid or otherwise infirm.)

ARGUMENT: Beyond the question of narrowed application, Mod P-29 was a graphic example of Government duress. By letter dated October 7, 1986, PCO Bankoff made clear to the company that

> "[a]s we discussed on 26 September 1986, **upon execution of modification P00029,** the current progress payment ceiling for the subject contract, per modification P00028, will be $14,900,725.00 based on delivery of 482,058 cases. To date you have been paid $14,178,838.00. This leaves a balance of $721,887.00 available to you. This amount will be paid to you by DCASMA N.Y. against progress payment requests submitted by Freedom N.Y., Inc."

Exhibit No. 6: Letter from PCO Bankoff to Freedom, dated October 7, 1986.

Even though the $721,887 was owed to the company under the terms of Mod P-28, the company had to execute Mod P-29 to receive it.

In addition to a revised delivery schedule, Mod P-28 provided for an increase in progress payments:

"The limit on progress payments is hereby increased over it's current ceiling of $13 million as follows:

Completion and acceptance of 330,000 cs ceiling is $13 million
Completion and acceptance of 410,000 cs ceiling is $14 million
Completion and acceptance of 490,000 cs ceiling is $15 million
Completion and acceptance of 570,000 cs ceiling is $15.8 million

"This schedule provides for an increase in the progress payment ceiling by $1,000,000, $1,000,000 and $800,000, respectively, for each delivery increment of 80,000 cases.

"If at the time of normal progress payment by the ACO the Contractor has completed only a portion of the 80,000 case delivery increment, the ACO is authorized to make a protanto progress payment based on this partial delivery and proportionate to the schedule. Upon completion of the remainder of the delivery increment, the ACO may complete the progress payment."

Further evidence of collusion and coercion is found in two internal memorandums authored by ACO Liebman.

Reference Exhibits 5A and 5B, at fn 9.

The first, dated September 26, 1986, makes note of the fact that

> "The PCO and Freedom are currently negotiating an extension in the delivery schedule as a result of stock outage of GFM item, Fruit Mix and shortage of GFM item, Potato Patties. **The PCO is trying to get a waiver of claims against the Government** as well as monetary consideration for GFM item, Crackers damaged at Freedom."

See Exhibit No. 5-A, at fn 9.

Two points.

One, the ACO's internal memorandum makes clear that the Government was responsible for the delay.

Two, **despite the fact that the contractor was legitimately entitled to an equitable adjustment**, the PCO "tried to get a waiver of claims."

> *Where a contractor's performance is delayed or interrupted by an act (or failure to act) of the Contracting Officer, "an adjustment (excluding profit) **shall be made** for any increase in the cost of performance."*

The language of the Government Delay of Work clause is mandatory and not permissive in instances of equitable adjustment.

The PCO extorted the contractor's agreement to waive its claims in exchange for payment of monies already owed.

The ACO's internal memorandum of October 3, 1986, shows this:

> "**Per PCO request** 1600 hrs, 3 Oct. 86, PP #21, in the amount of $700,000, is being **held in abeyance pending Freedom's execution of Mod P00029**. This is expected to be accomplished during week of 6 Oct 86."

See Exhibit No. 5-B, at fn 9.

Mutual assent on the part of both parties is essential to the creation of any binding agreement.

Fruehauf Southwest Garment Co. v. United States, 126 Ct.Cl. 51, 111 F.Supp 945 (1953); Monroe v. United States, 35 Ct.Cl. 199, 206; aff'd,. 184 US 524; Restatement of Contracts, § 3.

ARGUMENT: When assent is lacking on the part of one side, we have nothing more than the acceptance by one party of the views of another.

Since the contractor acted under duress in executing the supplemental agreement, what resulted was no different than a unilateral decision of the contracting officer.

What was incorporated into the agreement was not a compromise, but merely the contractor's unwilling adherence to a decision of the Government's authorized agent.

Monroe, supra, at 64.

Beyond doing what it did-- accepting short-changed and extortion-produced payments under protest, the company was in no position to argue.

See Exhibit No. 7: Letter from Freedom (Patrick J. Marra, CFO) to PCO Bankoff, dated September 22, 1986, complaining about the actions of the local DCASMA office and protesting a recently-approved "partial payment" of $311,446 against outstanding progress payment requests of

$2,315,927. "We protest this partial payment and accept it under duress, without a reasonable choice in this matter."

Mr. Marra noted that despite a 95% progress payment clause as late as the date of his letter, "the Government has released only 76% of our claimed incurred costs."

Abandonment of performance was not a viable option. Kept performing because of deceptive and fraudulent actions of the Contracting Officer.

Exhibit No. 8: Amendment 0005 to Solicitation DLA13H-86-R-8359 (MRE-7). Issued two weeks prior to execution of Mod P-29, on September 25, 1986

Exhibit No. 9: Letter from PCO Bankoff to Freedom, dated October 10, 1986.

Exhibit No. 10: Letter from Bankers Leasing to William Stokes, Financial Analyst, at DCASMA).

Mod P-29 was in part the result of this deception.

Paragraph 3.a. of Exhibit No. 8 reads, in pertinent part:

"Offerors will be evaluated in the following manner.

The 40% portion will be awarded * * *.
The 31% portion will be awarded * * *.
The 18% portion will be awarded * * *.
The final 11% will be awarded * * *."

This increase from three portions to four signalled Government living up to its Mod P-25 promise of future business. As early as April, 1986, PCO Bankoff advised the company that "**it is anticipated** that" four maximum share quantities would be awarded at 41%, 30%, 17% and 13% share levels.

Then, on October 10, 1986, PCO Bankoff advised the company by letter of same date that Freedom had been certified as capable of producing "the monthly allocated quantity of 700,000 cases of MRE ***. Your continued support in the Industrial Preparedness Planning Program is greatly appreciated."

See Exhibit No. 9, at fn 18.

Following this letter, and to demonstrate its support of the program effort, Freedom's lender made clear its intent to provide required financing in the form of a $6 million line of credit.

See Exhibit No. 10, at fn 18.

When the local DCASR office conducted a resurvey of the contractor's operation in November 26, 1986, the survey team

noted that the contractor was busy making modifications to its final assembly production area in anticipation of receiving the agreed-upon follow-on contract.

See Resurvey # S3310A6NO21PN, dated 4 Dec 1986.

But while the PCO was holding out the carrot stick of future awards, the ACO was refusing-- with the apparent consent of the PCO-- needed (and agreed upon) monies.

Mod P-29 required final delivery of all 114,528 MRE-6 configuration cases (to total 620,304) by December 5, 1986.

See the Mod

By November 13, 1986, the company had produced and the Government had accepted 512,462 cases of MRE.

See the production/MRE delivery records

Under the formula of Mod P-28, Freedom's progress payment entitlement had risen to $15,274,620.

> $15 million was the stated entitlement under Mod P-28 at 490,000 cases. At 570,000 cases the entitlement rose to $15.8 million. The $800,000 increase was to be spread over the additional 80,000 cases, for a progress payment increase based on $10 per case. The additional 22,462 cases produced mandated a concomitant increase of $224,620 in progress payment entitlement, for a total entitlement to that point in time of $15,224,620. Where is the flaw here? Can the government argue that it did in fact price the additional 114,000 cases-- at $10 per case? If so, could it do that without agreement of contractor?

The Government continued its breach of the contract by refusing to live up to the terms of Mod P-28, and paying nothing on progress payments legitimately requested.

WRONGFUL TERMINATION FOR DEFAULT

Contract DLA13H-85-C-0591 was terminated on June 22, 1987, for "failure to perform inventory control requirements and to make progress."

See Exhibit No. 11: Letter from PCO Bankoff to Freedom, dated June 22, 1987.

Where a contract is terminated for failure to make progress, the Government must be able to prove that **"on the basis of the entire record"** the contractor could not perform the contract within the time remaining for contract performance, and that there was no excuse for such nonperformance.

Appeals of Skip Kirchdorfer, Inc., ASBCA No. 32637, 91-1 BCA ¶23,380; RFI Shield-Room, ASBCA Nos. 17374, 17991, 77-2 BCA ¶12,714, at 61,735; also, Lisbon Contractors, Inc. v. United States, 828 F.2d 759 (Fed.Cir.1987).

Nonperformance is excusable when repeated delays and work interruptions caused by the Government prevents the contractor from performing.

Citation

Nonperformance is excusable when the Government fails to pay progress payments due and owing, or otherwise breaches the contract agreement.

Citation

And when nonperformance is found to be excusable, the Termination for Default is converted to a Termination for Convenience of the Government, **unless bad faith or a clear abuse of discretion is shown, entitling the contractor to breach of contract damages.**

See Kalvar Corp. v. United States, 543 F.2d 1298, 211 Ct.Cl. 192 (1976); John Reiner & Co. v. United States, 325 F.2d 438, 163 Ct.Cl. 381 (1963), cert. den., 377 U.S. 931, 84 S.Ct. 1332, 12 L.Ed.2d 295 (1964).

A termination for default may also be overturned upon a showing of **discriminatory treatment**,

Laguna Construction Co. v. United States, 88 Ct.Cl. 531 (1939).

or when it can be shown that the Contracting Officer did not exercise his independent discretion in making the termination decision.

Schlesinger v. United States, 182 Cl.Ct. 571, 590 F.2d 702 (1968).

ARGUMENT: Termination was improper because the prime, if not sole, source of the company's failure to perform inventory requirements and to make progress was the government, itself.

I. *Excusable delay*

a. "as of 8:00 a.m. today, Freedom, N.Y., Inc. has received all of the necessary Contractor Furnished Materials (CFM) to begin producing cases of MRE's for the MRE-6 configuration of Contract DLA13H-85-C-0591. We have completed the production of the 505,546 MRE-5 configuration portion of said contract.

Effective October 22, 1986, Freedom's final assembly production of cases of Meals, Ready-to-Eat, Individual is shut down for lack of GFM. * * *

We are presently producing cracker packets and accessory packets but have had to layoff (sic) production workers equivalent to the number of workers in final assembly...."

b. Delay in approving award of contract under MRE7

Government knew that its award was a necessary prerequisite to the company's continued receipt of financing from its lender.

