

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of -- )  
 )  
CTA Incorporated ) ASBCA No. 47062  
 )  
Under Contract No. F42600-89-C-1310 )

APPEARANCES FOR THE APPELLANT: Thomas A. Lemmer, Esq.  
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APPEARANCES FOR THE GOVERNMENT: COL John M. Abbott, USAF  
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OPINION BY ADMINISTRATIVE JUDGE HARTMAN

Appellant, CTA Incorporated (CTA), contends that it is entitled to an increase in the ceiling price of its fixed price, incentive fee contract to “eliminate the improper downward contract price adjustment effected” by the Department of the Air Force under contract Modification No. P00017, which “restructured” the contract’s production and logistic support options by, among other things, decreasing both the number of complexes CTA was to produce and the price ceiling set forth in the contract’s incentive price revision clause. According to CTA, target costs for both the prototype and production complexes should have been adjusted to reflect the costs of its substituted radar subcontractor, not just target costs for production, and, if that adjustment had occurred as required by contract clause H-990, regulations, and/or the Changes clause, its prototype target cost, as well as contract ceiling price, would now be higher.

The Air Force, in contrast, contends that: Modification No. P00017 is irrelevant to this appeal; the Board lacks jurisdiction to consider CTA’s theory that it is entitled to relief based upon a “change” to the contract; and CTA is not entitled to an adjustment in price for additional prototype costs it incurred due to substitution of radar subcontractors based on contract clause H-990, applicable regulations, or the Changes clause. According to the Air Force, contract clause H-990 allows only a downward adjustment in price, and CTA’s contrary construction is unreasonable and conflicts with CTA’s construction of the clause prior to the instant dispute.

## FINDINGS OF FACT

In 1989, the Department of the Air Force decided to “upgrade” its existing “T-45” navigational training simulators through use of more powerful computers and enhanced software to provide additional training features for its personnel. A critical element of each T-45 training simulator to be upgraded was a Digital Radar Landmass Simulator (DRLMS), a set of maps of the continental United States simulated through software and hardware to replicate cultural and weather features at various flying speeds. The Air Force discussed development and fabrication of an upgraded T-45 simulator with appellant, CTA. Pursuant to those discussions, CTA solicited proposals from potential vendors for the performance of DRLMS work. All proposals received by CTA and deemed viable presented basically a “hardware” approach to the DRLMS work, except one submitted by Merit Technologies, Inc. (Merit). CTA and the Air Force deemed Merit’s DRLMS proposal to be the most “attractive” because it presented essentially a “software-based” approach possessing lower life-cycle costs and was from a vendor who had developed radar mapping software previously for another defense program, which was thought applicable and would result in lower development costs. (Tr. 1/17-21, 25-27, 86-89, 163-67; R4, tab 16 at enclosures 2, 3, 4)

Subsequently, CTA furnished the Air Force a technical proposal for development and fabrication of an updated T-45 simulator, which incorporated Merit’s “software-based” approach for performance of DRLMS work. In addition, CTA furnished the Air Force a technical proposal for supply of engineering and logistics support (CLS) for the existing navigational training simulators during fiscal year (FY) 1990. (Tr. 1/17, 25, 89, 166, 2/129; R4, tab 2)

In September of 1989, pursuant to section 8(a) of the Small Business Act, 15 U.S.C. § 637, the Air Force entered into a letter contract, No. F42600-89-C-1310, with the Small Business Administration (SBA) to supply CLS during FY 1990 for existing navigational training simulators and, if an option was exercised, to develop and fabricate an updated T-45 navigational training simulator “prototype.” Simultaneously, SBA entered into a letter contract, No. SB88920201, with CTA for performance of that work. We refer to these contracts collectively as the “contract.” The parties’ letter contract incorporated by reference CTA’s technical proposals and numerous standard clauses, including Federal Acquisition Regulation (FAR) 52.216-25 CONTRACT DEFINITIZATION (APR 1984) and ALT. I (APR 1984). It also contained over 30 contract line item numbers (CLINs) to be definitized as cost reimbursable, labor hour, or firm fixed-price CLINs, and set forth 16 November 1989 as the “target date for definitization.” (R4, tab 2; tr. 1/17-20, 85-86, 2/129)

The parties attempted to finalize their letter contract, but had difficulty agreeing on a price. To resolve the impasse regarding price, they agreed to convert their contract’s

structure from firm, fixed price to fixed price incentive fee (FPIF), with some CLINs remaining cost reimbursable and labor hour. (Tr. 1/24, 70, 116, 120, 152-53, 176, 177-79, 2/153)

The parties thereafter negotiated a “total price” for the “prototype” simulator upgrade option and a new “production” option for supply of 12 upgraded simulators (tr. 1/28, 34, 40, 162, 2/112, 4/91). More than five months after their definitization target date, on 20 April 1990, CTA advised the Air Force’s contracting officer (CO), Shirley Wahl, who had been substituted as CO because of her familiarity with FPIF contracts, that agreement had been reached by the parties on definitization and this agreement was based, among other things, upon application of the FPIF ceiling and targets “against all FPIF CLINs in the aggregate for final pricing purposes” (R4, tab 2; ex. A-75; tr. 1/83-85, 97, 100, 115-16, 2/110-11, 138).

Shortly after the parties agreed on a definitization price, CTA notified the Air Force that Merit might not be performing the DRLMS work due to an inability “to do some of the data requirements that were necessary.” The Air Force advised CTA that it would not agree to increase the price negotiated if CTA had to substitute another DRLMS subcontractor and that, to meet the schedule and avoid delaying contract finalization for selection of another subcontractor, the parties should insert a standard clause allowing the Air Force to reopen negotiations for a downward adjustment of the subcontract effort in the event a new subcontractor was selected and its prices were less than those of Merit’s. (Tr. 1/65-66, 71, 92-93, 95-96, 117-18, 127, 130-31, 138, 151-52, 154-55, 168, 180-82, 2/118, 154-57, 161; R4, tab 5 at 4-24)

On 11 May 1990, the Air Force’s buyer completed the “blanks” in the standard form clause, retyped the clause, and sent the clause to CTA by facsimile for review and comments. The standard “reopener clause” stated:

IAW clause H-908, . . . [CTA] has selected Merit as the Digital Radar Landmass Simulator subcontractor. In the event that Merit will not be performing this task, the Government has the right to reopen negotiations. A cost impact proposal will be submitted by the contractor within 60 days of the decision to change subcontractors. The parties will agree to a downward only prime contract price adjustment. The equitable adjustment shall be evidenced by a modification to the contract. Failure to reach agreement on the requirement or amount of a cost impact shall be resolved under the Disputes Clause of the Contract.

(Exs. A-74, G-8; tr. 1/95-97, 168, 182, 2/109-10, 113-14, 119, 155-57, 160-61)

CTA's contract administrator reviewed the clause and proposed that additional language be added. The Air Force buyer advised CTA several times that the Air Force deemed CTA's proposed addition of the phrase "and any other adjustment as provided for in FAR 52.216-16" to be "meaningless" because FAR 52.216-16 INCENTIVE PRICE REVISION – FIRM TARGET (APR 1984) is among the clauses mandated to be included in the definitized contract and requires targets and ceilings "be adjusted down" if the contract price is reduced based upon a new DRLMS subcontractor. CTA's contract administrator, however, insisted the language be added because he was concerned targets and ceilings would not be adjusted downward. The Air Force was anxious to finalize the parties' contract because it was experiencing "schedule impacts" and "feeling pressure" from its "customer," the Air Training Command (ATC). While the Air Force buyer and CO Wahl preferred to utilize the stock language, they decided to acquiesce to CTA's request that language be added because they believed the additional wording already was in the contract, it was "meaningless" to insert the language a second time, and hopefully their acquiescence would expedite contract finalization. At the time, neither party deemed inclusion of the "reopener" clause a significant issue. (Tr. 1/66-67, 108-10, 120-25, 127-29, 147-48, 153-54, 161, 169-71, 182, 184-86, 206-15, 220, 2/97-98, 114-15, 118, 120, 124-26, 128, 137-40, 155-56, 158-63, 170-72, 174-75, 178)

As the parties were preparing the modification which would definitize their letter contract, \$435,000 "was pulled from the contract." The Air Force buyer, who was under pressure to issue the contract so that the delivery deadline could be met, decided that she would not halt issuance of the contract until funding was available, but transfer \$435,000 in the modification from the price of the "prototype" option, which had been exercised, to the price of the "production" option, which had not been exercised and was not scheduled to be exercised until the next fiscal year. CTA agreed to this change in the definitization modification because both it and the Air Force believed that the production option would be exercised and the price "differences between CLINS would, in fact, get washed out." The total complement of navigational trainer simulators owned by the Air Force was 13 and, at the time, no reason was apparent to cause either the buyer or CTA to believe that the modification program would involve anything other than the existing complexes at Mather Air Force Base (AFB) (one prototype plus 12 production units). (Tr. 1/43, 2/15-16, 18, 20-22, 143-45, 149-50, 153, 164-65, 3/5, 124-26, 148-49, 201-04)

During August of 1990, the parties executed contract Modification No. PZ0006 definitizing their letter contract. Their definitized contract contained 173 CLINs, 3 of which pertained to development of the prototype upgrade (CLINs 0031, 0032, and 0035) and 1 of which permitted the Air Force to purchase 12 production units of the prototype upgrade at a per unit target price of \$734,979.21 (CLIN 0050). Clause C-1 of the contract listed CTA's 1989 technical proposals among the "specifications, standards and

drawings” for the contract. Clause H-990 of the contract, the modified “reopener clause,” provided:

In accordance with Clause Number H-52, “Subcontract Cost Considerations”, the following supplemental information is incorporated: As stated in Clause C-1, “Specifications, Standards & Drawings”, CTA Incorporated has selected Merit Technologies, INC. as the Digital Radar Landmass Simulator (DRLMS) Subcontractor. In the event that Merit will not be performing this task, the Government has the right to reopen negotiations to address the impact of an alternate DRLMS source on the total program. A cost impact proposal will be submitted within 30 days of the decision to change subcontractors. The parties will agree to a one-time downward only prime contract price adjustment, if warranted, and any other adjustments as provided for in FAR 52.216-16, “Incentive Price Revision – Firm Target”. The equitable adjustment shall be evidenced by a modification to the contract. Failure to reach agreement on the requirement or amount of a cost impact shall be resolved under Disputes Clause of the contract.

