

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --)
)
Southwest Marine, Inc.) ASBCA No. 54550
)
Under Contract No. N00024-85-C-8506)

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OPINION BY ADMINISTRATIVE JUDGE THOMAS ON CROSS-MOTIONS
RELATING TO SECTION III.D OF APPELLANT'S RESPONSE

This is the quantum phase of ASBCA No. 47621. Southwest Marine, Inc. (SWM) appealed under the Contract Disputes Act, 41 U.S.C. §§ 601-613, from a contracting officer's final decision (COFD) asserting a government claim that the Navy had overpaid SWM's predecessor in interest, Northwest Marine Iron Works (NMIW), as a result of debt concessions by its subcontractors and other creditors subsequent to confirmation of its Chapter 11 reorganization plan. After prevailing on entitlement, the Navy filed Respondent's Statement of Costs (SOC) dated 21 May 2004 and SWM filed Appellant's Response to the Government's Statement of Costs (Response) dated 23 July 2004. This opinion is the third in a series of opinions resolving motions and cross-motions for summary judgment related to appellant's Response. The prior two opinions are reported

at 08-1 BCA ¶ 33,786 (sections III.A, B and C of the Response), and 08-2 BCA ¶ 33,981 (section III.E of the Response).

The motions decided in this opinion consist of “Respondent’s Motion For Partial Summary Judgment Addressing Section III.D Of Appellant’s Response” (gov’t mot.), dated 15 April 2008, and “Appellant’s Cross-Motion for Summary Judgment Denying the Government’s Claim for Negative Profit (or ‘Adjustment for Loss’) Including Separate Statement of Undisputed Facts” dated 11 June 2008. In addition, appellant has objected to the Declaration of James Altice dated 6 August 2008, filed with the Navy’s reply to appellant’s opposition to the Navy’s motion and the Navy’s opposition to appellant’s cross-motion. The motions have been fully briefed.

STATEMENT OF FACTS (SOF) FOR PURPOSES OF THE MOTIONS

1. On 19 August 1985, the Navy awarded NMIW the captioned fixed-price incentive contract for overhaul of the USS DULUTH. The contract set forth the following amounts for the work:

| | |
|---------------|--------------|
| Target Cost | \$12,282,010 |
| Target Profit | \$ -0- |
| Target Price | \$12,282,010 |
| Ceiling Price | \$15,966,613 |
| | (130%) |

(R4, tab 1 at 2 of 53)

2. The contract included Federal Acquisition Regulation (FAR) 52.216-16, INCENTIVE PRICE REVISION-FIRM TARGET (APR 1984) (the IPR clause). This clause provided:

(a) General. The supplies or services identified in the Schedule...are subject to price revision in accordance with this clause; provided that in no event shall the total final price of these Items exceed the ceiling price of one hundred thirty (130%) percent of the target cost for these Items....

....

(d) Price revision. Upon the Contracting Officer’s receipt of the data required by paragraph (c) [Data submission] above, the Contracting Officer and the Contractor shall promptly

establish the total final price of the items specified in (a) above by applying to final negotiated cost an adjustment for profit or loss, as follows:

....

(2) The total final price shall be established by applying to the total final negotiated cost an adjustment for profit or loss, as follows:

....

(ii) if the total final negotiated cost is greater than the total target cost, the adjustment is the total target profit, less thirty (30) percent of the amount by which the total final negotiated cost exceeds the total target cost.

....

(f) Adjusting billing prices....

....

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

(R4, tab 1 at 46-47 of 53)

3. During performance it became apparent that actual costs would exceed target costs and NMIW requested to bill progress based on the ceiling price. The Navy agreed to pay billings at that price. (App. statement of undisputed facts ¶¶ 5, 6; gov't opp'n at 6-7)

4. NMIW completed performance of the work in June 1986 (08-1 BCA ¶ 33,786 at 167,216).

5. On 11 March 1994, the contracting officer (CO) issued the COFD which led to this appeal (R4, tab 26). At that time, as a result of various modifications, the contract amounts, exclusive of a discrete amount for interest, were as follows:

| | |
|-------------------------|--------------|
| Target Cost | \$17,582,184 |
| Target Profit | \$ 550,724 |
| Target Price | \$18,132,908 |
| Ceiling Price (130%) | \$22,856,839 |

One modification, Modification No. A00121, remained unexecuted. The Navy had paid NMIW \$22,846,836, exclusive of the amount for interest, and retained \$10,003. The Navy alleges that total costs prior to the debt concessions were \$24,467,062, which would mean that NMIW had suffered a substantial loss on the contract. (R4, tab 26 at 2, 6)