By not making the promised award, the Government knowingly and intentionally stripped the company of its outside financing source.

c. The Government agreed to provide financing for the contract in the form of 95% progress payments. Failure to pay was intentional, and the company's failure to make progress under the MRE-6 portion was a direct result of this withdrawal of contract financing.

d. This failure to pay, and to promptly deliver MRE-6 conforming GFM to the job site, effectively suspended the contractor's performance, without its fault or negligence.

II. *Government's Breach of Contract-- Mod P00025*

Original contract for 620,304 cases-- $17,197,928.40.

January 29, 1986, partial t for d, Mod P-20, 114,758 cs removed reducing delivery requirement to 505,546 cases.

Contract price decreased from existing $16,997,928.41 to $13,816,262.86. This was the position of the contract at the time negotiation of Mod P-25 began.

The Government made the following promises, *inter alia*, during the negotiations leading up to Mod P-25:

1) to process a request for a guaranteed loan from Freedom's lender,

2) to maintain the company in the MRE program (provided the company was "otherwise qualified"), and

4) to assist the company in obtaining traypack and pouch contracts under the SBA 8(a) program.

As originally prepared, the claim sought $5.7 million for increased costs of performance. As part of the "side agreement" discussions, the claim was reduced by company negotiators to the $3.4 million figure. This was done "to show the company's good faith in beginning negotiations." To the extent this claim covers identical areas of cost increase, the original claim figures are used.

At the specific request of the Government's representatives, the negotiated side agreement was to be kept separate from the modification to be signed.

Mod P-25, as drafted by officials of DLA, was signed by Freedom's President, Mr. Henry Thomas, in the presence of the Contracting Officer, Bankoff on May 29, 1986.

plane ticket receipt, etc.

It was attached to a covering letter, also signed by Mr. Thomas, and directed to Raymond Chiesa, PCO Bankoff's superior and the Executive Director of Contracting at DLA.

Mr. Thomas at that place and time made clear to PCO Bankoff that if for any reason the side agreement as understood and expressed was not in fact the actual agreement, his signature should be considered withdrawn. After receiving verbal assurance from PCO Bankoff that his wishes in this regard would be respected, he signed and handed both the cover letter and the attached modification to the PCO, who subsequently signed without ever indicating the Government did not have the same understanding.

As an inducement to sign the modification, the Government deceptively and fraudulently took steps-- while negotiations were on-going-- designed to convince the company that the side agreement was in fact being acted on.

Exhibit No. 13: ACO Memorandum dated April 1, 1986.

Exhibit No. 14: DLA memo by Samuel Stern, Chief, Contract Mgt Div., dated 4 April 1986.

Exhibit No. 15: Telex from PCO Bankoff to Freedom, dated April, 17, 1986.

Exhibit No. 16: Solicitation DLA13H-86-R-8359, p. 98 of 135).

The chronology of relevant events is important.

January 29, 1986-- PCO issues telex advising that Solicitation to be issued indicating only 3 planned producers would participate in MRE program.

March 21, 1986-- Company's claim for $3.4 million (reduced from $5.7 million) formally filed with PCO. Freedom and Government commence negotiations.

March 26, 1986-- at meeting in Philadelphia, Freedom flatly refuses Government's proposed settlement offer to settle-- which offer is identical to language of Mod P-25; Freedom refuses to give up its rights under the claim.

See Exhibit No. 12: Telex from PCO Bankoff to Freedom, dated January 29, 1986. (Refusal noted in Exhibits 13 and 14.)

April 17, 1986-- Lambert negotiations in fourth week; PCO advises in writing that Government "anticipated" going from three planned producers to four. (Exhibit 15).

May 16, 1986-- PCO issues Solicitation DLA13H-86-R-8359 saying in writting four planned producers would participate. (Exhibit 16).

On May 20, the company received a call from Lt. Col. Doug Menarchick, an active duty officer assigned to then-Vice President Bush's staff, advising that according to DLA, agreement (on the side issues) had been reached, and were being confirmed in writing.

See Exhibit No. 17: Chiesa Memorandum for Record, dated May 15, 1986.

Exhibit No. 18: Letter from Raymond Chiesa to Col. Menarchick, dated May 19, 1986.

Chiesa admitted the existence of the side agreement, and memorialized its existence in at least two writings. *<< Impeachment issue. He also denied any other agreement of any kind.*

Within a couple of days, Lambert and Francois followed with a report that the agreement (as constituted in the covering letter) had been struck, and Mod P-25 was subsequently signed.

As late as November 1986, the contractor was still requesting prompt action on the award of contract under MRE-7.

See Exhibit No. 19: Internal Memo from Freedom's CFO to President, dated November 10, 1986.

Exhibit No. 20: Letter from Freedom to PCO Bankoff, dated November 12, 1986.

The contractor is seen here to once again have occasion to complain about the nonpayment of progress payments by ACO Liebman, who's verbalized position per Exhibit 19 was that he would not make additional payments until "either [the lender] shows additional financial support or DPSC awards a contract."

The Government's reversal, however, left the company struggling to continue performance under the very terms and conditions that the company expressly rejected before negotiations began.

See Exhibits 13 and 14, at fn 34.

In the interpretation of contracts, the intention of the parties is paramount.

North American Philips Co. v. United States, 358 F.2d 980 (Ct.Cl. 1966); Chase & Rice, Inc., 354 F.2d 318 (Ct. Cl. 1965); 4 Williston on Contracts §601 (3rd ed. 1961).

This intention is manifested by the words used in the contract and by the surrounding circumstances.

Corbetta Construction Co. v. United States, 461 F.2d 1330 (Ct.Cl.1972); Hayes International Corp., 79-1 BCA ¶13,596 (AS); Pure Water and Ecology Products, Inc., 77-2 BCA ¶12,718 (AS).

"[M]eaning can usually be given to writings only on consideration of all the circumstances, including the prior negotiations between the parties."

Appeal of Michael Guth, ASBCA No. 22663, 80-2 BCA ¶14,572.

As the Court of Claims said in *David Nassif Associates v. United States:*

> "[I]t is not the writing alone which attests to its own finality and completeness but the circumstances surrounding its execution, including the negotiations which produced it."
>
> *557 F.2d 249, 256 (Ct.Cl. 1977).*

ARGUMENT: Mod P-25 is effective **because** it includes the understanding of the side agreement as communicated to the Contracting Officer. Without the side agreement there was ***no meeting of the minds***.

Even without application of the parol evidence rule, the language of total release found in the Mod is not dispositive, because the Contracting Officer was made aware of the contractor's understanding, and not only said nothing to the contrary, but signed the modification based on that

understanding. In doing so, he assented to the "expanded" agreement and bound the Government thereto.

In a case involving somewhat similar circumstances, a contractor **signed a release purporting to "remise, release and forever discharge the Government, * * * of and from all liabilities, obligations and claims whatsoever in law and in equity under or arising out of said contract."** At the time the contractor delivered the modification he verbally notified the Contracting Officer that he had not intended to waive the company's claim by executing the release. Several days later, he followed up in writing, advising that his failure to make the exclusion clear was inadvertent, **and that if the Government would not accept the release with such a condition, it should be considered as withdrawn.** The Board held that the Government, **having been alerted to the nature of the release, was under a duty to make its position known to the contractor at the time, and where it failed to do so, acknowledged that it viewed the release in the same light as that viewed by the contractor.**

> *Leonard Blinderman Construction Co., (1974) ASBCA No. 18946, 74-2 BCA ¶10,811.*

In our case, both verbal and written notification were provided to the Government **both prior to and at the time of delivery and execution.** If the Contracting Officer was not in agreement with the expanded terms of the agreement, he was under a duty to make his position known-- by telling the contractor he did not agree, or by not signing the Modification.

With his execution of the document, however, the side agreement was effectively merged within the terms of the modification, and the Government became obligated thereunder to live up to its promises, including the award of future contracts.

As merged, this agreement formed the complete and total terms and conditions of the parties' substituted contract. Any other interpretation would fly in the face of both the facts and the law.

> *Leonard Blinderman Construction Co., (1974) ASBCA No. 18946, 74-2 BCA ¶10,811.*

The Government's failure to fulfill its Mod P-25 commitments constituted a material breach of its agreement with the contractor.

> *it is important to point out, that in exchange for the Government's long-term commitment to Freedom as one of the mobilization base planned producers, the loan was voluntarily agreed to, for in order for a*

guaranteed loan to be paid back, Freedom would have to be maintained consistent with the mandate of 10 U.S.C. 2304(a)(16).

It was only later that the company came to see Mod P-25 in its true and proper light-- that it was in fact the product of duress, bad faith and deceit. Should the modification for any reason be deemed not to include the side agreement, it is clear that grounds also exist to affirmatively argue that it is not the sort of bilateral agreement ordinarily contemplated within the meaning of a "substituted contract," and may not then be used by the Government to bar the company's claims for things occurring prior to its execution.

See Appeals of E.L. David Construction Co., Inc., ASBCA Nos. 29225, 34787, 89-3 BCA ¶22,140, where the Board called the Government's position both "untrue and unfair," after finding "that in our judgment the Government took advantage of appellant during the negotiations which led to Modification P00002."

In addition to the side agreement, the Government settled the contractor's claim by increasing the contract price by $3,381,666 of the $3,481,768 claimed, (with a resulting per unit price of $34.01), **and**

by adding back the 114,758 cases taken under Mod P-20, **at a price to be later determined and definitized by the ACO.** The specific contract language states that:

> WHEREAS Freedom has asserted and certified a claim against DLA in the amount of $3,481,768 in addition to the original contract price of $17,197,928.40 resulting from the actions on the part of DLA and
>
> WHEREAS DLA disputes the validity of that claim, ***
>
> NOW, THEREFORE, in consideration of these premises and pursuant to the authorities contained within the Contract Disputes Act, 41 U.S.C. 601 et. seq., the parties consent and agree to the following.
>
> * * *
>
> 1. The contract delivery schedule and quantity terms shall be amended as follows:
>
> a) The 114,758 cases eliminated from the contract as a result of prior partial terminations for default shall be reinstated in their entirety. The 114,758 cases shall be manufactured and delivered in MRE VI configuration, i.e., in accordance with DLA13H-85-R-8457, as amended, with contractor furnished material as set forth on page 14 of such solicitation. **Price adjustment, if any, <u>to be determined</u> in accordance with the Changes Clause of the**

> **contract. Definitization shall be accomplished by the cognizant ACO.**
>
> 4. The amounts of consideration furnished to the Government by Freedom . . . for modifications P00018 dated 15 November 1985 and P00011 dated 14 June 1985 are hereby rescinded and **the contract price is thus increased by $200,000.00 to $17,197,828.41.**

The 505,546 case requirement was fulfilled on November 5, 1986. The company became entitled to the full $17,197,828.41 for product delivered. The ACO never paid this amount, and the $1,242,544 balance due is still owing and payable.