The contract incorporated by reference various standard clauses, including FAR 52.216-16 INCENTIVE PRICE REVISION – FIRM TARGET (APR 1984), FAR 52.217-7 OPTION FOR INCREASED QUANTITY – SEPARATELY PRICED LINE ITEM (MAR 1989), FAR 52.243-1 CHANGES – FIXED PRICE (AUG 1987), and FAR 52.233-1 DISPUTES (APR 1984). At clause I-166, the contract listed CLINs 0031, 0032, 0035, and 0050 as among the 45 CLINs to which FAR 52.216-16 applies, and specified that there was one ceiling price for the contract of \$35,969,545.57 (118 percent of target). At clause I-193, the contract specified 1 October 1991 as the date by which the Air Force was to exercise Option I (CLIN 0050 for supply of 12 production units) pursuant to FAR 52.217-7. The schedule for the modification identified, among other things, a “target price” for each CLIN. For example, the target price of CLIN 0031, 0032, and 0035, respectively, was \$5,983,725.25, \$339,557.46, and \$4,037,823.65. While the target price for CLIN 0050 was \$8,819,750.52, this sum was not included in the estimated total award amount of \$15,090,279.09 set forth in the modification because the CLIN 0050 option had not been exercised as of the date of the modification. (R4, tab 4; tr. 1/27-28, 30-34, 40, 86, 167, 2/129, 201, 3/15-16, 43, 169-70, 218, 4/83, 91)

During summer 1990, CTA entered into a subcontract with Harris Corporation (Harris) to perform the DRLMS work the parties thought would be performed by Merit. On 7 September 1990, “[p]ursuant to Clause H-990,” CTA submitted to the Air Force’s

buyer at Hill AFB an “Engineering Change Proposal for Merit/Harris Change.” CTA’s proposal consisted of “an updated technical volume” for review and “incorporation into the contract,” and a “cost volume that reconciles the impact of changing . . . [DRLMS] subcontractor from Merit to Harris.” CTA’s cover letter advised that, “[s]ince Clause H-990 permits only a downward adjustment to the contract as a result of this change, we are not proposing an equitable adjustment to the contract price as a result of this proposal at this time.” The cost volume of the proposal indicated that there was about a \$724,000.00 increase to the cost of the prototype CLINs and about a \$448,000.00 decrease to the cost of the production option CLIN, leaving CTA with a net increase in total program cost of about \$276,000.00 as a result of changing from Merit-to-Harris. The technical volume of the proposal indicated that Harris’ approach to the DRLMS work was primarily hardware, not software, based. Nowhere in the proposal’s cover letter, technical volume, or cost volume did CTA request that the Air Force adjust the target prices of CLINs or state that the Air Force was required to make such adjustments. (R4, tabs 3, 5; tr. 1/58-60, 2/55-61, 3/7-8, 81, 106-08, 118-24, 160, 4/83-86)

The Air Force’s buyer forwarded the technical volume to Government technical personnel for review. For about nine months, CTA responded to questions posed by Air Force technical personnel regarding its substitution of Harris for Merit as DRLMS subcontractor. By letter dated 23 May 1991, CTA asked Danelle Woods, the Air Force CO as of December 1990, to advise whether the Government’s acceptance of its response to certain technical action items resolved “remaining issues relative to the Merit-to-Harris change.” By letter dated 10 June 1991, CO Woods advised CTA that “[t]he information submitted concerning [its] subcontractor change from Merit to Harris is acceptable,” and requested that CTA’s contract administrator contact her regarding the 23 May letter and “H-990 downward adjustment clause.” CO Woods had set aside CTA’s proposal when she was assigned the contract because she believed an “engineering change” proposal is not subject to review before establishment of a technical “baseline,” and decided in June she should speak with CTA’s administrator to verify the Government was not entitled to any downward adjustment in price under clause H-990 based upon the Harris substitution. CTA did not respond to the CO’s 10 June letter requesting its administrator contact her. (Exs. A-1, -3, -4, -62, -64, -65, -69, -70, -71; R4, tabs 6, 26; tr. 2/12-13, 28-41, 60-64, 182-98, 3/23-24, 79-82, 108-18, 161-65)

Several days after her 10 June letter, CO Woods received the following message from ATC:

1. The Air Force is reviewing options for specialized undergraduate navigator training . . . production as part of an overall scrub of navigator requirements. Initial results indicated production could drop as low as 100 blue suit navigators per year from previous highs of 600. This

reduction significantly reduces our requirements for the current planned buy of all 13 T45 complexes. Since out year navigator production numbers are still unresolved, and since the current contract would obligate the Government to procure the 12 training T45 complexes, we recommend restructuring the current contract.

2. To provide maximum flexibility to respond to Air Staff direction, we recommend breaking the production and installation options . . . into a series of priced options to be executed during FY92. The first option would procure five complexes. Subsequent options will be for either one or multiples of two complexes as required.

. . . .

5. We realize this is a significant contracting effort. We must move quickly to facilitate the planned relocation of navigator training and to protect FY92 production dollars. We stand ready to assist . . . in finalizing the details of our requirements.

(Ex. A-54 at 2-3) CO Woods conducted a conference by telephone with ATC officials on 28 June 1991 requesting that they supply her detailed information “to facilitate contract renegotiation” and, during July 1991, ATC further advised as follows:

2. The minimum number of complexes required to meet currently projected student production is six total. Therefore, we require an option for five production complexes in addition to the one prototype complex. Since out-year navigator production numbers are contingent on pending CSAF guidance, an additional, but unknown, number of complexes may be required. An option package should be structured which will minimize per-unit price and allow the Government to purchase up to seven additional units during the time frame between prototype acceptance and 30 Sep 92. No options should be exercised earlier than . . . acceptance of the prototype complex to insure suitability. Delivery schedule for the first production complex should be five months after option exercise with remaining complexes delivered at a rate of one per month.

3. The current contractor logistics support (CLS) effort should be rescoped and tied directly to the production options to properly match complexes with their CLS. . . .

(R4, tab 7)

CO Woods recognized that she was in a “dilemma”: the Air Force possessed the right contractually to exercise the option for production of 12 units, but no longer needed 12 units. CO Woods suggested that the Air Force exercise the existing option for 12 units and “terminate for convenience” part of the work when it ascertained the number of units it needed. ATC, however, opposed exercising the option for 12 units. While the Air Force could elect not to exercise the option and enter into another contract for production of less than 12 units, Ms. Woods did not currently possess the level of data necessary for issuance of such a contract and would not have been able to meet the schedule desired by ATC for acquisition of the units if she pursued such action. Ms. Woods, thus, decided on “a new rebirth” – she would negotiate to restructure the options, *i.e.*, to obtain less units and CLS, and then issue a modification to the contract incorporating the new terms for obtaining production units and CLS. By letter dated 23 July 1991, CO Woods “formally” notified CTA that:

1. Due to the reduction of defense forces with complementary reduction in the numbers of navigators requiring training, we will not be exercising subject options by 1 Oct 91. By not exercising these options as originally negotiated and contractually written, we are opening the contract to renegotiation to restructure options tailored to meet the government’s current needs. Consequently, please provide a pricing schedule with certified cost data . . . .
2. At this time it [is] our intent to proceed with production and installation of five plus X kits with delivery five months after prototype acceptance for the first kit and remaining kits delivered one each per month (no change to current delivery schedule). Consequently, please price the X kits in addition to five in lieu of a stand alone quantity.
3. The CLS reduction effort should be tied directly to the production options . . . .
4. Please submit your cost data as soon as possible, but not later than 23 Aug 91. We plan to exercise the restructured

Options . . . upon . . . prototype acceptance and the X option any time between acceptance and 30 Sep 92.

After receipt of Ms. Woods' notification, CTA began gathering the cost and pricing data necessary for a "formal response" regarding option "restructure," including collection of data relating to Harris. By letter dated 12 September 1991, Ms. Woods confirmed her verbal direction the prior day that CTA was to submit to the Air Force "cost and pricing data for five production kits" and "the CLS reductions can be negotiated during FY92." (R4, tabs 8, 9; exs. A-30, -52, -53, -54, -60; tr. 2/76-94, 3/10, 18-19, 60-65, 85-86, 89-90, 92, 94-101, 127-28)

On 1 October 1991, the date by which the existing option for 12 production units was to be exercised, CTA submitted to CO Woods and to ATC, as requested by the Air Force, a cost proposal for 5 production units under a restructured option. The proposal used Harris, rather than Merit, costs for production of the units and, as anticipated by the Air Force, had a cost per unit greater than the existing 12-unit option because "the more units [one purchases], the less per unit cost." Besides identifying costs for producing five units, CTA's proposal "separately" identified "two equitable adjustment 'offsets' directly attributable to changing the existing production Option." CTA described the two offsets as follows:

2. Funding Offset – A last-minute government transfer of dollars from prototype to production due to a funding shortfall experienced by the contracting office. Since CTA's FPIF contract performance was negotiated in the aggregate, it was mutually agreed that this [shortfall] would not affect the total consideration for the program as a whole. However, since consideration was thereby understated for [the] prototype, with the inherent promise to offset this shortfall via the production option, CTA respectfully requests an equitable adjustment to the prototype contract to reflect the original intent of the parties at the time negotiations were concluded. The value of this offset is \$435,550.

3. Merit-to-Harris Conversion Offset – At the time of negotiations, the parties recognized an impending change in radar subcontractors, from Merit to Harris, due to Merit's unwillingness to sign up to perform . . . . As a result, a contract clause (H-990) was created to obtain a CTA change proposal for changing subcontractors, and to ensure that any "total program" reduction would be passed on to the government. While the net affect of this change was an

increase in cost to CTA, no consideration could be provided due to the “downward only” provision. However, this change also disclosed an increase in cost to prototype, partially offset by a decrease in the production cost. Compared to the Merit baseline under which the contract was negotiated, this created an artificial shortfall in [the] prototype and overstatement in production. Since the government viewed . . . [CTA’s] change proposal in the aggregate, no action was taken to realign consideration between prototype and production, thereby leaving excess consideration in the production CLINs. CTA’s proposal for the [option] restructure change therefore includes recognition of this deferral in order to retain the equitable consideration originally contemplated for the radar portion of the contract. The value of this offset is \$493,585.

CTA’s proposal did not cite FAR 52.216-16 or assert that any adjustment was required to be made under that FAR. (R4, tab 10; tr. 1/80-81, 2/94-95, 209-11, 3/19-20, 22, 31-32, 52, 73-74, 128-30, 206)

Shortly after receipt of CTA’s proposal, the Air Force requested that the Defense Contract Audit Agency (DCAA) perform a field audit with respect to the proposal (exs. A-29, -30, -73). While DCAA was performing its audit, the Air Force transmitted to CTA some initial comments regarding the proposal, and CTA responded to those comments. Regarding the Air Force’s comment that the funding offset “cannot be allowed” because CTA agreed to transfer of funds to the option and an option “may not be exercised,” CTA stated that: it “relied on the . . . [CO’s] unilateral decision to move funds from prototype to production solely as a funding convenience, with the understanding that CTA would not suffer financial detriment from this funding transfer”; without an “intent to provide the funding shortage at a later date, the Government would in fact [have] be[en] acting in violation of the Anti-Deficiency Act, under which . . . [a CO] is expressly prohibited from authorizing work without monetary consideration”; and absent CTA’s “reliance in good faith that the . . . transfer of funds from one bucket to another was simply the deferral of a Government funding shortfall, and not an expectation for CTA to perform approximately \$425K of work for ‘free,’ CTA would not have executed the definitizing [No.] PZ0006 modification.” With respect to the Air Force’s further comment that the “Merit-to-Harris offset is unjustified” because it “cannot be expected to pay for contractor/subcontractor problems,” CTA stated that: because “the Government . . . elected not to exercise the production option as envisioned, the Government, in effect, created a constructive change . . .”; “[u]nless [CTA’s] proposed offset is incorporated, the production restructure results in a different (i.e., changed) ‘total program’ impact of (\$724,470) in lieu of the [impact of] (\$275,748) anticipated” under the FPIF contract for the Merit-to-Harris substitution; and “the changes clause has been

interpreted by the courts” as requiring the furnishing of an “equitable adjustment such that the contractor is not any worse off than it would have been, were it not for the change in the work.” (R4, tab 11; ex. A-32)

In response to CTA’s assertions regarding the funding offset, CO Woods traced the “administrative commitment documents” and found that “money had been taken away [from the contract] at the last minute.” She then contacted the buyer and CO previously assigned to the contract to ascertain if they had shifted monies to the production option due to the funding shortfall. The buyer advised CO Woods that she had moved \$435,550 from the prototype CLINS to the production option as a result of the shortfall and advised CTA that it would receive the funds when performing the option. CO Wahl advised CO Woods similarly, and confirmed that an equitable adjustment regarding the funding offset would be appropriate. CO Woods, therefore, decided she would grant the funding offset request, *i.e.*, restore to the prototype option monies removed due to the funding shortfall. (R4, tab 15 at 23; exs. A-25, -28, -60; tr. 2/14-16, 18-27, 143-50, 3/4-5)

With respect to the Merit-to-Harris offset, however, CO Woods contacted the Judge Advocate General office for advice and was told it “disagreed” with the offset. By letter dated 24 March 1992, CO Woods advised CTA:

The “Merit to Harris Offset” is not negotiable. The total Merit to Harris package, including your comments, has been discussed with our legal staff. There is no change in our position: the Government did not direct the change from Merit to Harris and cannot be responsible for the increase in costs caused by CTA’s decision to change subcontractors. Under the disputes clause of the contract CTA can file a certified claim.

