

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --)
)
Freedom NY, Inc.) ASBCA No. 55465
)
Under Contract No. DLA13H-85-C-0591)

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OPINION BY ADMINISTRATIVE JUDGE JAMES
UNDER BOARD RULE 11

This appeal arises from the contracting officer's (CO) 14 March 2006 denial of Freedom NY, Inc.'s (FNY) 17 January 2006 claim under the captioned contract for \$15,775,892.91 in Contract Disputes Act of 1978 (CDA) interest arising from respondent's exclusion of working capital interest in FNY's convenience termination settlement proposal in 2000. The Board has jurisdiction of this appeal under the CDA, 41 U.S.C. § 607. The parties elected to submit the appeal for decision on the record under Board Rule 11. The record includes the parties' Rule 4 documents and briefs and the record in ASBCA No. 43965 (*Freedom II*).¹ The Board is to decide entitlement only.

¹ *Freedom NY, Inc.*, ASBCA No. 43965, 01-2 BCA ¶ 31,585, *recons. denied*, 02-1 BCA ¶ 31,676, *aff'd in part, rev'd in part and remanded*, 329 F.3d 1320, *reh'g denied*, 346 F.3d 1359 (Fed. Cir. 2003), *cert. denied*, 541 U.S. 987 (2004), *on remand*, 04-2 BCA ¶ 32,775, *recons. denied*, 05-1 BCA ¶ 32,934, *aff'd*, 182 Fed. Appx. 988 (Fed. Cir. 2006).

FINDINGS OF FACT

1. On 16 October 1984 Freedom Industries, Inc.'s (FII, hereinafter FNY, FII's successor) proposed price on Defense Personnel Support Center's MRE-V (meals, ready to eat) Solicitation No. DLA13H-84-R-8257 included \$1,998,410 in profit that "will be used to pay projected interest of \$376,743, leaving a final [net] profit of \$1,621,667" with a spreadsheet showing "INTEREST-- . . . WORKING CAPITAL," \$385,983 (*Freedom II*, ex. FT060A at 811-12, 820).

2. The parties' 6 November 1984 "MEMORANDUM OF UNDERSTANDING" (MOU) stated that the parties had agreed upon a \$17,197,928 fixed contract price on the MRE-V solicitation, and broke out the following cost elements (R4, tab 7, ex. 24):

Materials	\$ 8,193,637
Direct Labor	811,002
Manuf. O/H	3,627,530
Depreciation	333,333
Other Costs	163,816
G & A	1,840,824
Total Costs	14,970,142
Profit 14.997%	<u>2,227,786</u>
TOTAL PRICE	\$17,197,928

The MOU did not include interest on borrowed financing money as a cost.

3. Among the spreadsheets FNY provided to respondent on 6 November 1984 to back up the foregoing MOU costs, "Exhibit 1," entitled "PROJECTED RESULTS MRE V," listed the foregoing six cost elements in the MOU with a subtotal of \$14,970,142, below which FNY stated (*Freedom II*, ex. FT062 at 00909):

PROFIT – PRE INTEREST	\$2,227,786
INTEREST:	
Fixed Asset Financing	135,000
Working Capital Financing	<u>171,664</u>
TOTAL INTEREST	306,664
 NET PROFIT	 <u>1,921,122</u>

4. "Exhibit 2" of those 6 November 1984 spreadsheets, entitled "PROJECTED CASH FLOW – MRE V," set forth under column 17 (*Freedom II*, ex. FT062 at 00910):

Cash Balance – Opening	0
Progress Payments	13,326,175
Sales Collections	17,197,928
Financing – Fixed Assets	1,500,000
– Working Capital	<u>1,798,936</u>
TOTAL PROCEEDS	33,823,039
Materials	8,193,637
Direct Labor	811,002
Other Direct Costs	163,816
Manufacturing Overhead	3,627,530
General & Administrative	1,840,824
Fixed Assets	1,500,000
Progress Payments Repaid	13,326,175
Financing – Fixed Assets	375,000
– Working Capital	1,798,936
Interest - Fixed Assets	135,000
- Working Capital	<u>171,664</u>
TOTAL OUTLAYS	31,943,584