On the same date, November 5, 1986, the company began producing the 114,758 add-on cases under the MRE-6 configuration as required. The ACO never definitized the price adjustment due, so the contractor is entitled to be paid at either the original price per case ($27.725) under which the MRE-5 cases were to be produced or the new per case price of $34.01 established by P-25.

Application of this rate would have entitled the contractor to the minimum sum of $3,181,666 for the 114,758 add-on cases. Profit would have totaled $477,250, based on the 15% profit rate set under the MRE-5 portion.

The company was attempting to fulfill its contractual obligations under the MRE-6 case requirement when the Government's failure to make payments caused it to stop all work. Lost profit of $477,250 owed $191,746 for 6,916 cs delivered.

III. *Breach of Contract-- Mod P00028*

Mod P-28 signed by PCO on August 7, 1986. By October 14, 1986,490,038 cases produced and accepted. Actual delivery to cold storage on October 16, 1986 under FNY0286. Progress payment entitlement, according to Mod P-28, was automatically set at $15 million. The ACO failed and refused to make the additional payment as required by the modification, saying instead that "the ceilings in Mod P-28 are not mandatory."

> *See Exhibit No. 21: Internal Memo from Freedom's CFO to its President, dated November 5, 1986, memorializing telephone conversations with the ACO). In this series of conversations, the company was first advised on October 25/27 that the ACO would have to discuss release of the pending progress payment with PCO Bankoff, in connection with DPSC's plans for award of MRE-7.*
>
> *On October 29, ACO Liebman advised that he was suspending further payment for deliveries made, but would not and was not obligated to put this decision in writing. He further advised that he had made no*

decision on releasing the progress payment, and cited DAR Appendix E as his authority for limiting the Government's exposure.

On November 5, ACO Liebman advised he would not make any further progress payments, notwithstanding the plain wording of Mod P-28, and further advised that PCO Bankoff was in agreement with this course of action.

If, in fact, the ceilings were not mandatory, this should have worked in favor of the contractor and not against it. For on October 14, 1986, only 15,508 cases were left to be delivered under the 505,546 MRE-5 configuration. This portion of the contract was then 97% complete. Notwithstanding the 95% progress payment clause, the ACO never paid more than $14.6 million, or 84% of the MRE-5 contract price, in progress payments.

III. Failure to establish reasonable delivery date-- Mod P00030

By November 14, 1986, some 6,916 MRE-6 cases had been completed, bring the total of all cases delivered to 512,462. The Government's unwavering refusal to make contractual payments rendered continued production impossible.

To the extent the contractor can be said to have abandoned performance, said abandonment was excusable in that the financial problems the contractor had were created by the government. The law is clear that a contractor has the right to stop performing upon a material breach of the contract by the government (Brenner Metal Products Corp., ASBCA No. 25294, 82-1 BCA ¶15,462). This right accrues upon the breach itself and is not dependent on proof that the breach (in cases of failure to pay) actually caused the default. (DWS, Inc., ASBCA No. 33245, 87-3 BCA ¶19,960, especially where the contractor is confronted with a "prolonged failure [by the government] to pay large amounts" of money due it. Northern Helex Co v U.S., 17 CCF 81,069, 197 Ct.Cl. 118, 125, 455 F.2d 546, 550 (1972).

By December 5, 1986, the cumulative MRE-6 cases delivered still totaled 6,916.

Accessory packet production continued, however, with Government inspection and acceptance being accomplished over the period from January 20 to January 27, 1987.

The contract required a four-pronged production effort: accessory packets, cracker packets, retort pouches and final case assembly. This was not the first time "subassembly" production had gone on without simultaneous final case assembly. Prove this.

The Contracting Officer said nothing and took no action of any kind until unilaterally issuing Modification P00030 in April, 1987.

This subsequent attempt to unilaterally impose revised delivery dates was improper and therefore invalid. In failing to act

sooner, the Contracting Officer effectively waived the Government's right to terminate for failure to deliver.

> *See E.L. David, supra., where the September completion date was missed, and the contractor "[made] submittals of materials and the Government took action on those submittals (all five were approved) * * * on 2 November, 7 November, 10 November, 14 November and 8 December; * * * ." The Board said there that "in our view, the Government waived appellant's failure to complete * * * by the date specified."*
>
> *See also, International Telephone & Telegraph Corp. ITT Defense Communications Division v. United States, 20 CCF 83,645, 206 Ct.Cl. 37, 509 F.2d 541 (Ct Cl 1975); Joseph DeVito v. United States, 13 CCF 82,319, 188 Ct.Cl. 979, 413 F.2d 1147 (1969); Bailey Specialized Buildings Inc. v United States, 404 F.2d at 1154; Oklahoma Aerotronics Inc., ASBCA No. 25605, 27879, 28006, 87-2 BCA ¶19,917 at 100,744-76; Vista Scientific Corp., ASBCA No. 25947, 26722, 28460, 87-1 BCA ¶19,603 at 99,190-91; Computer Products International, Inc., ASBCA Nos. 26107, 26130, 83-2 BCA ¶16,889 at 84,050-51-- reasonableness of revised delivery schedule established by unilateral Mod P-30, issued when the government was aware of Freedom's eviction from the plant.*

Mods P-28 and P-29 both concluded with the following recital:

> "It is agreed that no subsequent modification of this agreement shall be binding unless reduced to writing and signed by both parties."

Notwithstanding this express requirement, included in the modifications **by the Government** without input from the contractor, on April 23, 1987, PCO Bankoff unilaterally executed Mod P-30 to the contract establishing a purported "revised delivery schedule." This delivery schedule was not reasonable, and therefore not enforceable, as the PCO was then aware that the company had been forced, as a direct result of Government action and inaction, to lay off personnel and shut down its plant.

The contractor's failure to meet the November and December delivery increments under Mod P-29 was the fault of the Government, in failing to pay progress payments as required by Mod P-28.

Assuming, however, *arguendo,* that the contractor was somehow at fault in failing to deliver the MRE-6 cases, the Government waived its right to terminate by doing nothing, and allowing the contractor to continue production of subassembly items past the time specified for November and December deliveries.

> *DeVito, supra, at 990-91.*

And the case law is clear that

> ". . . in a waiver after breach situation, time may again become essential and the Government may regain the right to terminate a delinquent contractor for default, if (1) the Government unilaterally issues a notice under the contract's Default clause establishing a reasonable but specific time for performance on pain of default termination, or (2) the parties bilaterally agree upon a new delivery date. *DeVito, supra,* at 991-92, 413 F.2d at 1154."
>
> *Bailey, supra.*

In *DeVito*, the court specifically set out the procedure that must be followed to unilaterally establish a new delivery date:

> "* * * The proper way thereafter for time to again become of the essence is for the Government to issue a notice under the Default clause setting a reasonable but specific time for performance on pain of default termination. * * * The notice must set a new time for performance that is both reasonable and specific **from the standpoint of the performance capabilities of the contractor at the time the notice is given.** [Emphasis supplied]
>
> *DeVito, supra, at 991-92, 413 F.2d at 1154; Bailey, supra, at 99,190; Oklahoma Aerotronics, supra; International Telephone & Telegraph, supra, at 49-50, 509 F.2d 541 (1975).*

This is a subjective test, and where the Contracting Officer fully knew and understood that the sum total of his acts and omissions, as well as those of the ACO, were the direct and proximate causes of the contractor's inability to go forth, his action in unilaterally establishing the new delivery date was unreasonable and highly improper.

IV. Failure to Pay Progress Payments

Freedom's "failure to perform and make progress" was a direct result of the refusal of ACO Liebman to pay progress payments as required by the contract.

> *See Q.V.S., Inc. (1958) ASBCA No. 3722, 58-2 BCA 2007.*

This refusal began early in contractor performance and continued throughout the term of the contract.

> *List progress payment requests and nonpayments*

It has long been settled that a contractor's performance delay or failure may be excused if the contractor was rendered financially incapable of continuing performance by the Government's failure to make partial or progress payments when due.

> *Whitbeck, Receiver v United States, 77 Ct.Cl. 309, cert den 290 U.S. 671 (1933) (nonpayment for several months exhausted supply contractor's funds and caused it to close plant); Argus Industries, Inc., ASBCA No. 9960, 66-2 BCA ¶5711 (delay in making progress payments); Q.V.S. Inc., supra, ("inadequate" and "untimely" partial payments); West Coast Lumber, ASBCA No. 1131, 6 CCF 61,477 (1953) (failure to make progress payments more than 10 days after delivery of lumber impaired contractor's finances).*

This failure to pay justifies abandonment of performance by a service contractor, whether or not the nonpayment rendered the contractor unable to continue.

> *Contract Maintenance, ASBCA Nos. 19409, 19509, 75-1 BCA ¶11,207; Valley Contractors, ASBCA No. 9397, 1964 BCA 4071; U.S. Services Corp., ASBCA Nos 8291, 8433, 1962 BCA ¶3703.*

The nonpayment need not be deliberate. It can be inadvertent or result from administrative neglect.