Similarly, on a typed list of over 20 items to be negotiated by the parties that included “Merit-Harris” offset, CO Woods wrote next to the latter item the phrase “– Disputes Clause/Claim.” (R4, tabs 13, 15 at 24, 18; tr. 2/70-72, 3/25)

On 1 and 2 April 1992, CO Woods, other Air Force personnel, and CTA officials met to negotiate “restructure of production options . . . under T45 contract [No.] F42600-89-C-1310.” During the negotiations, the Air Force “accepted” the funding offset and provided CTA a “draft Mod,” which “appeared to contain the entire \$435K requested by CTA.” However, with respect to the Merit-to-Harris offset, the Air Force told CTA that it “was free to pursue an equitable adjustment under the disputes clause via submission of a formal claim,” submission of a claim “would not be held against . . . [CTA] should . . . [it] pursue this option,” and “this was . . . [CTA’s] only option left.” The Air Force’s contract price analyst wrote in “footnote I” of his memorandum

memorializing the negotiations that, with respect to Merit-to-Harris, “attorneys for the government disagreed with CTA’s proposed costs entirely” and CTA was told the Air Force “would not include these costs for this modification.” CTA’s contract manager similarly wrote in his memorandum of the parties’ negotiations that “[t]he Government believes . . . [the Merit-to-Harris offset] claim does not have an adequate basis to succeed based on discussions with their legal personnel” and “[t]his remains an unresolved issue,” which “is now to be resolved apart from the production effort.” In sum, for purposes of their option restructure negotiations, the parties set aside the Merit-to-Harris issue and proceeded to resolve other “restructure” issues, with the expectation that CTA was free to pursue the set-aside, Merit-to-Harris issue as a claim under the Disputes clause if it later wished to do so. (R4, tabs 13, 14 at 23-24, 18, 19; ex. A-24; tr. 1/47-48, 2/68-75, 3/20-22, 25-34, 72-79, 134-39, 206-10)

During April 1992, the parties executed a modification to their contract, No. P00021, which increased the prototype CLINs by \$435,550 and resolved the funding offset issue (tr. 3/75-76; R4, tabs 14, 24). About seven months later, during early November 1992, the parties executed another modification to their contract, No. P00017, which was intended “to reconfigure, fund and exercise production option . . . thereby reducing number of complexes from 12 to 5.” This modification changed the number of units or complexes to be produced by CTA under the contract’s production option from 12 to 5. It also changed the ceiling price set forth in the FPIF contract’s incentive price revision clause from \$35,969,545.57 to \$32,588,809.93. Because Modification No. P00017 was negotiated utilizing Harris cost and pricing data, the modification caused the contract pricing to become a “mixture” — production CLIN prices were based on Harris cost data (which had lower production and higher prototype costs than Merit), but prototype CLIN prices were based on Merit cost data (which had lower prototype and higher production costs than Harris). The modification included language indicating it incorporated “Statement of Work REVISION 8” which was dated 19 October 1992. The modification did not include any language indicating the parties had agreed upon an accord and satisfaction, a settlement, release, or waiver of any claim. (R4, tab 15; tr. 2/202-03, 209-11, 217, 3/6, 10-11, 14, 32, 144-47, 206, 4/85-86)

At a program management review on 19 November 1992, CTA furnished the Air Force a list of “OPEN ISSUES,” which included the “Merit-to-Harris” issue (R4, tab 20). At another program review two months later, in January 1993, CTA again referenced “Merit-to-Harris” as an open issue (R4, tab 23; tr. 3/209). In March of 1993, after CO Woods announced that she would retire from the Government in 1994, the Air Force assigned Stephen Harris as its CO for the contract (tr. 2/12, 3/215-18, 4/23). During spring and summer 1993, CTA continued to try to pursue the Merit-to-Harris issue on a “non-claim basis” by raising and discussing that issue with the Air Force’s new CO (tr. 3/210, 224-25). At a program management review on 28 July 1993, the Air Force agreed “to review” the “change from Merit to Harris as DRLMS subcontractor” and to “advise

CTA of any change in its position.” CO Harris wished to give CTA “an answer” and put the issue “to rest.” He reviewed the detailed files CO Woods maintained regarding the FPIF contract and Merit-to-Harris issue, and spoke with former CO Woods about the issue. Thereafter, by letter dated 11 August 1993, CO Harris advised CTA:

1. Several discussions have been held and letters have been written concerning subj “re-opener clause” and its application to the change in subcontractors from Merit to Harris Corp. This letter restates the Government position that this issue is not negotiable [sic] and will not be considered in conjunction with subj clause.
2. This clause [(H-990)] provided a unilateral right for the Government to reopen negotiations and negotiate a down-ward only adjustment to the total contract price if there was a change in subcontractors. CTA made a decision to change subcontractors . . . . The [subcontractor] change did not result in an opportunity for a downward only adjustment to the contract . . . . The clause is not applicable to the action that took place . . . .

(R4, tabs 22, 25; tr. 3/209-10, 224-26, 4/23-28)

On 7 September 1993, CTA submitted to CO Harris a certified claim regarding the “Merit-to-Harris offset,” which provided in part:

The Contract called for the Air Force to exercise the production units option on or before October 1, 1991. On July 23, 1991 the Air Force informed CTA that it would not meet the October 1, 1991 deadline and requested that CTA repropose production costs, but for five (5) units instead of the original twelve (12). . . .

In response to the Air Force’s request, CTA submitted its Production Restructuring Proposal on October 1, 1991. The production costs included in that proposal were significantly less than what they would have been if Merit had remained the DRLMS subcontractor because of the Harris’ solution and the lower price for the production units. CTA’s Production Restructuring Proposal also included a line item for the increased prototype costs associated with the DRLMS subcontract change which equalled [sic] \$724,470. . . .

....

The Air Force refused to consider the line item for increased prototype costs when negotiating the production restructure. CTA ultimately agreed to a new price for the production units that reflected the lower production costs of the Harris solution, but not the increased prototype costs, to accommodate the government's strong desire to conclude negotiations and to start production. CTA, however, reserved the right to reopen the issue of increased costs on the prototype because of the change in DRLMS subcontractors, and the parties agreed to resolve this dispute through the disputes process. . . .

....

The Air Force has failed to adjust CLIN prices in accordance with FAR § 52.216-16 and H-990. Thus, CTA is entitled to an upward adjustment of the billing prices for the prototype CLINs to reflect proper CLIN costs. Moreover, the Air Force adjusted the price of the Contract downward because of the change from Merit when the prices of the options were restructured. Clause H-990 did not authorize such an adjustment because the change from Merit increased total programs cost. CTA, therefore, is entitled to a corresponding Contract price increase to eliminate the improper downward contract price adjustment effected through the production restructuring modification.

....

Prior to the restructure, there can be no dispute that Clause H-990 did not permit a downward price adjustment and that CTA would absorb the net cost increase. Thus, the Air Force must believe that its failure to exercise the options somehow voids the intent of Clause H-990, allowing the Air Force a windfall. That windfall would occur because CTA has been required to bear the increased prototype costs of the change in DRLMS subcontractors, while the Air Force has effected a contract price reduction because of the change for which it is not entitled. . . .

CTA's claim sought an increase in the contract price of \$700,047.00. The record is not clear with respect to how CTA arrived at this amount. (R4, tab 16 at 1 and encl. at 4, 5, 9; *see* tr. 1/9-10, 3/119-21, 123-24, 146-47, 179-83)

In January of 1994, CTA appealed from the lack of a final CO decision. About two months later, in a final decision dated 24 March 1994, CO Harris denied CTA's claim. He stated in the decision that FAR 52.216-16 "does not require that a modification be issued repricing the prototype and production CLINs," and that the Air Force "did not exercise Clause H-990" when issuing "Modification [No.] P00017." In the conclusion to his decision, CO Harris added:

My final observations concern P00017 and the negotiations that preceded it. Specifically, . . . [CTA] made a strong effort to receive the moneys you are now claiming when submitting your proposal for Modification P00017. . . . In response, the [CO] consistently and clearly rejected your requests and even went so far as to describe the issue of the "Merit to Harris Offset[?]" as "non-negotiable" and invited you to enter into the dispute procedures if her position was unacceptable. Still later, when negotiating Modification P00017 in May of 1992, the [CO] offered you and you accepted zero dollars for the "Merit to Harris Offset". Furthermore, when you executed and agreed to Modification P00017 you did so without any reservation concerning the "Merit to Harris Offset" (while making specific mention of other matters). Accordingly, I find that Modification P00017 is an Accord and Satisfaction of and settlement of the "Merit to Harris Offset" issue and that by your conduct you released and waived any claim or claims for the "Merit to Harris Offset" . . . .

(R4, tab 17; tr. 3/226-27)

In April 1994, CTA filed its complaint with this Board, which asserted that the "Air Force adjusted the price of the Contract downward when the production options were restructured based upon the lower Harris subcontract price" and "CTA is entitled to an increase in the Contract target cost . . . , Contract target profit . . . , Contract target price . . . [,] and Contract ceiling price . . . to eliminate the improper downward contract price adjustment effected through the production restructuring contract modification" (compl. ¶¶ 35, 36). In its answer to the complaint, the Air Force asserted "accord and satisfaction," "release," and "waiver" as affirmative defenses to the appeal based upon CTA's execution of Modification No. P00017 (answer at 10-12). During a four-day trial

of the appeal in Denver, Colorado, on only the issue of entitlement, former CO Woods testified:

Q Okay. Now would you please read [into the record] Lines 18 through 24 on page 96 [of your deposition].

....

A . . . “And isn’t it true that what this is saying is that you did not resolve the issue of Merit-to-Harris offset in P00017?”

“What this tells me is that we did not include the Merit-to-Harris offset. We did not include it because we did not negotiate it. It was denied.”

....

Q So how could you have negotiated the issue if you felt you didn’t have the authority to negotiate it?