6. The COFD claimed that NMIW had received debt concessions from subcontractors and other creditors in the amount of \$3,238,248, reducing total costs to \$21,228,814 and resulting in an overpayment of \$2,161,287. In order to arrive at the amount of the overpayment, the CO applied the formula in paragraph (d)(2)(ii) of the IPR clause¹, as follows:

Because subtracting the \$3,328,248.00 [sic] noted above from the audit computed total final cost of \$24,467,062.00 would activate a price revision in accordance with paragraph (d) of the IPR clause, the computation of final price resulting from that revision is illustrated below:

| | |
|---------------------------|------------------|
| Target Cost | \$17,582,184 |
| Target Profit | 550,724 |
| Target Price | 18,132,908 |
| Ceiling Price | 22,856,839 * |
| | |
| Total Cost | 24,467,062 |
| Debt Forgiven | <u>3,238,248</u> |
| Adjusted Total Cost (ATC) | 21,228,814 |
| Target Cost Minus ATC | (3,646,630) |
| Incentive Fee | |
| Adjustment Rate | <u>30%</u> |
| | (1,093,989) |
| Target Profit | 550,724 |
| Profit Adjustment | (543,265) |

¹ Strictly speaking, as explained in the opinion at 08-1 BCA ¶ 33,786 at 167,219, the issue is whether the Navy is entitled to a return of progress payments.

| | |
|-----------------|---------------------|
| Total Cost | 21,228,814 |
| Billable Amount | 20,685,549 |
| Amount Paid | <u>22,846,836</u> * |

Amount of Overpayment \$ 2,161,287

(Asterisk denotes ceiling price/amount paid exclusive of interest paid on claim by Modification A00202)

(R4, tab 26 at 6)

7. Applying the formula in the IPR clause not only eliminated the target profit of \$550,724 but also kept the contractor from recovering all of its costs, to the extent of \$543,265. Thus, the profit adjustment was presented as a negative number: (543,265).

8. The COFD included the following explanation of why the contract originally had a target profit of zero:

On DULUTH, NMIW had offered a target cost that, when escalated by the 130% provided in the IPR clause, would meet what the company then considered to be a realistic offer for the costs of production, and which would cover all contract costs, though because of the contract type, would not likely allow for any profit.... As further evidence of this bidding strategy, NMIW offered no amount for target profit..., a fact which reduced the evaluated price for contract award.

(R4, tab 26 at 3-4) With respect to the decision to allow billing at ceiling, the COFD said: "Because of the extreme overrun forecast for the contract, the Administrative Contracting Officer (ACO) acquiesced in NMIW's requests for reimbursement up to the prevailing ceiling price" (R4, tab 26 at 4).

9. In the subsequent SOC, the Navy reduced the amount of the alleged debt concessions from \$3,238,248 to \$1,857,192, resulting in total costs of \$22,609,870. Applying the same methodology as in the COFD, the Navy calculated a profit adjustment of (957,582), corresponding to the amount of (543,265) in the COFC. The amount of (957,582) consisted of target profit of \$550,724 less \$1,508,306, which is 30% of the difference between the total cost of \$22,609,870 and the target cost of \$17,582,184 ($\$22,609,870 - \$17,582,184 = \$5,027,686 \times .30 = \$1,508,306$). Reducing total cost of

\$22,609,870 by \$957,582 results in a billable amount of \$21,652,288, or an overpayment of \$1,194,548. (SOC, exs. B, D)

10. In its Response, section III.D, appellant takes exception to reducing target profit of \$550,724 by more than \$550,724. It points out that the SOC “includes a negative profit or ‘IPR Clause Reduction’ of \$957,582.” It argues: “Interpreting the contract as a whole, as it was understood by both parties during performance, the DULUTH contract provided for a profit of zero—no more and no less—on the basic contract work, and the Navy’s claim item of \$957,582 in ‘negative profit’ is not recoverable.” (Response at 19, 21)

11. Appellant has provided a declaration of William H. Zavin II, who was president of NMIW at the time of contract award, in which he states that:

6. NMIW’s offer, accepted by the Navy, included a target profit of zero which we intended and understood to mean that no profit would be added to NMIW’s costs and that we would not incur a loss unless actual costs were to exceed the ceiling price. NMIW relied on that understanding in offering a target profit of zero and a ceiling price equal to our estimated costs. We also relied on that understanding in negotiating adjustments for changes and claims.