> *US Services Corp., supra; Valley Contractors, supra (deliberate refusal to pay).*

In neither case does the contractor assume the risk of nonpayment,

> *Consumers Oil Company, ASBCA No. 24172, 86-1 BCA 18,647.*

and the contractor need not show that the nonpayment rendered it unable to perform:

> "To require such a showing would accord the Government a license to abdicate with impunity its obligation to make payments when due to those contractors having sufficient financial resources to continue performance despite nonpayment."
>
> *Consumers, supra.*

If nonperformance is excusable when the government is delinquent in making progress payments, as noted above, the decision of the Contracting Officer to terminate for default must be set aside.

Especially here, where the failure to pay was the actual cause of the company's inability to perform.

> *Where the Government contracted to provide 95% of all incurred costs, it was clear that progress payments were actually to be the basis for*

financing the contract. See R.H.J. Corp., ASBCA No. 9922, 66-1 BCA 5361, in this connection.

Freedom's obligation under the contract was to manufacture (or assemble) and deliver 620,304 MRE cases as ordered. The fundamental obligation of the government was to accept and pay in accordance with the contract.

UCC Sec 2-301.

The Government fulfilled its obligation to accept product, but failed in its obligation to pay.

V. *Nonperformance Excusable Based on Entire Record*

A. Failure to Pay Progress Payments

The payments clause of the instant contract required payment of incurred costs upon the submission of proper invoices.

Payments clause

Since it did not specify the time within which payment was to be made, the time of payment became "a reasonable time" after submission of progress payment requests. A reasonable time to make payment under a properly prepared progress payment request was 5 to 10 days.

"A question arises on the proper treatment of contracts awarded between July 10, 1984, and when the necessary FAR revisions are published.

"The current DoD policy is to make progress payments in an expeditious manner, normally within 5 to 10 days after receipt of a properly prepared request." DoD Policy statement dated August 14, 1984, signed by Mr. R.D. DeLauer.

Accordingly, the ACO had a duty to make progress payment disbursements within 15 days of receipt. He failed in fulfillment of this duty.

Both Freedom and the Government recognized from the outset, during pre-award procedures and evaluation of Freedom's cost/price proposal, that the Company's cash flow requirements necessitated timely receipt of progress payments to support contract performance.

These agreements were reached during contract negotiations by and between Freedom and the Government (PCO Barkewitz), where the Government insisted on a reduction of Freedom's per unit price from $34.81 to $27.725. Freedom strongly protested any reduction below $29.90 per case, but relented in reliance on the

Government's offer to include in the contract its agreement to pay, as progress payments, 95% of **all** costs incurred.

See Exhibit No. 22: Clause L-4 of Solicitation DLA13H-84-R-8257, page 66 of 96, providing a maximum progress payment ceiling rate of "50% of the total item dollar value."

Exhibit No. 23: Letter from Freedom to PCO Barkewitz, dated November 2, 1984.

Freedom's protest was registered in its November 2 to PCO Barkewitz, pointing out that "further price reductions below $29.90 would appear to be imprudent and could result in extreme prejudice in the successful performance of the project. We alert DPSC to the potential dangers which might result from a less than 'fair and reasonable' price."

The exact costs to be so treated for progress payment purposes were specifically set forth in a contract document entitled "Memorandum of Understanding," and this agreement was the sole basis for arriving at the final unit price of $27.725."

See Exhibit 24: Memorandum of Understanding, dated 6 November 1984.

After contract award, Freedom began engaging contractors to make repairs to its newly leased plant facility as planned and contemplated by its projected plan of work.

This work was necessary, and money for making the repairs had been, as shown above, included in total contract costs.

While the subject costs were admittedly accorded special treatment, negotiating and definitizing them was the special province of the PCO.

This dispute should never have taken place. Defense Acquisition Regulation (DAR) 1-406 requires in essential part, that "When a contract is assigned for administration, . . . if special instructions pertaining to administration . . . are to apply, they should be contained in a letter accompanying the contract when it is assigned for administration." Further, the regulation provides that "Each contract assigned by a purchasing office to a contract administration component for administration shall contain or be accompanied by all procuring agency instructions or directives which are incorporated in such contract by reference. This will not be necessary if a copy has been previously furnished . . . ." The ACO should have been thoroughly advised regarding the treatment of special cost items, so that the type of misadministration that occurred would have been avoided.

Agreement on the costs under the Memo of Understanding was both permitted and recommended by the DAR, which specifically authorized contracting officers to enter into advance agreements which would make otherwise unallowable costs allowable.

DAR Sec 15-107. See also, General Dynamics Corp. v. United States, 202 Ct.Cl. 347 (1973); and Electric Boat Division, ASBCA No. 21737, 83-2 BCA Par. 16,907.

It is always desirable that advance agreement be sought with the government as to the treatment of special or unusual costs (General Dynamics Corp., supra; Rockwell Int'l Corp., ASBCA No. 20304, 76-2 BCA ¶12,131), and consonant with the holding of Philco-Ford Corp., ASBCA No. 14251, 70-2 BCA ¶8499, PCO Barkewitz properly made sure this agreement was both negotiated before the incurrence of the covered costs and incorporated into the instant contract.

ACO Liebman was charged with administering the contract, not renegotiating it.

Instead of managing the contract he was assigned, he chose instead to argue that the PCO erred in agreeing to it.

Liebman was made aware of the contract, its special cost provisions, and the mutual understanding of both DLA (i.e., the PCO and DLA legal counsel) and the contractor prior to the company's commencing performance.

In a meeting on December 14, 1985, after the contractor had commenced performance, the ACO was again advised of the parties' intentions, understandings and expectations under the contract. He purposely, intentionally and maliciously refused to honor the contract agreement as negotiated and awarded.

Exhibit No. 25: December 18, 1984 Report of Travel and Post-Award Conference, prepared by DLA Procurement Agent Keith Ford. At this conference, held at the contractor's plant on 14 December 1984, the subject of progress payments was discussed. Notwithstanding the advice of the PCO that the specially treated items were intended to be payable under the progress payment provision, and notwithstanding the advice of DLA counsel who was also present in the meeting, the ACO made it clear that he-- and not DLA-- would determine whether or not the costs would be paid under progress payment requests. He repeatedly ignored DLA advice, suggestions, and recommendations and reclassified the specially treated costs to be regularly treated costs, resulting in financial catastrophe to the company.

M.H. Rowles, Chief of Operational Rations at DLA pointed out that:

> "DCAA did not take exception to these costs being handled **as a one time cost rather than a depreciable element.** In view of the above and the contracting officer's **knowledge of the industry,** it was decided to pay for these elements as 100% cost rather than insist upon depreciation."

Exhibit No. 26: telex from M.H.Rowles, Chief, Operational Rations to Marvin Liebman, dated 5 Jun 1985.

In failing to pay, the ACO breached the contract,

A breach occurs upon the nonperformance of any duty under a contract when due. RESTATEMENT (SECOND) OF CONTRACTS Sec 235, comment b.

attempted to justify his actions by:

a. de facto reclassifying equipment costs from their negotiated classification as direct, to capital items allegedly requiring a DAR deviation to be paid;

Exhibit No. 27: Memo from ACO Liebman to DLA dated 18 Jul 1985. He was fully aware of the contractor's predicament, and of the full impact of his actions in requesting the deviation. He acknowledged that without it, "there could be a failure of the contractor to obtain the required equipment and, consequently, an inability on his part to successfully perform the contract."

Notwithstanding repeated directives from DPSC that the costs were properly payable, having been paid to other contractors within the context of the mobilization industry, ACO Liebman refused to comply, even though he knew he had no prior experience with contracts of this sort.

It is interesting to note that some 6 months later, the monies were subsequently paid without the requested deviation-- as part of the negotiated settlement under Mod P-25. There was no change in the contractor's position over the period of nonpayment to suddenly make a necessary deviation unnecessary. So, the deviation request should be seen for what it was-- a ruse, used to justify the ACO's continuing nonpayment of monies needed by the contractor over the period of time the request was under review.

b. challenging Freedom's financial capability because of its reduction in outside contract financing;

When Freedom reduced its best and final offer in exchange for the increased progress payment rate, the Government was advised that its agreement to the reduction was based solely on the elimination of interest costs for loans from Dollar Dry Dock which it could now dispense with because of the increased progress payments. This was again discussed at the December 14, 1985 post-award conference. (See Exhibit No. 25, at fn. 72).

c. challenging the propriety of paying the costs he objected to on the ground that the costs were improperly categorized by the PCO;

Where a company is in serious financial trouble because of the nonpayment of progress payments, and where the reason for nonpayment is more a matter of administrative wrangling than production-related behavior of the contractor, case law suggests that the Contracting

Officer should have paid the money to keep the contractor functioning while he resolved the PCO-ACO dispute at the agency level.

In Virginia Electronics Company, Inc.,ASBCA 18778, 77-1 BCA ¶12,393. See also, Brooklyn & Queens Screen Mfg. Co. v. United States, 97 Ct.Cl. 532 (1942); West Coast Lumber Corp., supra; Mifflinburg Body Works, Inc., ASBCA 723 (1951); Pilcher, Livingston and Wallace, Inc., ASBCA 13391, 70-1 BCA 8331. the Board held that the Government's refusal to make progress payments to which a contractor was entitled on the ground that the payment request was not in precise, proper form was unreasonable and arbitrary, especially where the Government knew the tight financial position of the contractor and should have known that the contractor probably needed the progress payments to pay its suppliers and get on with performance.

d. challenging the reliability of Freedom's accounting system for billing the costs to the government under those categories.

The company's accounting system was reviewed prior to award and found satisfactory. After the contract was assigned for local area management and administration, ACO Liebman and the local area accounting staff had problems with it. The accounting system employed was not inequitable, in that it did not cause the Government to bear a disproportionate share of the costs. In fact, it only attempted, by allocating the "special costs" to the manufacturing overhead category, to make the accounting system truly reflective of the contract agreement and thereby prevent problems with progress payment disbursement later on. We were obviously not successful. Absent a finding that the Government was being inequitably charged, the company's accounting system should never have been challenged. (See Litton Systems, Inc., ASBCA No. 10395, 66-1 BCA ¶5599; Itek Corp., NASA BCA No. 27, 1963 BCA ¶3967).

e. requesting a DAR deviation to permit payment of costs he had already been repeatedly advised were proper for progress payment purposes.