A I understand what you are saying: How could you apply a zero-dollar value to something that we didn’t negotiate.

Q That is a good question.

A That is what you are asking me?

Q That is correct.

A Okay. Then I agree with the deposition, that it was not included in P00017.

....

Q And did you sign this document?

A Yes.

Q And isn’t it true that the purpose of this document was to record or memorialize the price negotiations between the Government and CTA regarding restructure of the options?

A Yes.

Q Is there any statement in this document that the Merit-to-Harris issue had been negotiated or in any way settled?

A No.

Q Can you think of a single document that records the fact that the Merit-to-Harris issue was negotiated with CTA and settled?

A No.

(Tr. 2/69-72, 75) CO Harris similarly testified at trial:

Q Okay. And Ms. Woods, I believe you have described as an exceptionally thorough documenter. Is that correct?

A Exceptionally.

....

Q Okay. What I am asking you is, just based on your testimony today, your review of the file, the letters, your discussions with Ms. Woods, your own knowledge as the contacting officer, do you, as Steve Harris, contracting officer for the Air Force, believe that the Merit to Harris issue is truly resolved in P00017?

A I would have to honestly say no.

(Tr. 4/27-28, 36)

## DECISION

### I. Affirmative Defenses

In its post-trial briefs, the Air Force does not expressly argue that this appeal is barred by accord and satisfaction, release, or waiver. The Air Force asks in its proposed findings, however, that this Board find that: “the parties met and successfully resolved the issue of how much . . . [it] was to pay . . . [CTA] for delivering five production units”;

“. . . [it] did not agree to pay . . . [CTA] anything for the Merit to Harris Offset Issue”; its “Pricing Negotiation Memorandum shows zero dollars was negotiated for this matter”; and “Modification P00017 . . . was signed by . . . [CTA] on 30 October 1992 (without relevant exception)” (GPF 23, 24). Further, the Air Force states in its post-trial reply brief that it does not “accept” CTA’s proposed finding that the “Merit to Harris ‘offset’ issue was neither negotiated or settled by the parties . . .” (Gov’t reply br. at 18-19, ¶ 20; app. br. at 10, ¶ 46) We, therefore, are not free to conclude that the Air Force has waived or withdrawn its affirmative defenses of accord and satisfaction, release, and waiver, but must address those defenses. *See, e.g., United Technologies Corp., Pratt & Whitney Group*, ASBCA Nos. 46880, 46881, 97-1 BCA ¶ 28,818 at 143,790 (affirmative defenses not addressed were “withdrawn with prejudice” before conclusion of trial); *C. Martin Co.*, ASBCA No. 23607, 84-1 BCA ¶ 17,117 at 85,228 (affirmative defense not addressed was withdrawn by counsel during hearing and not at issue).

#### A. Accord and Satisfaction

Discharge of a claim by accord and satisfaction occurs when some performance different from that which was claimed as due is rendered and the substituted performance is accepted by the claimant as full satisfaction of the claim. *E.g., Brock & Blevins Co. v. United States*, 343 F.2d 951, 955 (Ct. Cl. 1965). In order for an accord and satisfaction to exist, there must be, among other things, a meeting of the minds or mutual agreement of the parties, with the “intention” that substituted performance is being accepted by the claimant as full satisfaction being clearly stated and known to the claimant. *Asbestos Transp. Servs., Inc.*, ASBCA No. 46263, 98-1 BCA ¶ 29,502 at 146,376; *Chantilly Constr. Corp.*, ASBCA No. 24138, 81-1 BCA ¶ 14,863 at 73,397-98.

The Air Force contends in its answer that CTA’s “execution and acceptance of Modification P00017 to the contract . . . operates as a complete settlement and Accord and Satisfaction of the disputed ‘Merit to Harris offset’ issue” (answer at 12). According to the Air Force, “[i]n negotiating . . . Modification P00017, the Contracting Officer settled all matters presented or disputed by . . . [CTA] in its . . . 1 October 1991 proposal for the five (5) production units” (answer at 10).

Modification No. P00017, however, includes no statement that it settles the Merit-to-Harris issue or any other dispute. Where a modification fails to contain any statement that the dispute is being settled or other indicia of final resolution of the dispute, as here, one should examine the circumstances surrounding that modification to determine if the modification was intended to be, and is, a fully integrated settlement of the disputed issue. *Mass. Bay Transp. Authority v. United States*, 129 F.3d 1226, 1235 (Fed. Cir. 1997).

An examination of the circumstances surrounding Modification No. P00017 does not show that the modification was intended to be an integrated settlement of the Merit-to-Harris issue. Rather, such an examination shows that the parties set aside the Merit-to-Harris issue and proceeded to resolve other “restructure” issues, with the expectation that CTA could pursue the set-aside issue as a claim under the Disputes clause if it wished to do so. While CTA raised the Merit-to-Harris and funding offsets in addition to CTA’s costs of producing five complexes as part of CTA’s 1 October 1991 option “restructure” proposal, before conduct of formal negotiations regarding that proposal, the Air Force’s CO notified CTA that the issue had “been discussed with our legal staff,” “[t]he ‘Merit to Harris Offset’ is not negotiable,” and “[u]nder the disputes clause of the contract CTA can file a certified claim.” Similarly, during formal negotiation of the proposal in April 1992, the CO advised CTA that that it “was free to pursue an equitable adjustment under the disputes clause via submission of a formal claim,” submission of a claim “would not be held against . . . [it] should . . . [it] pursue this option,” and “this was . . . [CTA’s] only option.” The Air Force’s willingness to negotiate a portion of the three issues set forth in CTA’s option restructure proposal does not equate to a resolution of all of CTA’s claims. “The Government cannot refuse to negotiate specific claims, reach an agreement on the remaining items being considered and then argue that appellant is barred from pursuing claims regarding all claim items including the excluded items.” *Varaburn Ltd. & Lin Heng Eng’g Ltd., J.V.*, ASBCA No. 22177, 82-1 BCA ¶ 15,744 at 77,926; *Kurz & Root*, ASBCA No. 17146, 74-1 BCA ¶ 10,543 at 49,940-41.

At trial, the Air Force’s CO testified the Merit-to-Harris issue was not negotiated as part of Modification No. P00017 and she was aware of no document showing that it had been. Similarly, the Air Force’s successor CO testified that the CO who negotiated the modification was exceptional in documenting the actions she took and, based on his review of the documents and discussions, he honestly did not believe the Merit-to-Harris issue was resolved in Modification No. P00017. Based on the COs’ un rebutted testimony, this Board cannot possibly conclude that there was an understanding between the parties that Modification No. P00017 would constitute a settlement of the Merit-to-Harris offset. *See Asbestos Transp. Servs., Inc.*, ASBCA No. 46263, 98-1 BCA ¶ 29,502 at 146,376-77 (bilateral modification containing waiver of claims language did not bar claim where CO knew claim not settled); *Chantilly Constr. Corp.*, ASBCA No. 24138, 81-1 BCA ¶ 14,863 at 73,396-98 (incumbent upon CO to advise that CO considered adjustment set forth to be a settlement of all claims).<sup>1</sup>

The party who asserts the existence of an accord and satisfaction carries the burden of proving that affirmative defense. *Asbestos Transp. Servs., Inc.*, ASBCA No. 46263, 98-1 BCA ¶ 29,502 at 146,376; *Varaburn Ltd. & Lin Heng Eng’g Ltd., J.V.*, ASBCA No. 22177, 82-1 BCA ¶ 15,744 at 77,926. There is no evidence here that the parties reached a meeting of the minds that CTA would accept any substituted performance on the part

of the Air Force in full satisfaction of its Merit-to-Harris offset claim. Lacking any such proof, we hold that CTA's claim is not barred by the defense of accord and satisfaction.

### B. Release and Waiver

“Release or waiver of claims is basically a matter of intention.” *Maintenance Eng'rs*, ASBCA No. 23131, 81-2 BCA ¶ 15,168 at 75,073; *accord Southeastern, Inc.*, ASBCA Nos. 7677, 8614, 1963 BCA ¶ 3904 at 19,362. The parties' contemporaneous actions are of great weight in reaching a conclusion as to their intention. *See Asbestos Transp. Servs., Inc.*, ASBCA No. 46263, 98-1 BCA ¶ 29,502 at 146,376-77; *Christenson Raber Kief & Assocs., Inc.*, ASBCA No. 18649, 75-1 BCA ¶ 11,152 at 53,121. In fact, we have consistently construed releases based upon the circumstances surrounding their execution. *See, e.g., Varaburn Ltd. & Lin Heng Eng'g Ltd., J.V.*, ASBCA No. 22177, 82-1 BCA ¶ 15,744 at 77,926; *National U.S. Radiator Corp.*, ASBCA No. 3506, 61-2 BCA ¶ 3192.

The record in this appeal does not permit the conclusion that CTA intended to release or waive its Merit-to-Harris offset claim. With respect to its release defense, the Air Force relies solely upon the bilateral modification pertaining to “restructure” of the production option, Modification No. P00017 (answer at 9-10). However, Modification No. P00017 does not contain any “release of claims,” qualified or unqualified. “Waiver is defined as the intentional relinquishment of a known right.” *United Technologies Corp., Pratt & Whitney Group*, ASBCA Nos. 46880, 46881, 97-1 BCA ¶ 28,818 at 143,795. As we explain above, there is no evidence here of any intent on the part of CTA to relinquish its rights with respect to the Merit-to-Harris offset. Since the Air Force has failed to show it obtained any release from CTA regarding the Merit-to-Harris offset or any intent upon the part of CTA to relinquish its rights regarding the offset, we also hold the claim is not barred by the defense of release or waiver.

## II. Clause H-990

A fixed-price incentive (firm target) contract, such as the parties' here, does not contain a final price when issued. Rather, it specifies a target cost, a target profit, a price ceiling (but no profit ceiling or floor), and a profit adjustment formula. Parties negotiate each of these elements at the outset, and their contract schedule sets forth a “target” cost, profit, and price for each item subject to incentive price revision. Their contract's price ceiling is the maximum that may be paid the contractor, except for any adjustment under other contract clauses. When the contractor completes performance, the parties negotiate the final cost, and establish the contract's final price by applying the formula. If the final cost is less than the target cost, application of the formula results in a final profit greater than target profit. Conversely, if the final cost is more than target cost, application of the formula results in a final profit less than target profit, or even a net loss. When the final

negotiated cost exceeds the contract's price ceiling, the contractor absorbs the difference as a loss. Because profit varies inversely with cost, this type of contract gives contractors a positive, calculable profit incentive to control costs. FAR 16.403(a), 16.403-1(a), (d), 52.216-16(a), (d), (k).