5. On 15 November 1984, Defense Personnel Support Center, Philadelphia, awarded Contract No. DLA13H-85-C-0591 (the contract) to FNY (R4, tab 5). The contract incorporated by reference clause I09, DAR 7-103.21(b) TERMINATION FOR CONVENIENCE OF THE GOVERNMENT (OCT 1974), which provided:

(f) Costs . . . agreed to . . . pursuant to . . . (d) . . . hereof shall be in accordance with Section XV of the Armed Services Procurement Regulation in effect on the date of the contract.

(R4, tab 3 at 2 of 16) The contract included Standard Form 32 General Provisions, including:

24. PRICING OF ADJUSTMENTS

When costs are a factor in any determination of a contract price adjustment pursuant to the Changes clause or any other provision of the contract, such costs shall be in accordance with the contract cost principles and procedures in . . . Section XV of the Armed Services Procurement Regulation . . . which are in effect on the date of this contract.

(R4, tab 2) and incorporated by reference FNY's final offer and the spreadsheets backing up the 6 November 1984 MOU (*Freedom II*, 01-2 BCA at 156,048, finding 22).

6. We find that in the contract and in FNY's offers therefor, FNY consistently and properly treated all projected interest costs, including interest costs on working capital, as deductions from profit.

7. ACO Liebman's 14 and 15 February 1985 letters confirm his requirement for FNY to obtain \$3.8 million in outside financing as a condition for paying FNY's pending progress payment requests (*Freedom II*, exs. F49, FT104 at 1, exs. FT097, F68 at 1; tr. 1793-95). With respect thereto, FNY obtained Bankers Leasing Association's (BLA) February 1985 letters of commitment for financing loans of 80% of FNY's monthly contract receivables, which commitment respondent eventually accepted (*Freedom II*, exs. FT094, FT096; tr. 1798, 1801-05).

8. Bilateral contract Modification No. P00025 (Mod. 25), executed on 29 May 1986, included a waiver of all prior claims, with one irrelevant exception (R4, tab 6 at 1, 4 of 4).

9. On 22 June 1987, the contracting officer (CO) terminated the contract for default (*Freedom II*, 01-2 BCA at 156,058, finding 120).

10. FNY's 1 May 1991, certified, \$21,959,311 claim under the contract included, among its exhibits, a schedule of G&A costs including \$490,628 for "INTEREST EXPENSE AND FEES." The schedule did not identify what portion was for working capital interest. (App. supp. R4, tab 3, ex. 36 at 4)

11. FNY's timely appeal of the CO's 7 October 1991 decision denying the foregoing 1 May 1991 claim was docketed as ASBCA No. 43965, with ASBCA jurisdiction based on the Contract Disputes Act of 1978 (*Freedom II*, 01-2 BCA at 156,058, finding 121).

12. The Board's 7 May 1996 decision in *Freedom NY, Inc.*, ASBCA No. 35671, 96-2 BCA ¶ 28,328 (*Freedom I*) sustained the appeal and converted the default termination of the contract to a termination for the convenience of the government (*Freedom I*, 96-2 BCA at 141,479²).

² Partially vacated and corrected in *Freedom NY, Inc.*, ASBCA Nos. 35671, 43965, 96-2 BCA ¶ 28,502.

13. On 29 December 2000, the parties entered into a convenience termination settlement, memorialized in bilateral contract Modification No. A00004 (Mod. A00004), that provided (R4, tab 10 at 1, 3):

The attached settlement memorandum signed by both parties clarifies the basis on which the settlement was agreed to and provides detailed loss computations as to how the settlement was agreed to. That memorandum is hereby incorporated as part of this modification.