By March of 1985, Freedom had incurred and was literally financing on its own some $1,724,000 of debt. Under the contract, Freedom's 5% **total** cash contribution requirement was only $748,507.

See Exhibit 28: Letter from Noel V. Siegert of Dollar Dry Dock Commercial to Thomas Barkewitz, Contracting Officer, DPSC, dated August 10, 1984. Prior to execution of the Memorandum of Understanding (see fn 58), Freedom had arranged contract financing from its equity stockholder, Dollar Dry Dock Commercial Bank of New York, NY, in the amount of $7.2 million. It was understood by all parties that this financing was based on Freedom's securing a contract at the $34.81 per case price, where the proposed progress payment rate totalled only 50%.

In agreeing to pick up 95% of all incurred cost, including the cost of the capital expense items set forth in the Memorandum of Understanding,

the Government effectively reduced the company's working capital requirements from 50% to 5%, and rendered the need for the full $7.2 million line of credit unnecessary.

The December 7, 1984 progress payment was rejected on the basis there were:

"...unbooked accruals for indirect expenses not necessarily related to progress of the contract."

and because:

"The contractor has not started production and therefore does not qualify for progress payments. **We cannot perform any progress payment audit until such time as the contractor starts production** and qualifies for progress payments."

Rejection of this payment for the reasons expressed was arbitrary, capricious and unreasonable since the ACO knew that the Memorandum of Understanding made it clear that the very pre-production cost accruals in question were to receive special treatment for progress payment purposes.

The first monies Freedom received from the Government was paid in May 1985 -- some six months after the contract was awarded.

By the time the $1.7 million was received, Freedom's total costs incurred through that date amounted to $2.44 million. Government was still in breach.

ACO said progress payments payable at his sole discretion.

See Exhibit 29: letter dated 15 July, 1985 from Mr. Marvin Liebman.

Confrontational nature of the relationship.

See Exhibit No. 30: Letter to Freedom from Randolph Gross of Bankers Leasing Association, Inc., dated August 16, 1985. In this letter Mr. Gross pointed out that based upon his having been led to believe that progress payments for incurred costs could be challenged, withheld or even rejected by the government, "a very real concern exists as to the 'asset value' of the monies due . . . and hence, (his) comfort with the value of (the receivable)."

Production impact can be assessed in terms of diminished ability to make progress as projected. $7 million originally projected as being necessary to support a July 1985 delivery.

a) repair the building;

b) purchase / lease necessary equipment and machinery;

c) await delivery of the machinery and equipment and install same when received;

d) hire and train personnel;

e) purchase and install a computerized system for accounting, quality control, security and building maintenance purposes.

Freedom was unable, because of the government's failure and refusal to pay progress payments, to reach the $7.2 million figure at the time projected. Put differently, it was unable, because of lack of necessary and agreed-upon Government financing, to complete the above items by the time originally projected.

> *The company was forced to use inefficient labor intensive manufacturing and assembly equipment. Purchase orders for thirteen Doboy Model CBS-B Continuous Band and Sealers, one Koch Multivac Rollstock Package Machine Model R5100 MC, and one Koch Model R5100 TF Rollstock Vacuum Packaging Machine had to be canceled because the sellers and lessors refused to honor purchase orders or provide financing when they were made aware that progress payments #1, #2, and #3 had been suspended.*

By July 1985, Freedom had been able to incur costs of only $4,054,366. This $3.1 million disparity between projected and actual costs incurred represents work Freedom was unable to perform because of the government's refusal to pay according to the contract, and reflects the amount of disruption in work sequence that added additional time to the delay the company was then experiencing.

The ACO's repeated refusal to make full and prompt progress payments caused Freedom to make major alterations in its administration and performance of the contract in a manner totally inconsistent with the original understanding of the parties. It also added $2,426,826 in costs to Freedom's performance.

B. Failure to Cooperate

The Government failed in its duty to cooperate with the contractor during performance of the contract.

> *Implied warranty not to hinder performance and implied warranty of cooperation exist in every government contract. Florida East Coast Railway Co. v United States, 29 Cont. Cas. Fed. (CCH) 81,927 (1981). See also, Space Dynamics Corp., 71-1 BCA 8853 (1971).*

The Government was well aware the company's cash flow projections were based upon renovation of the production facility and receipt of progress payments prior to commencement of actual production. ACO, failed and refused to cooperate with the

company in its efforts to perform the contract by refusing to pay any monies for 6 full months.

In a letter dated 15 Feb 85, the ACO made payment of any progress payment monies contingent upon Freedom's acquiring additional outside financing in the sum of $3.8 million and a novation of its contract.[1] This borrowing was far in excess of the amount that would otherwise have been necessary had the ACO made timely progress payments at 95% of incurred costs.

In addition, the Government improperly offset monies through the wrongful withholding of progress payments. Under the Assignment of Claims Act of 1940, payments actually made to the assignee may not be recovered by the Government on the basis of any liability of the assignor to the Government.[2]

Additionally, in or around July 1985, after paying three progress payments out of a total of seven submitted, ACO Liebman again stopped paying. The stated reason for his action was deficiencies in the contractor's accounting system, but this was merely a ruse to permit the government to investigate a report that the contractor was defrauding the Government of money.[3] The ensuing 3-month "suspension" of payments caused the company considerable increase in cost of performance. The case law is clear that any suspension of progress payments for alleged improprieties of this magnitude should have occurred only **after** a proper investigation **and proof** of irregularity.[4]

Further, unfulfilled promises of guaranteed loan financing made by the Government were relied upon by the company to its detriment. The Government promised the company a guaranteed loan, but refused to follow through because it never intended to honor its commitment. The company was unable to continue its performance, and the contract was subsequently defaulted. This was not a pre-bid commitment, but was part of an agreement made in settlement of a pending contractor claim. The Government's

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[1]

[2] G*reat American Ins. Co. v. United States,* 19 CCF 82864, 203 Ct.Cl. 592, 492 F.2d 821 (1974); *Central National Bank of Richmond, VA v. United States,* 4 CCF 61048, 117 Ct.Cl. 389, 91 F.Supp. 738 (1949).

[3] See Exhibit No. 32: Memorandum from Vito Soranno, Branch Manager of the New York Office of Defense Contract Audit Agency, to the Regional Director, dated August 2, 1985. The allegations advanced were subsequently determined to be baseless.

[4] This type action nearly rises to the level of an unconstitutional deprivation of property without due process of law. In the 1954 case of *Edgerton ta Edgerton Flying Service v. United States,* 127 Ct.Cl. 515, 117 F.Supp. 193 (1954), a contractor was held entitled to recover where the evidence showed that the suspension on the ground that the contractor's airplanes were not airworthy was a ruse to permit the Government to investigate a report that he had defrauded the Government of a sum of money. Under the contract, the Veteran's Administration had no right to close down the contractor's school on a mere accusation of irregularities without proof of proper investigation.

failure to deliver the guaranteed loan is both a breach of contract and another cause of excusable delay.[5]

Failure to cooperate can be clearly seen throughout the ACO's administration of the contract, evidenced in one graphic example by his decision to suspend progress payments because of an alleged impropriety in the contractor's accounting system--rather than attempt to work with the company to cure what was clearly a surmountable problem.

C. Interference with Contractor Performance

The Government has an implied obligation not to hinder, interfere with, or delay the contractor's performance.[6] As the factual recitation above clearly points out, ACO Liebman repeatedly and consistently breached this obligation.[7]

Not only did the ACO refuse to pay, he also advised critical suppliers that he intended not to pay, and on at least one occasion, he actually "instructed [the company's financial backers] not to advance any monies (to Freedom)."[8] This was an arbitrary and capricious action which resulted in loss of needed equipment, supplies and trade creditworthiness.[9] The result was that less efficient and more labor intensive assembly equipment had to be manufactured and/or obtained and modified from other sources. This added 95 additional employees to the payroll for an estimated increase of $15,238 per week or a total estimated $548,057 increase in direct labor costs.

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[5] While the case law suggests that a contractor will not be excused for failure of an expected loan to come through where there is no evidence of a pre-bid commitment (*Security Signals, Inc.*, ASBCA 4634, 58-2 BCA 2045), the case presented here is different in that the commitment was made in settlement of claims charging the Government with responsibility for creating the financial difficulty.

[6] *Argus Industries, Inc.* (1966) ASBCA No. 9960, 66-2 BCA ¶5711.

[7] In a case surprisingly similar to ours, the Armed Services Board of Contract Appeals held that a contractor's default was excused and a default termination was ordered converted to one for convenience of the government because throughout performance the Contract Management District unreasonably interfered with performance of the contract by requiring of the contractor things that had already been waived by the procuring agency. The contractor's financial position grew worse because the government failed to make some progress payments and delayed in making others. Knowledge by subcontractors and suppliers that the contractor was failing to receive approvals and progress payments caused them to refuse deliveries and the contractor became insolvent and had to cease operations. *Argus Industries,* supra.

[8] See Exhibit 33: Letter from Performance Financial Services, Inc. to Freedom, dated June 17, 1985.

[9] By way of illustration, the company's production plan called for acquisition and use of certain state-of-the-art machinery, to wit: a Doboy Model CBS-B Continuous Band Sealers with accessories, a Koch Multivac Rollstock Package Machine Model R5100MC (Accessory Room), and a Koch Multivac Rollstock Vacuum Packaging Machine with accessories Model R5100TF. These were all high cost and long lead-time items. After the ACO refused to confirm his payment of 95% of the costs to be incurred, the supplier refused to honor Freedom's purchase orders.

In a separate incident, in January 1986, the Government directed Freedom's CFM suppliers to divert subcontract items produced for the 114,758 case delivery period of December 1985 and January 1986 to other Government prime contractors. This action was taken without any provision being made for current production needed by Freedom for the uncancelled portion of its contract. Production lead time required by the subcontractors caused an additional six week delay and costs of $899,285.

D. Late Deliveries of GFM

Late deliveries of GFM were repeated under the Contract, and continued through the period of October-November, 1986. They caused changes in production scheduling and sequences, with resulting loss of efficiency by rescheduling of work production down-time. Late deliveries of GFM ultimately led to a situation where GFM item in inventory had to be substituted for those that were not on hand, causing unplanned engineering of production changes, slowed production and increase in overhead costs.