Until establishment of the final price, the contractor submits invoices or vouchers in accordance with "billing prices," *i.e.*, the target prices shown in its contract. Billing prices may be adjusted, within ceiling limits, upon request of either party to the contract, when it becomes apparent that final negotiated cost will be substantially different from target cost. FAR 16.403(d), 52.216-16(f)(1), (2)

CTA asserts that "[c]ause H-990 entitles . . . [it] to an adjustment of any CLIN prices affected by the Merit to Harris change based upon cost estimates" existing at the time the change occurred (*e.g.*, app. br. at 18). CTA contends that: (1) the Air Force reopened negotiations to address the impact of an alternate DRLMS source on the total program by reviewing Harris' technical approach and subsequently issuing modification No. P00017 restructuring the production option; (2) CTA submitted to the Air Force a cost impact proposal regarding the change from Merit-to-Harris, showing no downward price adjustment was warranted; (3) clause H-990 provided "[t]he parties will agree to a one-time downward only prime Contract price adjustment, if warranted, and any other adjustments as provided for in FAR § 52.216-16"; (4) the parties were to "agree to 'any other adjustments . . . provided for in FAR § 52.216-16' because "[t]here is no language . . . in H-990, which either indicates or mandates that the second action is contingent upon the first;" and (5) "[i]n the context of clause H-990," FAR 52.216-16 requires the parties to adjust CLIN prices to reflect cost estimates when triggered by the change in DRLMS subcontractors (app. br. at 18, 21-25 (emphasis in original); app. reply br. at 11-14, 17-22).

The Air Force asserts that clause H-990, in referring to FAR 52.216-16, does not require the adjustment of prototype CLIN prices because the clause "does not anticipate an action that would affect the total final price (the contract ceiling)." The Air Force contends that: (1) clause H-990's reference to FAR 52.216-16 has "only one reasonable meaning," *i.e.*, "[a]fter negotiating a one-time downward only prime contract adjustment, the parties will make an adjustment to lower the target or ceiling required by FAR 52.216-16(k)"; (2) clause H-990 "gives the Government, and the Government only, the right to reopen negotiations if Merit does not perform the DRLMS work"; (3) the Air Force "never reopened pricing negotiations relating to the Merit to Harris switch" because CTA submitted a cost impact proposal showing that no downward price adjustment was warranted; (4) no basis therefore exists to make an adjustment under FAR 52.216-16(k); and (5) CTA's interpretation of FAR 52.216-16 as requiring the parties to adjust CLIN prices to reflect cost estimates upon a change in DRLMS subcontractors is unreasonable

and not the construction relied on by the parties prior to existence of this dispute. (Gov't br. at 20, 23, 25-26, 32-34 (emphasis in original); Gov't reply br. at 31-32, 34-35, 36-38)

While the parties disagree regarding whether the Air Force reopened negotiations and whether a downward adjustment in contract price is a prerequisite for the parties to agree to "any other adjustments . . . provided for in FAR 52.216-16," this Board need not address those issues. CTA can prevail on its claim for an equitable adjustment pursuant to clause H-990 only if this Board holds clause H-990's reference to "other adjustments as provided for in FAR 52.216-16" required the parties to adjust CLIN prices to reflect cost estimates which existed at the time CTA substituted Harris for Merit as its DRLMS subcontractor. We cannot, however, so rule.

We interpret a contract in accordance with its express terms and begin with the plain language of that agreement. *E.g.*, *C. Sanchez & Son, Inc. v. United States*, 6 F.3d 1539, 1543 (Fed. Cir. 1993); *Gould, Inc. v. United States*, 935 F.2d 1271, 1274 (Fed. Cir. 1991). If the "provisions are clear and unambiguous, they must be given their plain and ordinary meaning." *E.g.*, *United Int'l Investigative Servs. v. United States*, 109 F.3d 734, 737 (Fed. Cir. 1997); *Alaska Lumber & Pulp Co. v. Madigan*, 2 F.3d 389, 392 (Fed. Cir. 1993).

Both parties agree that no downward contract price adjustment was warranted or occurred under clause H-990 due to CTA's substitution of DRLMS subcontractors, and that CTA inserted the phrase "and any other adjustments as provided for in FAR 52.216-16" into clause H-990. Both parties agree additionally that that phrase requires a reader to review FAR 52.216-16 to determine what "other adjustments" the parties are to agree to if Merit does not perform the DRLMS work. (App. br. at 5, 12, 18, 22; Gov't br. at 10, 21-23, 30, 33-35)

We, therefore, must examine the language of FAR 52.216-16, the Incentive Price Revision – Firm Target clause set forth in the contract, in order to construe clause H-990. Paragraph (a) of FAR 52.216-16 identifies the supplies or services which are subject to price revision under the clause and sets forth the "ceiling price" that the total final price of those items shall not exceed. Paragraph (b) defines costs under the clause as allowable costs described in FAR Part 31. Paragraph (c) specifies the deadline for submission of a final cost report after completion of the work, the data to be set forth in that report, and repayment terms if the contractor fails to submit the report and it is later determined the Government overpaid the contractor. Paragraph (d) sets forth procedures for establishing the "total final price" of items identified in paragraph (a) after the contractor provides the data specified in paragraph (c). Paragraph (e) provides that the "total final price" of items identified in paragraph (a), which is established under paragraph (d), shall be evidenced by a bilateral contract modification and not subject to revision, unless the parties agree in writing otherwise or adjustments are explicitly permitted or required by a contract clause.

Unlike paragraphs (c), (d), and (e), paragraph (f) does not address establishment of “total final price” of items identified in paragraph (a). Rather, the paragraph addresses “billing prices” used by the parties pending execution of the contract modification mandated by paragraph (e). Paragraph (f) provides that:

the contractor shall submit invoices or vouchers in accordance with billing prices, which “shall be the target prices shown” in the contract;

if at any time “it appears from the information provided” by the contractor under paragraph (g) that “then-current billing prices will be substantially greater than the estimated final prices, the parties shall negotiate a reduction in the billing prices”;

“[s]imilarly, the parties may negotiate an increase in billing prices by any or all of the difference between the target prices and the ceiling price upon the [c]ontractor’s submission of factual data showing that final cost under th[e] contract will be substantially greater than the target cost”; and

any billing price adjustment shall be reflected in a contract modification and not affect determination of the total final price under paragraph (d).

Paragraph (g) applies until final price revision under the contract has been completed. That paragraph requires the contractor to submit, within 45 days after the end of each quarter of its fiscal year in which a delivery (or service) is first performed and accepted, and for each quarter thereafter, a statement cumulative from start of the contract showing contract prices, costs, and other sums specified in the paragraph, and sets forth additional procedures for the Government to obtain refund of overpayments made to the contractor. Paragraph (h) bars the contractor from entering into subcontracts providing for payment on a cost-plus-a-percentage-of-cost basis, and sets forth provisions the contractor is to include in specific subcontracts. Paragraph (i) provides that, if the parties fail to agree on the “total final price” within a specified period after submission of a final cost report under paragraph (c), the CO shall issue a decision pursuant to the contract’s Disputes clause. Paragraph (j) specifies that, if the contract is terminated before “total final price” is established, prices of supplies or services subject to price revision shall be established in accordance with the clause for completed supplies and services accepted. Paragraph (k) specifies that, “[i]f an equitable adjustment in the contract price is made under any other clause of th[e] contract before the total final price is established, the adjustment shall be made in the total target cost and may be made in the maximum dollar limit on the total final price, the total target profit, or both.” Paragraph (l) specifies that, if any contract clause provides that the contract price does not or will not include an amount for

a specific purpose, then neither any target price nor the total final price includes or will include any amount for that purpose. Paragraph (m) specifies that, if any contract clause expressly provides that the cost of performance of an obligation shall be at Government expense, that expense shall not be included in any target price or in the total final price, but reimbursed separately. Paragraph (n) provides that, if one of the tax clauses requires that the contract price be increased or decreased as a result of changes in the obligation of the contractor to pay or bear the burden of certain taxes or duties, the increase or decrease shall be made in the total target price or, if it has been established, in the total final price, so that it will not affect the contractor's profit or loss on the contract. Finally, paragraph o (of Alternate I), which is added to the clause when the contract provides for supplies or services under a Government option at prices subject to incentive price revision, as here, states that prices established for such items shall be treated as target prices, and the target cost and profit covering such items "may be established separately, in the aggregate, or in any combination, as the parties may agree." FAR 52.216-16.

The language of FAR 52.216-16 thus references only three types of "adjustments": (1) an increase or decrease negotiated in billing prices pursuant to paragraph (f) when "it appears from the information provided" by the contractor under paragraph (g) that "then-current billing prices will be substantially" greater or less than the estimated final prices; (2) an increase or decrease in total target cost and possibly the maximum dollar limit on the total final price, the total target profit, or both pursuant to paragraph (k) when "an equitable adjustment in the contract price is made under any other clause of th[e] contract before the total final price is established"; and (3) an increase or decrease in total billing price or, if it has been established, in the total final price pursuant to paragraph (n) when one of the standard tax clauses requires the contract price be increased or decreased as a result of changes in the obligation of the contractor to pay or bear the burden of specified taxes or duties. The adjustment pursuant to paragraph (n) clearly is not applicable here. No standard tax clause requires an increase or decrease in any billing price based upon a contractor's substitution of subcontractors. The adjustment pursuant to paragraph (k) for an equitable adjustment in contract price under another contract clause would be applicable here if there had been a decrease in the contract price under clause H-990 as a result of CTA's substitution of Harris for Merit as DRLMS subcontractor. However, the parties agree that no equitable adjustment occurred under clause H-990. An adjustment pursuant to paragraph (k), therefore, also cannot be a basis for altering billing prices when CTA substituted DRLMS subcontractors. The adjustment pursuant to paragraph (f) is negotiated when it appears from information provided by the contractor in a cumulative statement of costs that the then-current billing prices will be substantially greater or less than estimated final prices. An adjustment pursuant to paragraph (f) can be requested by either party to the contract. FAR 16.403(d). When CTA substituted Merit for Harris in 1990, it did not request that the Air Force negotiate an adjustment pursuant to paragraph (f) or point to any cumulative cost statement submitted pursuant to paragraph (g) showing its then-current billing prices were substantially different than its estimated

final prices. In its post-trial briefs, CTA suggests it was not required to cite a cumulative cost statement showing a substantial difference between its then-current billing prices and estimated final prices or request the Air Force negotiate a paragraph (f) adjustment. According to CTA, in the context of clause H-990, a paragraph (f) billing price adjustment is triggered simply by CTA's substitution of another subcontractor for Merit. (App. br. at 18-19; app. reply br. at 19-20) However, neither the language of paragraph (f) nor that of any other paragraph of FAR 52.216-16 specifies that billing prices are to be adjusted if one subcontractor is substituted for another. Because FAR 52.216-16, the incentive price revision clause, does not specify a billing price adjustment due simply to replacement of a subcontractor, and because clause H-990 expressly provides only for "other adjustments as provided for in FAR 52.216-16," the clauses' plain language does not mandate the billing price adjustment CTA now seeks.

CTA asserts that, if the language of clause H-990 is not clear, the Board should look to "extrinsic testimony" explaining the purpose and intent of clause H-990. CTA states that such testimony shows its interpretation of clause H-990 is the only reasonable interpretation. (App. reply br. at 30-32)

As discussed above, however, we find the language of the contract to be clear. Contract clause H-990 authorizes other adjustments "provided for in FAR 52.216-16," and the FAR provides only for three types of "adjustments," none of which mandates the billing price adjustment CTA now seeks. Authorization for parties to "negotiate" an adjustment of billing prices when cumulative cost data shows a "substantial" difference between target and final cost is not the same as mandating adjustment upon substitution of one subcontractor for another. If CTA wished to mandate adjustment of billing prices at time of subcontractor substitution based on cost estimates, rather than authorize negotiation of such an adjustment after a specified factual showing, CTA could have easily so provided by inserting other, specific language in clause H-990. *See, e.g., Alliant Techsystems, Inc. v. United States*, 178 F.3d 1260, 1272 (Fed. Cir. 1999).