14. Mod. A00004 appended a Memorandum of Agreement (MOA) which provided in pertinent part (R4, tab 10 at 5-7, 10):

2. Freedom and the Government agree that the negotiated settlement finalizes the Contractor's entitlement for the following termination costs in the amounts set forth below

. . . .

[Note 1] General and Administrative expenses have been agreed to and settled by the parties in total for the amount of \$3,593,672 with the two exceptions as noted below (see a.).

a. The two exceptions to the agreement on total General and Administrative costs are as follows: . . . (2) The auditor also questioned Freedom's claim for interest cost in the amount of \$484,890 as unallowable under DAR. Of that amount, Freedom is pursuing a claim before the Board in the amount of \$313,236 for additional interest incurred by Freedom which Freedom alleges is due to the Government's failure to provide progress payment financing. This termination settlement does not provide a resolution of that \$313,236 portion of the interest expense and that matter remains open at the Board for final determination [in ASBCA No. 43965]. .

..

. . . .

[Note 6] . . . This agreement does not affect Freedom's right to pursue its claim before the Board . . . specifically including

but not limited to the right to recover interest, which Freedom claims resulted from the late payment of invoices, including progress payment requests, or the recoupment of unliquidated progress payments by the Government. This agreement not to include interest as part of the recovery under this termination settlement does not negate Freedom's right to pursue interest in another forum, nor does it affect the Government's right to deny it.

....

3. The net payment in the amount of \$799,947.00 in paragraph 1 above, together with sums previously paid, constitutes payment in full and complete settlement of the amount due the contractor for the complete termination of the contract and all other demands and liabilities of the Contractor and the Government under the contract for termination costs and settlement expenses. The concept of full and complete settlement does not negate the rights of the parties, as specifically reserved herein, to pursue their various positions in ASBCA No. 43965 or in any appeal from a decision therein.

4. This settlement

The items and elements settled here are explicitly compensated via the termination settlement. The intent of the parties is to avoid duplicate compensation under ASBCA docket 43965, for costs and elements of the settlement which have been settled under the termination for convenience as directed by ASBCA docket # 35671. Nothing in this agreement is to be a bar to the ASBCA in compensating or giving relief to Freedom for other matters not compensated herein, or for impacts on the contract not considered herein, if it determined that Freedom deserves such relief.

15. DAR 15-205.17 provided, as last amended 28 February 1983 (R4, tab 4 at 9):

Interest and Other Financial Costs. . . . Interest on borrowings (however represented), bond discounts, costs of financing and refinancing capital (net worth plus long-term

liabilities) . . . and directly associated costs, are unallowable except for interest assessed by State or local taxing authorities under the conditions set forth in 15-205.41. (But see 15-205.24.)

16. In *Freedom II* FNY claimed, *inter alia*, as of March 2001, item (a), “\$9,686,129 equitable adjustment for Government-caused cost overrun” which included allocation (9), “\$313,236 due to ‘unnecessary and unreasonable’ interest costs,” explaining that--

FNY’s allocation (9) [\$313,236] is the difference between its incurred interest costs of \$484,900 stated in Modification No. A00004 . . . and its pre-award, negotiated and budgeted amount of \$171,664 for (working capital) interest cost.

and item (d) \$16,611,660 in “financial damages,” including “\$4,900,000 in interest on BLA’s \$3.5 million loan balance.” We found that “FNY’s alleged cost overrun allocations, . . . 6-10, cite no substantiating evidence.” (*Freedom II*, 01-2 BCA at 156,059-60, findings 125-27, 132(c))

17. *Freedom II* held that FNY’s Claim Item (5), Government Interference, including interferences with prospective financiers, was a breach of contract which delayed physical progress “until 11 February 1985, when FNY arranged contract financing from . . . BLA” and that FNY was entitled to recover \$2,738,206 for Claim Items (1), (4), and (5) (01-2 BCA at 156,063, 156,068).