E. Failure to Act in Reasonable Time

The progress payment issue was forwarded by the ACO to the Defense Logistics Agency on 18 Jul 1985 for resolution. In his conveying communication, he requested that "a one-time deviation to [sic] DAR 7-104-35(b) be approved * * * [to] permit certain office equipment, quality control equipment and supplies and automated building management and control systems in the approximate amount of $311,838 to be treated as direct costs for progress payment purposes."[10]

In the same letter, he accurately pointed out that "[i]f a deviation is not granted, the result could be a failure of the contractor to obtain the required equipment and, consequently, an inability on his part to successfully perform the contract."

Two points must be made. First, the ACO delayed unreasonably in requesting a deviation if he thought one was necessary for payment of the costs the company was then, and had for the past 7 months been, incurring.

Second, the Government had a duty to resolve the problem in a reasonable time. Submitted in July, 1985, payment was not made for one full year-- in June, 1986, after the signing of Mod P-25. This was not a reasonable time for problem resolution.

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[10] Reference Exhibit 27, at fn 75.

F. Defective Specifications

Finally, specifications susceptible to more than one interpretation caused delay in production and required the company to accelerate internal efforts in attempting to comply with delivery schedules.

By way of example, Army Veterinary Inspection (AVI) personnel assigned to Freedom's facility refused to inspect product when offered, claiming that they could not inspect unless and until a palletized load of MRE cases had been capped and strapped. Because the unit load strapping had been (improperly, as it later turned out) determined unacceptable by Government laboratory personnel, Freedom could not use the strapping it had in-house. Interpreting the specification to identify a single case of MRE rations as an end-item for acceptance inspection, Freedom continued to produce and offer the said lots to AVI. Interpreting the specification refer to a capped and strapped & palletized load as the contract end-item, the government inspectors refused to inspect.

Ultimately, the strapping was determined to have been improperly declared defective, and the contract end-item was defined to be the single case of MRE rations. The cost to Freedom was six weeks lost production and learning curve inefficiencies, and $555,478.

In addition, the Medical Hold problem growing out of the Star Foods production operation caused considerable disruption of work. The contractor was required to visually inspect for micro-holes, which by their very definition were not susceptible to identification by the naked eye. Also imposed was a requirement to perform zyglo-dye testing, which caused considerable loss of efficiency, rescheduling of work and performing testing out-of-sequence. It was impossible to segregate the costs associated with the impact of this change, but the company's loss was a direct and necessary result of the ordered change.[11]

On the basis of the entire record (i.e., the history of Government performance under the contract), a finding of no excuse for contractor nonperformance would be incredible. When production reports are juxtaposed to prompt distribution progress payments, it is easy to see that high-level production output consistently resulted when the contractor was paid in accordance with contract terms.

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[11] The Government contractually assumed risk of having to pay these costs when it ordered change. (See *Electronic & Missile Facilities, Inc. v. United States*, 14 CCF 83,109, 189 Ct.Cl. 237, 416 F.2d 1345 (1969).

VI. *Abuse of Discretion, Bad Faith and Discriminatory Treatment*

Even if a contractor is in technical default, the decision to terminate must fall within the discretion of the contracting agency, and that discretion must not be abused.[12]

The entire record of performance under MRE-5 (see §V, above), evidences a designedly oppressive course of conduct on the part of Government representatives. We do not repeat the factual allegations here. Conduct of this sort has previously been held by the Courts to constitute the requisite abuse of discretion.

Additionally, when a default termination is taken solely to rid the Government of having to deal with the terminated contractor, it is a clear abuse of discretion.[13]

The Government's decision to terminate was made solely to rid the Government of having to deal with the contractor. It was made despite written guarantee from the company's lender that Freedom would be provided with a $6 million line of credit in future procurements-- and that its existing debt would not impact MRE-7 once awarded. Given the rationale for award of all planned producer contracts, the history of contractor performance, and the Government's role in the contractor's shortcomings, this decision constituted a gross abuse of discretion.[14] And where abuse of discretion is shown, the decision of the Contracting Officer must be reversed.[15]

The Contracting Officer's decision, whether made by him alone or in concert with higher authorities, continued a conscious course of discriminatory conduct aimed at keeping the company out of the program, and it began with the contractor's initial attempt to enter the MRE program.

Freedom submitted its first price proposal as part of the MRE-1 reprocurement, in 1980. There were only two companies in the program at the time-- Southern Packaging and Storage Company, Inc. (Sopaco) of Mullins, South Carolina; and Right Away Foods Corporation (Rafco) of McAllen, Texas. Freedom was told by PCO Michael Cunningham that if it withdraw its proposal from the reprocurement effort, it would be allowed to participate in MRE-2.

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[12] *Darwin Construction Co., Inc. v. United States*, 811 F.2d 593 (Fed.Cir. 1987) rev'g & remanding ASBCA No. 29340 on mtn for reconsid., 86-2 BCA 18,959.

[13] *Darwin Construction*, *supra*, at 596.

[14] See *Darwin Construction*, *supra*.

[15] *Quality Environment Systems, Inc.,* ASBCA No. 22187, 87-3 BCA ¶20,060, at 101,569.

Freedom was not allowed to participate in MRE-2. Contracts were awarded by letter contract to the two existing suppliers. Freedom was simply advised that the MRE program had been placed under Industrial Preparedness Planning, and that only those companies with IPP plans on file were eligible for contract award.[16] Freedom was told it would have to meet the requirements of the program in order to participate in MRE-3. As evidence of the Government's discriminatory conduct, Rafco and Sopaco, however, had no such plans on file.

Freedom undertook to comply and prepared prime contractor IPP plan under IPP 1519,[17] and submitted said plans to the Government.

Freedom was then told by Government officials that it would have to do subcontractor planning to show sources and supplier commitments for raw material items. While Freedom was complying with this latest requirement, the Government arbitrarily and discriminatorily awarded the MRE-3 contracts to Rafco and Sopaco. Again, neither Rafco nor Sopaco had been required to do similar subcontractor planning.

Freedom then protested the award of MRE-3, and sought Congressional assistance in halting this discriminatory treatment. As a result, the Government subsequently offered Freedom an opportunity to manufacture a quantity of retort pouches under MRE-3 in order that it might first be "test-qualified" as a manufacturer under the Walsh-Healey Act.[18]

MRE-4 was announced, and with all imposed qualifications having been met, Freedom submitted its pricing proposal. Once again, the Government arbitrarily and discriminatorily failed and refused to negotiate with Freedom, and contracts were awarded to Rafco and Sopaco.

Freedom then sued the Government in the Federal District Court. As part of the resulting case settlement, the Office of the Secretary of Defense issued a Determination & Findings ordering that all three existing planned producers be negotiated with and awarded contracts with price differentials included.[19]

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[16] To ensure that the industrial preparedness mobilization base remains intact and available in the event of troop mobilization or national emergency, DPSC is required to give to the existing IPP producers an opportunity to offer on a solicitation to produce the MRE ration during peacetime.

[17] To be an IPP program producer, Freedom was required to estimate within the context of a full-scale production plan the total quantities of MREs it could produce within 90 days if a national emergency arose. The plan had to demonstrate equipment acquisition, man-power loads and build-up, learning curve and overall production efficiency. Based on its per case per month war-time estimate, Freedom was declared eligible to offer on a specific quantity of MRE peacetime production.

[18] Title 41, United States Code, §§35-45, and Title 5, United States Code, §616. This was an express requirement of the Solicitation and every resulting contract award.

[19] All prior Determination & Findings required only that "at least two" suppliers

MRE-5 was awarded in accordance with the new D&F, but even while the contract was being performed, steps were already being taken internally to remove Freedom from the program.

Specifically, the Government, in furtherance of its bad faith design to keep Freedom out of the program, advised in the D&F to MRE-6[20] that a fourth supplier, Cinpac, Inc. of Cincinnati, Ohio, would be allowed to participate in the upcoming procurement.[21] Cinpac was not a manufacturer under the terms and meaning of the Walsh-Healey Act, and therefore not eligible for award under the express terms of the Solicitation itself.[22]

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be awarded peacetime contracts.

[20] See Exhibit No. 34: Solicitation DLA13H-85-R-8457, at pages 137-38 of 158. The Solicitation to MRE-6 was identical to that of MRE-5 in laying out the duties of the PCO in evaluating offers. The solicitations both provided in clear terms:

> Section M - Evaluation of Offers
>
> B. Award Evaluation Will Be Performed As Follows:
>
> 1. The Procuring Contracting Officer (PCO) will **determine** if an offeror has qualified as a planned offeror has qualified as a planned producer **with respect to this solicitation** . . . This determination will be based on the Government's **verification** and approval of the signed DD Form 1519 **and** the recommendation of the Armed Services Production Planning Officer's (ASPPO) Industrial Preparedness Planning (IPP) Survey. An offeror's participation in the IPP program **must** meet or exceed the minimum level of allocated MRE assembly capacity **at M+90** as set forth in Table "A" below.
>
> * * *
>
> D. M+90 Assembly Capacity is defined as **verified production capacity** from a cold base within a 61 to 90 day time frame following notification of an award under mobilization procedures.
>
> * * *
>
> Table A
>
> Maximum award quantities correspond to allocated M+90 **monthly** capacity levels as follows:

Monthly Allocated IPP Quantity at M+90	Maximum Share Quantity	% of Requirement
1,800,000 - Unlimited	1,879,401	45%
1,200,000 - 1,799,000	1,461,756	35%
600,000 - 1,199,000	835,000	20%

[21] The D&F provided in part that "[a]ccomodations will be made to allow any new firm who has an *approved, negotiated* IPP agreement to offer on this solicitation. In addition to those who have written plans on file, CINPAC Inc, of Cincinnati, Ohio has expressed interest in MRE assemble and their IPP capability is currently being evaluated." *DLA/DPSC Justification for Other Than Full and Open Competition,* dated 20 Jun 1985.