Moreover, CTA's current interpretation of FAR 52.216-16(f), as requiring an adjustment of billing prices upon subcontractor substitution does not appear to have been its interpretation of the FAR before the current dispute arose. When CTA notified the Air Force that Harris was being substituted for Merit as DRLMS subcontractor during September 1990, it did not assert that adjustment of billing prices was required by paragraph (f) or any other provision of FAR 52.216-16. Further, when CTA gave the Air Force its option restructure proposal over a year later, in October of 1991, while it sought an "offset" with respect to prototype prices due to "excess consideration in the production CLINs," it did not assert that adjustment of prototype billing prices was mandated by FAR 52.216-16. Indeed, it appears CTA never expressly advised the Air Force that it believed FAR 52.216-16 required adjustment of prototype billing prices due to the substitution of Harris until submission of CTA's certified claim in September 1993, over

three years after Harris' substitution. CTA, therefore, apparently thought the contract was being interpreted properly when the Air Force did not adjust the billing prices upon CTA's substitution of Harris for Merit in 1990. It is well-established that, in construing a contract, the parties' interpretation of the contract before their dispute arose is to be given "great, if not controlling, weight." *E.g., Dittmore-Freimuth Corp. v. United States*, 390 F.2d 664, 679 (Ct. Cl. 1968).

"The words of a contract are deemed to have their ordinary meaning appropriate to the subject matter, unless a special or unusual meaning of a particular term or usage was intended, and . . . understood by the parties." *Lockheed Martin IR Imaging Sys., Inc. v. West*, 108 F.3d 319, 322 (Fed. Cir. 1997). The "special meaning" that CTA now seeks to afford clause H-990 and FAR 52.216-16 was not intended nor understood by the parties. In sum, we do not find CTA's current reading of the clauses to be reasonable.

### III. Changes Clause

CTA alternatively asserts that the Changes clause entitles it to an adjustment of prototype CLIN prices affected by the substitution of Merit for Harris. CTA contends that Modification No. P00017's "restructuring" of the production option (1) "was the direct result of the government's unilateral desire to order [seven] fewer production units," (2) "represents a government initiated change," and (3) "changed the contract by requiring that the Harris technical approach be used for the prototype unit." (App. reply br. at 35-36; app. br. at 11-15)

The Air Force asserts that we lack jurisdiction to entertain CTA's "change" claim. According to the Air Force, the CO "never had an opportunity to evaluate . . . allegations of a change" because "there is no allegation of entitlement based upon a change or the Changes Clause in . . . [CTA's] claim." Alternatively, if we hold that we may entertain CTA's change claim, the Air Force asserts that its "purchase of the five production units [under Modification P00017] [i]s irrelevant to the Merit to Harris substitution." The Air Force contends that: "the purchase of the five production units . . . was the only change made to the contract by [Modification No.] P00017"; "the record is void of any written or other direction by the . . . [CO] to change . . . [CTA's] DRLMS subcontractor or method of performance"; and "changes must originate from the . . . [CO]." (Gov't reply br. at 4, 20-24)

The Contract Disputes Act (CDA), 41 U.S.C. §§ 601-613, does not require that a claim be submitted upon any particular type of form or that a claim use any particular wording. *Contract Cleaning Maintenance, Inc. v. United States*, 811 F.2d 586, 592 (Fed. Cir. 1987). Rather, it simply requires "that the contractor submit in writing to the . . . [CO] a clear and unequivocal statement that gives the . . . [CO] adequate notice of the basis and amount of the claim." *Id.* A "new claim" is one that does not arise from the

same set of operative facts as the claim submitted to the CO. *See Glenn v. United States*, 858 F.2d 1577, 1580 (Fed. Cir. 1988); *Tecom, Inc. v. United States*, 732 F.2d 935, 937 (Fed. Cir. 1984).

CTA stated in the certified claim submitted that “the Air Force adjusted the price of the Contract downward because of the change from Merit [to Harris] when the prices of the options were restructured” and that “CTA has been required to bear the increased prototype costs of the change in DRLMS subcontractors, while the Air Force has effected a contract price reduction because of the change for which it is not entitled.” CTA added that the Air Force believes “its failure to exercise the options somehow voids the intent of Clause H-990, allowing the Air Force a windfall” and CTA “is entitled to a corresponding Contract price increase to eliminate the improper downward . . . price adjustment effected through the production restructuring modification.” The CO therefore was on notice that: CTA believed the Air Force had effected a contract price reduction because of the change in DRLMS subcontractors to which the Air Force was not entitled; CTA believed it had been required improperly to bear increased prototype costs resulting from the change in subcontractors; and CTA was seeking a contract price increase to eliminate the reduction effected by the CO in Modification No. P00017. While CTA did not expressly cite the Changes clause in its claim, there was no requirement that it do so. CTA presented to the CO a very detailed factual narrative, which referred repeatedly to the change in DRLMS subcontractors and the reduction in contract price effected in Modification No. P00017 “restructuring” the production option. We believe CTA’s claim gave the CO adequate notice CTA was asserting entitlement under the Changes clause to an adjustment arising from Modification No. P00017 and Harris’ substitution as DRLMS subcontractor. *See Lockheed Martin IR Imaging Sys., Inc. v. West*, 108 F.3d 319 (Fed. Cir. 1997) (Government constructively changed contract by departing from the option terms); *Int’l Telephone & Telegraph v. United States*, 453 F.2d 1283, 1293 (Ct. Cl. 1972); *General Dynamics Corp.*, ASBCA No. 20882, 77-1 BCA ¶ 12,504 at 60,622. We thus possess jurisdiction to entertain CTA’s “Changes clause” claim. *See Contract Cleaning Maintenance, Inc. v. United States*, 811 F.2d at 592; *Tecom, Inc. v. United States*, 732 F.2d at 936-37.

While CTA argues Modification No. P00017 changed the contract by requiring that the Harris technical approach be used for the prototype unit (app. br. at 12, 14; app. reply br. at 35-37), the modification was not issued until after CTA had substituted Harris for Merit and Harris had been working upon the prototype for over two years. Moreover, the text of Modification No. P00017 makes no explicit reference to the “technical approach” to be utilized with respect to either the production option or the prototype. Rather, it simply incorporates “Statement of Work REVISION 8” dated 19 October 1992, purports to exercise the option for five units, and sets forth a new target cost, target profit, target price, and reduced ceiling price. In view of these facts, it is difficult to comprehend

how the modification, by itself, could possibly constitute direction by the Air Force to use “the Harris technical approach.”

We recognize that the parties’ contract referenced CTA’s technical proposal which incorporated the Merit technical approach. That proposal, however, was not the subject of any detailed testimony and was not made part of the record. Thus, even if we were to conclude that Modification No. P00017 required use of the Harris approach, we have no basis to compare the approach of Merit-to-Harris to ascertain if there was a true difference in technical approach. Indeed, due to the paucity of technical information/specifications presented, we cannot even say whether the parties’ contract contained a performance or design specification. *See, e.g., Ordnance Research, Inc. v. United States*, 609 F.2d 462, 479 (Ct. Cl. 1979); *J.L. Simmons Co. v. United States*, 412 F.2d 1360, 1362 (Ct. Cl. 1969). Accordingly, based on the record, we cannot hold that Modification No. P00017 changed the contract by requiring that “Harris’ technical approach” be used.

We do, however, hold that Modification No. P00017 changed the parties’ contract. The option set forth in the parties’ contract, as awarded, specified that CTA produce and deliver 12 complexes on specified dates, if the Air Force exercised the option on or before 1 October 1991. Under Modification No. P00017, which was executed in November 1992, the parties “reconfigured” their “expired” option to provide that CTA produce and deliver five complexes on different dates, and the Air Force exercised that “reconfigured” option.

As found above, in July 1991, ATC advised CO Woods that it required an option for production of 5, rather than 12, complexes. CO Woods realized that, due to ATC’s downsizing, she faced a “dilemma.” Under the FAR, a CO may exercise an option only after determining that the “requirement covered by the option fulfills an existing” need. FAR 17.207(c)(2). CO Woods could not make this required determination because she knew ATC no longer required 12 complexes and thus could not exercise the option for production of 12 complexes. Absent exercise of the existing option for 12 complexes, there was no quantity of complexes to be produced, which CO Woods could purport to change to 5 under the Changes or Termination for Convenience clauses of the parties’ contract. Moreover, if she awarded a new contract for the production of five complexes, she could not procure the complexes by ATC’s desired deadline. CO Woods, therefore, decided to attempt a “new rebirth” of the production option. Apparently recognizing that parties to a contract, at any time after contract execution, may modify not only prescribed procedures of their contract, but their contract’s substantive provisions, *e.g., Pinewood Realty, Ltd. v. United States*, 617 F.2d 211, 215 (Ct. Cl. 1980); *General Dynamics Corp. v. United States*, 558 F.2d 985, 990 (Ct. Cl. 1977), she initiated negotiations with CTA to modify the existing production option. By letter dated 23 July 1991, CO Woods notified CTA that she would not be exercising the option for production of 12 complexes, which

was set forth in the contract, and was “opening the contract to renegotiation to restructure options tailored to meet the ... [Air Force’s] current needs” which she planned to exercise on prototype acceptance. In the same letter, CO Woods directed CTA to provide cost and pricing data for the production of five complexes no later than 23 August 1991.

Upon receipt of CO Woods’ letter, CTA also faced a “dilemma.” While CTA could demand that CO Woods exercise the option for 12 complexes, it could not require that she do so. *See, e.g., Government Sys. Advisors, Inc. v. United States*, 847 F.2d 811, 812-13 (Fed. Cir. 1988) (Government was free not to exercise option); *Dynamics Corp. v. United States*, 389 F.2d 424, 431 (Ct. Cl. 1968) (option is an obligation by which one is bound to sell, but it is discretionary with other party whether to buy); FAR 17.207(c)(3) (CO may exercise option only if CO determines exercise is most advantageous method of fulfilling Government’s need, price, *etc.*). Thus, CTA had to decide whether to accept or reject CO Woods’ overture to “renegotiate” the contract’s production option.