18. The Board’s 14 October 2004 decision in ASBCA No. 43965 on remand from the Federal Circuit Court of Appeals “eliminate[d] the \$2,936,707 recovery found in [*Freedom II*] for claim items (1), (4), (5) and (6), and reduce[d] FNY’s total recovery to \$2,970,947, plus CDA interest on such amount, from 6 May 1991 until the date of payment” (04-2 BCA at 162,070).

19. On 12 January 2005 appellant wrote to respondent seeking to negotiate the working capital interest issue reserved in Mod. A00004 (R4, tab 16). On 10 February 2005 respondent declined to negotiate such issue (R4, tab 18).

20. FNY’s 17 January 2006 certified claim under the contract sought “payment of working capital interest as an increased line item cost under the Contract (the ‘Spread Sheet Line Item Interest’)” in the amount of “\$15,775,892.91 (plus interest on that unpaid amount through the date of payment).” FNY calculated that \$15,775,892.91

interest on a “Beginning Balance” of \$3,518,230.24 on loans payable to BLA from 31 March 1987 through 31 October 2004. (R4, tab 21 at 1, 3, 5, 30 of 30)

21. The CO’s 14 March 2006 letter to FNY denied its 17 January 2006 claim for \$15,775,892.91 (R4, tab 22). On 9 June 2006 FNY timely appealed that decision to the Board, which docketed the appeal as ASBCA No. 55465.

POSITIONS OF THE PARTIES

Appellant argues that its working capital interest claim (1) is not barred by Mod. A00004 because it was reserved from the release in Mod. A00004 (app. br. at 13-14), (2) is not barred by the DAR 15-205.17 cost principle disallowing interest, because the DAR was not in effect on 15 November 1984 when the contract was awarded (*id.* at 15-17), strict accounting principles do not guide costs under convenience termination settlements, but rather the DAR 8-301 standards of business judgment and fair compensation (*id.* at 18-20), and the DAR cost principles do not apply to terminations for convenience of firm fixed price contracts, such as the instant contract (app. reply br. at 5 n.3) and (3) has never before been litigated and hence cannot be barred by *res judicata* (*id.* at 11).

Respondent contends that appellant is not entitled to recover its working capital interest costs because (a) DAR 15-205.17 made interest costs unallowable (gov’t br. at 11-12), (b) the DAR was in effect on 15 February 1984 when the MRE-V solicitation was issued (*id.* at 13), (c) such interest was not a “cost” element of the contract (*id.* at 14), (d) such interest was “waived” by Mod. A00004 and not reserved therein (*id.* at 14-15), (e) such interest was “waived” by Mod. P00025, since all government failures to pay and suspensions of progress payments occurred before 25 May 1986 (*id.* at 15), and (f) FNY claimed such working capital interest under the label “unnecessary” interest in *Freedom II*, which claim the Board denied for lack of substantiating evidence, and so it is barred by *res judicata* (*id.* at 16).

DECISION

Appellant has the burden of proving its affirmative monetary claim. *Whitton Construction Co.*, ASBCA No. 40756, 94-1 BCA ¶ 26,341 at 131,022 (appellant has burden of proving entitlement with respect to affirmative claims). Respondent has the burden of proving its affirmative defenses of release and *res judicata*. Fed. R. Civ. P. 8(c) (release and *res judicata* are affirmative defenses); *Bridgestone/Firestone Research Inc. v. Automobile Club de L’Ouest de la France*, 245 F.3d 1359, 1361 (Fed. Cir. 2001) (party raising affirmative defense bears the burden of proof).

To identify what is FNY's "working capital interest" claim in this appeal, it is instructive to recall FNY's following description of its working capital interest claim in its 8 March 2001 post-hearing brief in *Freedom II* (app. br. at 222, 227-28):

The parties agreed at contract formation (November 1984) that the Government would provide prompt financing in the form of progress payment reimbursement of 95% of incurred costs. Accordingly, Freedom projected an amount of \$171,664 as working capital interest expense to cover its share of working capital financing. . . .