[22] The process was well-defined (see fn 106). First, the PCO was required to determine Cinpac qualified as an IPP program producer. Second, Cinpac had to qualify as a planned producer with respect to the particular solicitation.

Third, the solicitation required that Cinpac meet or exceed the minimum level capacity at M+90 days, meaning that between days 61 and 90, Cinpac must be capable

MRE-6 was subsequently awarded to Rafco, Sopaco and Cinpac-- while Freedom was still struggling under the strain of unpaid progress payments. At DLA's request, the United States Department of Labor reviewed the actions of the PCO in connection with the qualifications of Cinpac and found "that Cinpac, Inc. did not qualify for award under Public Contracts Act and 41 CFR 50-201.101(a)(1)."[23]

"[A] decision may constitute an abuse of discretion if found to be arbitrary and capricious, and one of four factors that should be used in determining if a Government decision is arbitrary and capricious is a 'proven violation of an applicable statute or regulation'."[24] In its desperate bid to keep Freedom out of future procurements, the Contracting Officer made the award to Cinpac in violation of Walsh-Healey, the interests of the Government under mobilization planning, and the very requirements Freedom had been rigorously compelled to comply with over the period of the first three procurements.

CONCLUSION AND SUMMARY

Mod P-25 as expanded by the merged side agreement is valid and enforceable as a substituted contract. It was breached by failure of the Government to award a contract to the company

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of producing 600,000 cases. Cinpac certified it could do this.

Fourth, the PCO was required to make a determination that Cinpac qualified as an IPP producer, meaning he was required to verify the information in Cinpac's DD Form 1519.

Finally, the PCO was allowed to use the recommendation of the ASPPO survey in making his decision.

The PCO used a pre-award survey in making this critical decision. (See pp. 15 and 16 of Report and Recommendation of the Contracting Officer.) No ASPPO survey was used; no verification of Cinpac's DD Form 1519 ever took place. Pre-award surveys are designed only to ascertain standards of responsibility, and therefore focus on such concerns as adequacy of financial resources, performance records, business ethics, and accounting systems. (FAR 9.104-1, 9-106) A contractor could have all those items in place, and be responsible, and still not qualify as an IPP producer. This is not the IPP survey that was required by the solicitation.

Perhaps more importantly, the threshold requirement for being an IPP planned producer was that the company be a manufacturer under the terms of Walsh-Healey. Cinpac was not a manufacturer-- it had no manufacturing facilities of its own. As Rafco complained in its Protest filed with the General Accounting Office, "Cinpac had no suitable production capacity to allow it to participate. . . . In addition, Cinpac will be unable to acquire the necessary production capacity in the event of a national emergency. This is due in part to the finite number of companies with capacity to produce the required retort pouches, most of whom are already committed to the other participants in the IPP program. * * * [So that], in making this award to CINPAC, the DLA has ignored the evaluation criteria . . . ."

[23] Exhibit 35: Letter from Herbert Cohen, Deputy Administrator, U.S. Department of Labor, to Vera E. Zappile, Assoc. Dir. of Small Business, DLA.

[24] _____, ASBCA No. 36764, citing *United States Fidelity & Guaranty Co. v. United States,* 230 Ct.Cl. 355, 368, 676 F.2d 622,630 (1982).

under MRE-7. Its breach entitled the contractor to cease production and the subsequent termination for default was therefore wrongful, as it was the Government that was at fault--not the contractor.

The Government's continuing refusal to pay progress payments as required by the terms of Mod P-28 likewise constituted breach of the parties' agreement, rendering the subsequent termination for default wrongful for the same reasons stated above.

Both Mods P-28 and P-29 are limited in scope and application insofar as language of release is concerned, and in any event, the breach of Mod P-25 occurs subsequent to the signing of Mod P-29, so that the company's entitlement is not affected by the language of either later Mod.

The Government's course of conduct during the period of the contract term evidenced a clear design to remove the contractor from the MRE program. This renders the Contracting Officer's decision to terminate arbitrary and capricious, and suggestive of bad faith, allowing the Breach of Mod P-25 to be redressed by breach of contract damages, outside the terms of the Termination for Convenience Clause.

The Government's course of conduct during the period of the contract term constituted a designedly oppressive performance environment for the contractor, giving rise to bad faith, and allowing the Government's various breaches to be redressed outside the terms of the Termination for Convenience Clause.

Finally, the PCO, in overseeing the ACO's mismanagement of the contract (and in subsequently terminating the contract) was guided by his superiors, who forced the PCO to renege on the agreements of Mod P-25 after he knowingly and willingly signed off in acceptance of the "side agreement" provisions.

RELIEF SOUGHT
(See Exhibits 36 & 37)

		Note
Adjusted increase in cost of contract:	$ 3,275,798	a
Original profit under contract:	2,227,544	
Profit under 114,758 case add-on:	477,250	b
Company income improperly offset and taken by ACO:	375,436	
Equipment, machinery, special tooling and leasehold improvements to facility lost through insolvency:	1,167,563	c
Lost profits on promised future MRE procurements (MRE7-MRE11):	14,435,720	d
Total entitlement:	$ 21,959,311	

Re-entry to the MRE program and development as a prime contractor/planned producer

Freedom is prepared to meet with you or any duly designated representative of your office to discuss this request for payment. and re-entry into the MRE program.

BY

Henry Thomas, President Kevin Seraaj, Sr. V.P.

kss:s\wp\claimltr
Enclosures:
(1) Appendix
(2) Table of Authorities
(3) Exhibits 1-37
(4) Certification of Claimed Costs

APPENDIX

APPLICABLE STATUTES and REGULATIONS

1-905.4. (d) Walsh-Healey Public Contracts Act Eligibility Determination. The contracting officer shall accept the representation by the offeror that the firm is either a manufacturer or regular dealer pursuant to the requirements of the Walsh-Healey Public Contracts Act (Section XII, Part 6) unless--

(ii) a protest has been lodged pursuant to 12-604;

(iii) the offeror in line for contract award has not previously been awarded a contract subject to the Act by the individual acquisition office; or

(iv) a preaward investigation or survey of such offeror's operations is otherwise made to determine the technical and production capability, plant facilities and equipment, and subcontracting and labor resources of such offeror.

Where these conditions exist, the PCO shall determine the Walsh-Healey Act eligibility status of the offeror, based on available evidence, including preaward surveys, experience of other acquisition offices, information available from the cognizant contract administration office or information provided directly by the offeror.

1-2202 Industrial Preparedness Production Planning--General. The Industrial Preparedness Production Planning is conducted jointly among DoD components and industry to provide a means for * * * rapid application of industrial capability to military production during an emergency.

1-2203 Policy.

(a) The Department of Defense will conduct Industrial Preparedness Production Planning to assure capability for the sustained production of essential military items to meet the needs of the U.S. and Allied Forces during an emergency.

* * *

1-2205 Existing Authority Affecting the Industrial Base

Specific authority under current contracting procedures to accomplish industrial planning actions includes the following:

(ii) purchases in the interest of national defense or industrial preparedness (see 3-216)

Section 3. Procurement by Negotiation

DAR 3-101 General.

(a) Pursuant to the authority of 10 U.S.C. 2304(a), procurement may be effected by negotiation under any one of the exceptions (1) through (17) set forth in Part 2 of this Section. . . .

(b) When supplies or services are to be procured by negotiation, offers shall be solicited from the maximum number of qualified sources consistent with the nature and requirements of the supplies or services to be procured.

(c) No contract shall be entered into as a result of negotiation unless a business clearance or approval as is prescribed by applicable Departmental procedures has been obtained.

(d) * * * When a proposed procurement appears to be necessarily noncompetitive, the contracting officer is responsible not only for assuring that competitive procurement is not feasible, but also for acting whenever possible to avoid the need for subsequent noncompetitive procurements. This action should include both examination of the reasons for the procurement being noncompetitive and steps to foster competitive conditions for subsequent procurements[.] * * * [C]ontracts in excess of $10,000 shall not be negotiated on a noncompetitive basis without prior review at a level higher than the contracting officer to assure compliance with this subparagraph.

3-216 Purchases in the Interest of National Defense or Industrial Mobilization.

3-216.1 Authority. Pursuant to 10 U.S.C. 2304(a)(16), purchases and contracts may be negotiated if--

"he [the Secretary] determines that (A) it is in the interest of national defense to have a * * * producer, manufacturer or other supplier, available for furnishing property or services in case of a national emergency; or (B) the interest of industrial mobilization in case of such an emergency * * * would be subserved."

3-216.2 Application. The authority of this paragraph 3-216 may be used to * * * provide an industrial mobilization base which can meet production requirements for essential military supplies and services. The following are examples of situations when use of this authority should be considered:

(i) when procurement by negotiation is necessary to keep vital facilities or suppliers in business; or to make them available in the event of a national emergency;

(ii) when procurement by negotiation with selected suppliers is necessary to train them in the furnishing of critical supplies or services . . .;

(iv) when procurement by negotiation is necessary to limit competition to * * * planned producers with whom industrial preparedness agreements for those items exist; or to limit award to offerors who agree to enter into industrial preparedness agreements;

(vii) when procurement by negotiation is necessary to divide current production requirements among two or more contractors to provide for an adequate industrial mobilization base.

3-216.3 Limitation. The authority of this paragraph 3-216 shall not be used unless and until the Secretary has determined, in accordance with the requirements of Part 3 of this Section III, that:

(i) it is in the interest of national defense to have a particular * * * producer, manufacturer or other supplier available for furnishing supplies in case of a national emergency, and negotiation is necessary to that end;

(ii) the interest of industrial mobilization, in case of a national emergency, would be subserved by negotiation with a particular supplier;

* * *

DAR 3-402(5) Adequacy of the Contractor's Accounting System. Before reaching agreement on price and contract type, determination should be made that the contractor's accounting system will permit timely development of all necessary cost data in the form required by the specific contract type contemplated.

DAR 3-809(b)(3) Responsibilities for Pre-Award Surveys and Reviews.

Pre-Award surveys of potential contractor's competence to perform proposed contracts shall be managed and conducted by the contract administration office. When information is required on the adequacy of the contractor's accounting system or its suitability for administration of the proposed type of contract, such information shall always be obtained by the ACO from the auditor. The contract administration office shall be responsible for advising the PCO on matters concerning the contractor's financial competence or credit needs.