CTA was free to decline CO Woods’ “renegotiation” overture because the CO did not possess a “unilateral” right to amend the contract to require CTA to produce only five complexes. *See Lear Siegler Inc., Management Services Div.*, ASBCA No. 30224, 86-3 BCA ¶ 19,155 at 96,795 (power conferred upon option holder is “power of acceptance”); *Lockheed Martin IR Imaging Sys., Inc. v. West*, 108 F.3d at 323 (option exercise must be unconditional and in exact accord with terms of contract being renewed); FAR 52.243-1 (under Changes clause, CO may make changes within general scope of contract only to the drawings, designs, specifications, method of shipment or packing, and place of delivery). However, if CTA rejected CO Wood’s overture to “renegotiate” the option, she most likely would award a new contract for production of five complexes, which might be obtained by one of CTA’s competitors. *See, e.g., FAR 6.101* (a CO shall promote and provide for full and open competition in soliciting offers and awarding contracts, with certain limited exceptions). Rather than risk losing the chance to produce some complexes for the Air Force, CTA decided to accept the CO’s overture to “renegotiate” the option, and submitted cost and pricing data for the production of five complexes.<sup>2</sup>

When CTA submitted its cost and pricing data, it asserted that, if the production option was “restructured” to provide for supply of only five complexes, it was entitled to receive an equitable adjustment for the funding and Merit-to-Harris offsets. CO Woods agreed to give CTA an equitable adjustment with respect to the funding offset. However, with respect to the Merit-to-Harris offset, she advised CTA that she would not negotiate an equitable adjustment as part of the production option “restructure” and it could obtain such an adjustment only “[u]nder the [D]isputes clause of the [parties’] contract.” CO Woods and CTA subsequently executed a contract modification increasing prototype funding, as sought by CTA for the funding offset. They also executed another contract

modification, No. P00017, agreeing upon pricing for the production and delivery of five complexes. The parties, however, did not negotiate or reach any agreement regarding CTA's entitlement to an equitable adjustment for the Merit-to-Harris offset. Rather, as directed by CO Woods, both parties "set aside" that issue for later resolution under the Disputes clause. Thus, there was no definitization between the parties with respect to the total compensation due CTA if the Air Force exercised a "reconfigured" option for five complexes. *See, e.g., A-Transport Northwest Co. v. United States*, 36 F.3d 1576, 1581 (Fed. Cir. 1994) (issue is whether, from an objective standpoint, there is an "offer" and an "acceptance," supported by mutuality of consideration); *Texas Instruments, Inc. v. United States*, 922 F.2d 810, 815 (Fed. Cir. 1990) (issue is whether totality of the factual circumstances show a final binding agreement).

In setting aside the Merit-to-Harris offset issue for resolution under the Disputes clause, the parties' actions resemble those which occur where a CO unilaterally orders changes in contract work. When a CO unilaterally directs changes, parties often will negotiate quantum, *i.e.*, equitable adjustments in contract price, sign a modification or modifications altering the contract price with respect to the changes upon which they agree, and resolve any remaining "quantum" issues under the Disputes clause. *See, e.g., JOHN CIBINIC, JR., & RALPH C. NASH, JR., ADMINISTRATION OF GOVERNMENT CONTRACTS* 408 (3rd ed. 1995); *Bechtel Nat'l, Inc., NASA BCA No. 1186-7, 90-1 BCA* ¶ 22,549 at 113,161-62. The parties are authorized to take such action when the CO issues a change order unilaterally because: (1) the standard Changes clause provides that (a) the CO may make specified changes in contract terms, (b) whenever one of those changes causes an increase or decrease in the cost of, or time required for, the performance of contract work, the CO shall make an equitable adjustment in contract price, and (c) a failure to agree to an adjustment shall be a dispute under the Disputes clause; and (2) the standard Disputes clause provides (a) all disputes arising under or relating to the contract shall be resolved under that clause and (b) a contractor shall proceed with performance of contract work pending a final resolution of any dispute arising under the contract. FAR 52.233-1, 52.243-1. "Reconfiguring" an unexercised option, however, is not one of the changes in contract terms a CO may make under the express language of the Changes clause. *See FAR 52.243-1; JOHN CIBINIC, JR., & RALPH C. NASH, JR., ADMINISTRATION OF GOVERNMENT CONTRACTS* 391-99, 442-43 (3rd ed. 1995). Thus, if the CO deemed herself to be acting under, or within the scope of, the Changes clause when she reconfigured the production option and set aside the Merit-to-Harris issue for resolution under the Disputes clause, she clearly was mistaken. *See Alliant Techsystems, Inc. v. United States*, 178 F.3d 1260, 1275 (Fed. Cir. 1999) (attempt to exercise an option outside its terms does not constitute a valid exercise of option); *Edward R. Marden Corp. v. United States*, 442 F.2d 364, 370 (Ct. Cl. 1971) (CO's order to reconstruct the hangar constructed under a contract after hangar's collapse due to defective specifications was not "essentially the same work as the parties [had] bargained for when the contract was awarded" and not within scope of Changes clause).

When a CO's order altering a contract is outside the scope of the Changes clause, it is denominated a "cardinal change." *E.g., Saddler v. United States*, 287 F.2d 411, 413-14 (Ct. Cl. 1961); *accord AT&T Communications, Inc. v. Witel, Inc.*, 1 F.3d 1201, 1205 (Fed. Cir. 1993). A cardinal change is a breach of contract and not redressable under the Changes clause. *Allied Materials & Equipment Co. v. United States*, 569 F.2d 562, 563-64 (Ct. Cl. 1978); *Air-A-Plane Corp. v. United States*, 408 F.2d 1030, 1032-33 (Ct. Cl. 1969). Thus, if a CO orders a contractor to perform duties materially different than those bargained for, the contractor is free to pursue a breach of contract claim and, if the breach is "material," to halt contract work. *Allied Materials & Equipment Co. v. United States*, 569 F.2d at 563-64; *Edward R. Marden Corp. v. United States*, 442 F.2d at 369-70.

A material breach does not automatically "end" a contract. Rather, it simply gives the injured party the right to "end" the contract. The injured party may choose between canceling the contract and continuing it. *Cities Service Helex, Inc. v. United States*, 543 F.2d 1306, 1313 (Ct. Cl. 1976). If the injured party elects to end the contract, both parties are relieved of their further obligations and the injured party is entitled to damages to the end of the contract term to place it in the position it would have occupied if the contract had been fully performed. If the injured party elects to continue the contract, the parties' obligations remain in force and the injured party retains only a claim for "partial breach," unless it explicitly reserves its right to claim material breach and promptly pursues that right. *Id.* at 1313-19; *Northern Helex Co. v. United States*, 455 F.2d 546, 552-55 (Ct. Cl. 1972).

Here, after the CO's direction to "reconfigure" the production option, CTA signed contract modifications altering the option and prototype funding, performed work under the modified contract, and did not expressly reserve any right to claim "material" breach. Thus, if the CO's "reconfiguration" of the expired option (without a bilateral agreement regarding the total compensation to be paid CTA for that "reconfiguration") was a "material" breach, CTA must be deemed to have elected to continue, not end, the contract and to have waived any claim for material breach. As we discussed above, CTA only set aside or reserved a claim for partial breach, *i.e.*, the Merit-to-Harris offset claim set forth in its October 1991 request for an equitable adjustment. *See Pinewood Realty, Ltd. v. United States*, 617 F.2d at 215 (if contractor ignores breach and continues to perform, it waives right to terminate and retains only claim for partial breach); *Cities Service Helex, Inc. v. United States*, 543 F.2d at 1313-19 (where contractor continues performing and accepts benefits of Government's continued performance, contract remains in effect and there is no "material" breach claim); *USD Technologies, Inc.*, ASBCA No. 31305, 87-2 BCA ¶ 19,680 at 99,620 (bilateral modification altering option signifies knowing and intentional conduct by contractor that contract continues and that "material" breach claim is waived).

In consenting to “reconfigure” or restate the terms of the production option after the date for exercising the option, with only a reservation that it be allowed to pursue the Merit-to-Harris offset issue under the contract’s Disputes clause, CTA agreed to continue performing under the “reconfigured” terms of the option. We, therefore, conclude that the parties agreed “implicitly” to amend the Changes clause of their contract to allow for option “reconfiguration” under that clause and to permit CTA to pursue a claim for an equitable adjustment under that clause with respect to the Merit-to-Harris offset. *See, e.g., General Dynamics Corp. v. United States*, 558 F.2d at 991 (parties can modify contract to authorize administrative relief under a clause otherwise not available); *accord Pinewood Realty, Ltd. v. United States*, 617 F.2d at 215-16 (where Government accepted extension of closing date which was conditioned on contractor’s reservation of right to seek delay damages, while denying liability, extension could be deemed a “modification” whereby the parties agreed to continue performance and resolve their dispute subsequently); *USD Technologies, Inc.*, ASBCA No. 31305, 87-2 BCA ¶ 19,680 at 99,620 (in executing an amendment conforming terms of prior amendment purportedly exercising option to the option terms, contractor agreed to continue contract’s performance). Thus, whether the CO’s “reconfiguration” of the option is viewed as a partial breach (confined to CTA’s 1991 request for an equitable adjustment regarding the Merit-to-Harris offset) or as a contract “change” entitling CTA to seek an equitable adjustment under the Changes clause regarding the Merit-to-Harris offset, we must decide if the Air Force is liable to CTA for the Merit-to-Harris adjustment sought.

Under the Changes clause, the contract price must be equitably adjusted when a change in the contract work causes an increase or decrease in the cost of performance of the work. *E.g., Mills Trucking, Inc.*, ASBCA Nos. 50163, 50164, 97-1 BCA ¶ 28,907 at 144,115; FAR 52.243-1(b). The formula or measure for an equitable price adjustment is “the difference between the reasonable cost of performing without the change or deletion and the reasonable cost of performing with the change or deletion.” *Celesco Indus., Inc.*, ASBCA No. 22251, 79-1 BCA ¶ 13,604 at 66,683; *accord Keco Indus., Inc. v. United States*, 364 F.2d 838 (Ct. Cl. 1966), *cert. denied*, 386 U.S. 958 (1967). This formula or measure is sometimes referred to as the “would have cost rule.” *E.g., JOHN CIBINIC, JR. & RALPH C. NASH, JR., ADMINISTRATION OF GOVERNMENT CONTRACTS* 675-77 (3d ed. 1995).

Simply put, equitable adjustments are corrective measures used to keep a contractor whole when the Government modifies a contract. *Bruce Constr. Corp. v. United States*, 324 F.2d 516, 518 (Ct. Cl. 1963). An equitable adjustment should not increase or reduce a contractor’s profit or loss, or convert a loss to a profit or vice versa, for reasons unrelated to a change. *Pacific Architects & Engineers, Inc. v. United States*, 491 F.2d 734, 739 (Ct. Cl. 1974); *Keco Indus., Inc. v. United States*, 364 F.2d at 850; *see S.N. Nielsen Co. v. United States*, 141 Ct. Cl. 793, 796-97 (Ct. Cl. 1958). Because the

purpose underlying an equitable adjustment is to safeguard both contractors and the Government against increased costs engendered by modifications, which add or delete contract work, respectively, an equitable adjustment must be closely related to and contingent on the altered position in which the contractor finds itself by reason of the modification. *Nager Elec. Co. v. United States*, 442 F.2d 936, 946 (Ct. Cl. 1971); *Bruce Constr. Corp. v. United States*, 324 F.2d at 518.

A price reduction for deletion of contract work thus should leave a contractor in the same financial condition it would have been in if the change had not occurred. *E.g.*, *Hensel Phelps Constr. Co.*, ASBCA No. 15142, 71-1 BCA ¶ 8796 at 40,873. Where a credit is claimed for decreased work, the credit is measured by the contractor's net cost savings. *E.g.*, *Fordel Films West*, ASBCA No. 23071, 79-2 BCA ¶ 13,913 at 68,298. Generally, there will be no price reduction if the contractor realizes no savings from a change. *See, e.g.*, *Dawson Constr. Co.*, GSBCA No. 5672, 81-2 BCA ¶ 15,387, *recon. denied*, 82-2 BCA ¶ 15,914. In sum, with respect to a change deleting contract work, the Government is entitled to a downward adjustment in contract price to the extent of the savings flowing to the contractor therefrom. *S.N. Nielsen Co. v. United States*, 141 Ct. Cl. 793 (1958); *Celesco Indus., Inc.*, ASBCA No. 22251, 79-1 BCA ¶ 13,604 at 66,683.