[On February 14-15, 1985] Liebman breached this agreement. He forced Freedom to obtain an outside line of credit As a result, Freedom incurred \$484,900 in working capital interest expense. . . .

The added interest cost was included as part of the G&A incurred cost base Freedom is seeking an amount of \$313,236 which represents the additional working capital interest expense incurred under the Contract [as part of FNY's \$9,686,129 cost overrun equitable adjustment damages].

. . . .

. . . Freedom obtained financing from Bankers Leasing Association As Government caused contract losses deepened, the investment from Bankers, in the form of unpaid loans grew to \$3.5 million. That amount plus interest remains due and payable today.

. . . .

Bankers Leasing Association \$3.5M
10% per annum X 14 years = \$4,900,000
[included in FNY's \$16,611,660
Financial Damages].

From the foregoing summary we see that FNY's working capital interest cost claim in *Freedom II* contained \$313,236 and \$4,900,000 components, both of which arose from ACO Liebman's February 1985 alleged breach. The appeal record in ASBCA

No. 55465 addresses both components: (1) Mod. A00004's MOA mentioned "\$313,236 for additional interest incurred by Freedom . . . due to the Government's failure to provide progress payment financing" (finding 14). That \$313,236 corresponded to FNY's "allocation (9)" of its contract cost overrun damages component in *Freedom II*, which was "the difference between its incurred costs of \$484,900 stated in [Mod. A00004] . . . and its pre-award, negotiated and budgeted amount of \$171,664 for (working capital) interest cost," and with respect to which difference we found that FNY cited no substantiating evidence (finding 16). (2) In *Freedom II*, FNY also claimed "\$4,900,000 in interest on BLA's \$3.5 million loan balance" as of March 2001 (finding 16). In ASBCA No. 55465, FNY does not claim that \$313,236 "unnecessary and unreasonable" interest component. But by extrapolation of the \$4,900,000 claim component, it does claim \$15,775,892.91 in interest through 31 October 2004 on a "Beginning Balance" of \$3,518,230.24 on loans payable to BLA (finding 20), which loans FNY would not have obtained but for ACO Liebman's February 1985 breach.

Having so identified the working capital interest claim in issue, it is not necessary to address or to decide whether the DAR 15-205.17 interest cost non-allowability principle applies to the FNY contract or whether FNY released or reserved its working capital interest claim in Mod. A00004, or whether such claim is barred by *res judicata*.

It is sufficient to decide that FNY's working capital interest claim, as so identified, was a damages component in FNY's 1 May 1991 claim, whose operative, causal facts arose on 14-15 February 1985 which antedated the 29 May 1986 contract Mod. 25 (findings 7-8). Therefore, FNY's working capital interest claim was released by Mod. 25. *Rumsfeld v. Freedom NY, Inc.*, 329 F.3d 1320, 1329 ("we reverse the Board's decision invalidating Modification 25 on the ground that the government breached the alleged side agreement"), *reaffirmed*, 346 F.3d 1360, 1361 (Fed. Cir. 2003), *cert. denied*, 541 U.S. 987 (2004); *Freedom NY, Inc.*, ASBCA No. 43965, 04-2 BCA ¶ 32,775 (holding that neither lack of consideration, duress, unconscionability nor fraud invalidated the release provision in Mod. 25), *recons. denied*, 05-1 BCA ¶ 32,934, *aff'd*, 182 Fed. Appx. 988 (Fed. Cir. 2006).

We deny the appeal.

Dated: 13 December 2007

DAVID W. JAMES, JR.
Administrative Judge
Armed Services Board

of Contract Appeals

(Signatures continued)

I concur

I concur

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

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

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. 55465, Appeal of Freedom NY, Inc., rendered in conformance with the Board's Charter.

Dated:

CATHERINE A. STANTON
Recorder, Armed Services
Board of Contract Appeals