DAR 3-809(b)(4) Reviews of Contractor's Estimating Systems:

(ii) * * * A copy of the survey report, together with a copy of the official notice of corrective action required, shall be furnished to each purchasing and contract administration office having substantial business with that contractor. Any significant deficiencies in the system not corrected by the contractor shall be referenced in Part V of subsequent Pre-Award Surveys and will be considered in subsequent proposal reviews and by the ACO and PCO in negotiating with, and in determining the reasonableness of prices proposed by, that contractor. Where deficiencies continue to exist and where they have an adverse effect on prices, the problem should be brought to the attention of procurement officials at a level necessary to bring about corrective action.

DAR 3-809(b)(5) Cost Accounting Standards Board Rules and Regulations

In accordance with Section III, Part 12-- Cost Accounting Standards, and Section XV-- Contract Cost Principles and Procedures, the cognizant contract auditor shall be responsible for making recommendations to the ACO as to whether:

(iii) a contractor's or subcontractor's failure to comply with applicable Cost Accounting Standards or to follow consistently his disclosed cost accounting practices has resulted, or may result in, any increased cost paid by the Government; * * *

DAR 7-103.17 Walsh-Healey Public Contracts Act (1958 Jan)

If this contract is for the manufacture or furnishing of materials, supplies, articles, or equipment in an amount which exceeds or may exceed $10,000 and is otherwise subject to the Walsh-Healey Public Contracts Act, as amended (41 U.S.C. 35-45), there are hereby incorporated by reference all representations and stipulations required by said Act and regulations issued thereunder by the Secretary of Labor, such representations and stipulations being subject to all applicable rulings and interpretations of the Secretary of Labor which are now or may hereafter be in effect.

DAR 7-104.35(b) Progress Payment Clause for Small Business Concerns (1981 Oct)

Progress payments shall be made to the Contractor when requested as work progresses, but not more frequently than

monthly, in amounts approved by the Contracting Officer under the following terms and conditions.

(a) Computation of Amounts.

(1) Unless a smaller amount is requested, each progress payment shall be (i) ninety-five percent (95%)** (See footnote at end of clause) of the amount of the Contractor's total costs incurred under this contract, except as provided herein with respect to costs of pension contributions, plus (ii) the amount of progress payments to subcontractors as provided in (j) below; all less the sum of previous progress payments.

(2) The Contractor's total costs ((a)(1)(i)) shall be reasonable, allocable to this contract, and consistent with sound and generally accepted accounting principles and practices. However, such costs shall not include (i) any costs incurred by subcontractors or suppliers, or (ii) any payments or amounts payable to subcontractors or suppliers, except for completed work (including partial deliveries) to which the Contractor has acquired title and except for amounts paid or payable under cost-reimbursement or time and material subcontracts for work to which the Contractor has acquired title, or (III) costs ordinarily capitalized and subject to depreciation or amortization except for the properly depreciated or amortized portion of such costs.

(4) The aggregate amount of progress payments made shall not exceed ninety-five percent (95%)** (See footnote at end of clause) of the total contract price.

(b) Liquidation. Except as provided in the clause entitled "Termination for Convenience of the Government ," all progress payments shall be liquidated by deducting from any payment under this contract, other than advance or progress, the amount of unliquidated progress payments, or ninety-five percent (95%) * * *

(c) Reduction or Suspension. The Contracting Officer may reduce or suspend progress payments, or liquidate them at a rate higher than the percentage stated in (b) above, or both, whenever he finds upon substantial evidence that the Contractor (i) has failed to comply with any material requirement of this contract, (ii) has so failed to make progress or is in such unsatisfactory financial condition, as to endanger performance of this contract, * * * (v) has so failed to make progress that the unliquidated progress

payments exceed the fair value of the work accomplished on the undelivered portion of this contract, or (vi) is realizing less profit than the estimated profit used for establishing a liquidation percentage in paragraph (b), if that liquidation percentage is less than the percentage stated in paragraph (a)(1).

DAR 7-103.11 Default (1969 Aug)

* * *

(e) If, after notice of termination of this contract under the provisions of this clause, it is determined for any reason that the Contractor was not in default under the provisions of this clause, or that the default was excusable under the provisions of this clause, the rights and obligations of the parties shall, if the contract contains a clause providing for termination for convenience of the Government, be the same as if the notice of termination had been issued pursuant to such clause. * * *

DAR 8-602.3 Procedure for Default.

(c) If, after compliance with the foregoing procedures, the PCO determines that termination for default is proper, he shall, . . . [i]f the termination is predicated upon . . . failure of the contractor [other than failure to make timely deliveries] . . . give the contractor written notice specifying such failure and providing a period of 10 days (or such longer period as the PCO may authorize) in which to cure such failure. . . . Upon expiration of the 10 days (or longer period), the PCO . . . may issue a notice of termination for default unless he determines that the failure to perform has been cured.

DAR 8-602.4 Procedure in Lieu of Termination for Default.

The following courses of action, among others, are available to the PCO . . . in lieu of termination for default, when in the best interests of the Government:

(i) permit the contractor, his surety, or his guarantor, to continue performance of the contract under a revised delivery schedule (see 10-112(b) for requirement of notification of surety);

(ii) permit the contractor to continue performance of the contract by means of a subcontract, or other business arrangement with an acceptable third party; provided the rights of the Government are adequately preserved;* * *

DAR 15.205.20(ii)

Extraordinary maintenance and repair costs are allowable, provided such are allocated to the periods to which applicable for purposes of determining contract costs.

DAR Appendix K-201 Procedure for Requesting Pre-Award Survey.

(a) The contracting officer shall request a pre-award survey . . . indicating . . . the scope of the survey desired. * * * If information is needed on the offeror's eligibility under the Walsh-Healey Act, it must be specifically requested in block "14" of Section III.

K-203.3 Designation and Responsibilities of Team Coordinator and Members.

(a) When an on-site survey by a team is necessary, members should include specialists qualified to evaluate all appropriate phases of the firm's capabilities.

K-303.1(d) Specific Factors to be Considered. [T]hose factors described in K-303.2 through K-303.4 below and all others needed to provide the report and recommendations in the detail and to the extent required by the purchasing office shall be considered.

K-303.2 Production.

(a) General. The production portion of the on-site survey consists of an evaluation of the prospective contractor's ability to manufacture the product(s) in accordance with the specifications and delivery schedule of the proposed contract.

K-303.3 Quality Assurance.

(a) The standing of the quality assurance organization in the prospective contractor's overall organization must be evaluated. . . . and be reviewed:

K-303.4 Financial.

(a) General. The normal procedure for determining a prospective contractor's financial capability shall be initial pre-survey planning, followed by verification of financial data as required. . .

(b) Procedure. Aspects to be considered in determining the prospective contractor's financial capability (DD Form 1524-3) include the following:

(1) The latest balance sheet and profit and loss statement shall be reviewed. The following are indicative of the soundness of the prospective contractor's financial structure:

(i) rates and ratios;
(ii) working capital as represented by current assets over current liabilities;
(iii) financial trends such as net worth, sales and profit.

(2) The method of financing the contract shall be evaluated. Where sources of outside financing, other than the Government, are indicated, their availability should be verified.

(3) When financial aid from the Government is to be obtained, the necessity should be verified. Review shall be made concerning the applicability of such financing as progress payments or guaranteed loans.

TABLE OF AUTHORITIES

STATUTES

REGULATIONS

CASES

TEXTS

EXHIBIT 36

Note a

Total contract costs	$ 21,727,850
(less) contract costs projected	14,970,284
Total increase in cost of contract performance	$ 6,757,566
(less) sum released by Modification P-25	3,481,768
Adjusted increase in cost of contract performance	$ 3,275,798

Note b

114,758 cases priced at $27.725 total		$ 3,181,666
Profit rate of 15% equals profit of		x .15
		$ 477,250

Note c

Leasehold improvements		$ 838,510
Furniture and fixtures		50,349
Machinery and equipment		689,656
		$ 1,578,515
(less) accumulated depreciation & amort		257,652
Net		$ 1,320,863
(less) equipment credit	98,300	
	55,000	153,300
Total value of equipment lost through insolvency		$ 1,167,563

Note d

Award of MRE7 to Cinpac at $19,247,625; application of Freedom's profit rate of 15% = 2,887,144; contract level and profit held constant over MRE8, MRE9, MRE10 and MRE11 to arrive at projected lost profit of 2,887,144 x 5 contracts	$ 14,435,720

C E R T I F I C A T I O N

Pursuant to the Contracts Disputes Act of 1978 (Public Law 95-563, 41 U.S.C. 601-613) and the Defense Acquisition Regulation 1-314 (L), the undersigned certifies that this request for equitable adjustment submitted by Freedom NY, Inc., is submitted in good faith; that the supporting data are accurate and complete in all material respects, to the best of my knowledge and belief; and that the amount
requested accurately reflects the contract adjustment for which the contractor believes it is entitled.

_____
Henry Thomas
President

May 1, 1991

_____
Kevin Seraaj
Senior Vice President

CERTIFICATE OF OVERHEAD COSTS

This is to certify that:

1. I have reviewed the request for equitable adjustment submitted herewith;

2. All costs included in this request are allowable in accordance with the requirements of contracts to which they apply and with the cost principles of the Department of Defense applicable to those contracts;

3. This request does not include any costs which are unallowable under applicable cost principles of the Department of Defense, such as (without limitation); advertising and public relations costs (FAR 31.205-1), contributions and donations (FAR 31.205-8), entertainment costs (FAR 31.205-14), fines and penalties (FAR 31.205-15), lobbying costs (FAR 31.205- 22), defense of fraud proceedings (FAR 31.205-47), and goodwill (FAR 31.205-49); and

4. All costs included in this request benefit the Department of Defense and are demonstrably related to or necessary for the performance of the Department of Defense contract(s) covered by the request.

I declare under penalty of perjury that the foregoing is true and correct in all material respects.

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Henry Thomas
President

May 1, 1991

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Kevin Seraaj
Senior Vice President