An exception to the "would have cost" rule occurs when there has been a complete deletion of a severable item. In such cases, the starting point of the equitable adjustment is the amount which was included in the contract price for the item. *Keco Indus., Inc. v. United States*, 364 F.2d at 849-50; *Holtzen Constr. Co.*, AGBCA No. 413, 75-2 BCA ¶ 11,378, *aff'd*, 546 F.2d 431 (1976); *Gregory & Reilly Assocs., Inc.*, FAA-CAP No. 65-30, 65-2 BCA ¶ 4918. Whether items in a contract are severable depends upon the provisions of the solicitation, the nature of the work, and the parties' intentions. Mere recitation of a separate unit price does not make an item severable. *Compare J.F. Shea Co. v. United States*, 10 Ct. Cl. 620, 625-26 (1986), and *Griffin Services, Inc.*, GSBCA No. 10841, 92-2 BCA ¶ 24,945, *with Eugene Iovine, Inc.*, PSBCA No. 2867, 92-2 BCA ¶ 25,013.

The Government has the burden of proving the amount of cost savings due to deletion of work. *Nager Elec. Co. v. United States*, 442 F.2d at 946; *Celesco Indus., Inc.*, ASBCA No. 22251, 79-1 BCA ¶ 13,604 at 66,684. A contractor, therefore, is entitled to receive the contract price, unless the Government shows it is entitled to a price reduction for deleted work. *Mills Trucking, Inc.*, ASBCA Nos. 50163, 50164, 97-1 BCA ¶ 28,907 at 144,115.

Here, the Air Force adjusted the price of the parties' contract under Modification No. P00017 based on its "restructure" of the option. While stating that it was exercising an option under an existing contract, in adjusting the contract ceiling price, the Air Force treated the production option as a "separate contract" or "severable" item, rather than part

of an existing contract. The Air Force deducted Merit's prices for the original production CLIN work from the contract ceiling, obtained cost and pricing data for the restructured production work by Harris, relied solely upon the Harris data to add funding to the total contract price, and refused to consider how CTA originally priced the entire contract with Merit, even though there was one contract ceiling for both prototype and production. The Air Force thereby obtained the benefit of both Merit's lower prototype prices and Harris' lower production prices in promulgating Modification No. P00017. As discussed above, however, in negotiating Modification No. P00017, the parties reserved or "set aside" the issue of an adjustment relating to Merit prices for resolution under the contract's Disputes clause.

The Air Force erred in treating Modification No. P00017 as if it was a separate contract or severable item. Obligations arising from "exercise" of an option are part of a "new contract" only if the option is the principal subject matter of the parties' bargain, *i.e.*, an option contract. *Alliant Techsystems, Inc. v. United States*, 178 F.3d at 1275-76; *Int'l Bus. Invs., Inc. v. United States*, 21 Cl. Ct. 79, 80 (1990). The production option at issue was not the principal subject matter of the parties' original bargain. The parties' rights and obligations under the "restructured" production option accordingly must be viewed as part of their original contract. *See VHC, Inc. v. Peters*, 179 F.3d 1363, 1366 (Fed Cir. 1999); *Alliant Techsystems, Inc. v. United States*, 178 F.3d at 1275-76; *C.M.P., Inc. v. United States*, 8 Cl. Ct. 743, 746 (1985). More importantly, the parties intended, and their contract provided, that the production option was not a "severable" item. As found above, in an April 1990 letter to the Air Force regarding agreement to "definitize" the contract, CTA stated that the definitized agreement was predicated upon application of the FPIF ceiling and targets "against all FPIF CLINs in the aggregate for final pricing purposes." Further, the contract's express terms evidence an intent that FPIF items be aggregated for purposes of pricing. The definitized contract expressly sets forth only one contract ceiling for both prototype and production FPIF CLINs. *See FAR 52.216-16(d), (o)*; *Reflectone, Inc.*, ASBCA No. 34891, 89-3 BCA ¶ 21,962 at 110,476, *aff'd*, 891 F.2d 299 (Fed. Cir. 1989) (table) (insertion of two price revision clauses – one for basic work and one for options – shows that two separate price revisions were to be made); *Aerojet-General Corp.*, ASBCA No. 13548, 70-1 BCA ¶ 8245 at 38,327 (Government cannot arbitrarily create separate price ceilings for CLINs if ceilings not set forth in contract); *Aircraft Engineering & Maintenance Co.*, ASBCA No. 4318, 60-1 BCA ¶ 2488 at 11,812 (contract language establishing number of ceilings should not be disregarded). Moreover, as discussed above, while clause H-990 does not entitle CTA to receive an equitable adjustment, it does provide that, if another subcontractor is substituted for Merit, the Government may reopen negotiations "to address the impact of an alternate DRLMS source on the total program" (emphasis added). Thus, the Air Force's use of CLIN prices to delete the price of the original "unrestructured" production option from the FPIF contract ceiling bargained for by the parties was improper. *See J.F. Shea Co. v.*

*United States*, 10 Cl. Ct. at 625-26; *Griffin Services, Inc.*, GSBCA No. 10841, 92-2 BCA ¶ 24,945 at 124,333.

We recognize that the Air Force was not under any obligation to exercise the production option. *E.g.*, *Government Sys. Advisors, Inc. v. United States*, 847 F.2d at 813. However, simultaneously with its “reconfiguration” of the production option, the Air Force exercised the “reconfigured” option, and cannot now seriously assert that its actions in doing so are “irrelevant.”

Due to the withdrawal of Merit after contract definitization, CTA retained Harris as the DRLMS subcontractor. If there had been no change in the contract, using Harris and its hardware-based approach, CTA would have incurred greater costs for prototype work and lower costs for production work than if Merit performed this work. While CTA incurred greater overall costs as a result of its retention of Harris, CTA is not seeking to charge the Air Force with the difference between the cost of Merit and Harris performing the DRLMS work. Rather, CTA is only seeking one of the benefits of its original bargain – the difference between the cost of having Merit and Harris perform the production work – which the Air Force eliminated from the contract’s ceiling when repricing the restructured production option with Harris data. (*See, e.g.*, tr. 1/9-10, 3/119, 121, 182-83)

In making a change to the contract, the Air Force is not entitled to wipe out CTA’s decrease in production option cost, which partially offset CTA’s increase in prototype cost. As discussed above, a contractor that is in a “profit position” should not lose that “profit” simply because there is a change in the contract work. *Pacific Architects & Engineers, Inc. v. United States*, 491 F.2d at 739; *Hensel Phelps Constr. Co.*, ASBCA No. 15142, 71-1 BCA ¶ 8796 at 40,873. The contract ceiling price here is expressed in terms of a total FPIF price, including both prototype and production. Further, the parties’ contract was negotiated as, and remains a lump sum contract. Since the contract is not severable, but for a lump sum, in determining the proper measure of an equitable adjustment for a contract change, this distinction should be maintained. *See J.F. Shea v. United States*, 10 Cl. Ct. at 624-25; *Griffin Services, Inc.*, GSBCA No. 10841, 92-2 BCA ¶ 24,945 at 124,333. Use of the “would have cost” rule as the measure of the equitable adjustment here maintains that distinction and preserves the parties’ original bargain. It entitles the Government to a downward adjustment in contract price only to the extent of the savings CTA experienced with respect to the change. *See J.F. Shea v. United States*, 10 Cl. Ct. at 628; *Griffin Services, Inc.*, GSBCA No. 10841, 92-2 BCA ¶ 24,945 at 124,333-34.

Allowing CTA its originally bargained for “production offset” does not result in a windfall to CTA. Rather, it maintains legal symmetry between this case and cases such as *Keco Indus., Inc. v. United States*, 364 F.2d at 850, *Bruce Constr. Corp. v. United States*,

324 F.2d at 518-19, and *S.N. Nielsen Co. v. United States*, 141 Ct. Cl. at 796-97, where a contractor's loss position was left unaltered by change orders. Accordingly, CTA has shown that the Air Force altered its contract in promulgating Modification No. P00017 and that it is entitled to an equitable adjustment to its contract with respect to the Air Force's actions. *See, e.g., J.F. Shea v. United States*, 10 Cl. Ct. at 624-28; *Aerojet-General Corp.*, ASBCA No. 13548, 70-1 BCA ¶ 8245 at 38,326; *Keco Industries, Inc.*, ASBCA No. 16645, 73-2 BCA ¶ 10,056 at 47,176.

CONCLUSION

The appeal is sustained and remanded to the parties to negotiate quantum in accordance with the discussion above.

Dated: 24 May 2000

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TERRENCE S. HARTMAN  
Administrative Judge  
Armed Services Board  
of Contract Appeals

I concur

I concur

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MARK N. STEMLER  
Administrative Judge  
Acting Chairman  
Armed Services Board  
of Contract Appeals

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EUNICE W. THOMAS  
Administrative Judge  
Acting Vice Chairman  
Armed Services Board  
of Contract Appeals

NOTES

<sup>1</sup> Moreover, even if we were to conclude otherwise, accord and satisfaction may not bar the Merit-to-Harris offset claim. After execution of Modification No. P00017,

CTA treated Merit-to-Harris as an “open” issue and pursued the issue with both the Air Force CO who negotiated the modification and her successor. Indeed, as we found above, the successor CO sent CTA a letter in August 1993 stating that “[s]everal discussions have been held . . . concerning subj ‘re-opener clause’ and its application to the change in subcontractors from Merit to Harris Corp.,” and “[t]his letter restates the Government position that this issue is not negotiable [sic] and will not be considered in conjunction with subj clause,” clause H-990. Where parties continue to consider a claim after execution of a release, a tribunal may refuse to bar that claim based on accord and satisfaction. *E.g., Community Heating & Plumbing Co. v. Kelso*, 987 F.2d 1575, 1581 (Fed. Cir. 1993).

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In discussing the “dilemmas” faced by the parties and the actions they took to “renegotiate” the production option, this Board does not approve of or, in any manner, condone the course of conduct that the parties selected. The parties’ actions here may violate various procurement regulations. *See, e.g.,* FAR 6.101(b) (CO shall provide for full and open competition), 6.303-1 (CO shall not commence negotiation of sole source contract or award any other contract without full and open competition based on unusual and compelling urgency unless CO justifies use of such action in writing, as required by FAR 6.302(c), and obtains approval from competition advocate or head of procuring activity under FAR 6.304), 17.207(f) (“[t]o satisfy requirements of . . . full and open competition, option [which is being exercised] must have been evaluated as part of the initial competition” and, before option exercise, CO shall make written determination for the contract file that “exercise is in accordance with the terms of the option . . . and Part 6” of the FAR). Neither party here, however, has raised a question of legality. Indeed, the Government argues the CO’s “action should be considered *de jure*” (Gov’t br. at 46). We, therefore need not and do not address the legality of the parties’ actions in reconfiguring the production option.

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA No. 47062, Appeal of CTA Incorporated, rendered in conformance with the Board's Charter.

Dated:

EDWARD S. ADAMKEWICZ  
Recorder, Armed Services  
Board of Contract Appeals