7. During performance of the DULUTH contract, it became apparent that actual costs would exceed target costs. NMIW therefore requested to bill progress based on the ceiling price. The Navy agreed and accepted and paid our progress billings without any deduction or reduction for negative profit or “loss.”

....

11. I am advised that the Navy is now seeking a revised price for DULUTH that reduces the payable price by 30% of the difference between target cost and actual cost. Such a price revision is inconsistent with NMIW’s offer of zero profit and our understanding, known to the Navy (according to Mr. Morrison [the CO]), that the ceiling price would cover our costs up to that ceiling price.

(Zavin decl. dtd. 8 May 2008, attached to app. separate statement of undisputed facts dtd. 11 June 2008)

DECISION

On motion for summary judgment, we follow the familiar rule that summary judgment “is properly granted only where there is no genuine issue of material fact and the movant is entitled to judgment as a matter of law.” *Mingus Constructors, Inc. v. United States*, 812 F.2d 1387, 1390 (Fed. Cir. 1987).

The parties’ motions on the “negative profit” issue present the question of whether, in arriving at the amount of the overpayment attributable to the debt concessions, one should apply the formula set forth in the IPR clause or modify it so that the profit adjustment is no more than the amount of the target profit. The motions do not address what the correct amount of the debt concessions is, an issue deferred for hearing. Nothing herein should be construed as determining that the Navy’s alleged numbers are correct.

The IPR clause states unequivocally that the “total final price shall be established by applying to the total final negotiated cost an adjustment for profit or loss.” If the total final negotiated cost is greater than the total target cost, “the adjustment is the total target profit, less thirty (30) percent of the amount by which the total final negotiated cost exceeds the total target cost.” (SOF ¶ 2) Here, subsequent to the debt concessions, the total cost allegedly was \$22,609,870. This amount is greater than the total target cost of \$17,582,184. (SOF ¶¶ 5, 9) Accordingly the adjustment for loss is applicable. The practical effect of the formula is that appellant shares the costs (as reduced by the debt concessions) to the extent of 30% of the amount above the target cost. Part of that is covered by the target profit of \$550,724 and part of it comes out of appellant’s pocket (negative profit in appellant’s terminology).

Appellant would modify the formula. It argues that there was a “special provision for zero profit on the basic work” that “excludes both positive and negative profit on that work.” It agrees that the formula “does apply to eliminate the positive target profit that the Government agreed to on changes, some \$550,000 that it will not pay.” (App. reply at 8) It argues that the overpayment, at most, is \$237,023 (prior payments of \$22,846,836 + rounding of \$57 – adjusted total costs of \$22,609,870) (app. opp’n at 2). We are unable to find support for this view in the language of the IPR clause. Stating that the target profit is zero stops short of excluding both positive and negative profit on the work. There is no “special provision.”

The regulations support the Navy's interpretation. They make clear that in the case of fixed-price incentive contracts, there is no profit floor and the contractor may suffer a net loss. Thus, FAR 16.403-1(a) states:

A fixed-price incentive (firm target) contract specifies a target cost, a target profit, a price ceiling (but not a profit ceiling or floor), and a profit adjustment formula.... When the contractor completes performance, the parties negotiate the final cost, and the final price is established by applying the formula. When the final cost is less than the target cost, application of the formula results in a final profit greater than the target profit; conversely, when final cost is more than target cost, application of the formula results in a final profit less than the target profit, or even a net loss. If the final negotiated cost exceeds the price ceiling, the contractor absorbs the difference as a loss. Because the profit varies inversely with the cost, this contract type provides a positive, calculable profit incentive for the contractor to control costs.

In view of the plain language of the contract, we do not think that Mr. Zavin's declaration raises a triable issue of material fact. Whatever NMIW's reasons for bidding on a zero profit basis, it assumed the risk of any overrun when it entered into the contract. We also do not think that the fact that NMIW was allowed to bill at ceiling during performance makes a difference. Paragraph (f) of the IPR clause makes clear that billing does not control the results of the paragraph (d) calculation. The COFD is consistent with this conclusion. Although it alludes to NMIW's bidding strategy and the increase in billings, it applies the formula in the IPR clause without limiting the adjustment to the amount of the then contractual profit.

We deny appellant's objection to Mr. Altice's declaration, but note that we have not relied upon it in view of the plain language of the contract.

CONCLUSION

The Navy's motion for summary judgment as to Section III.D of the Response is granted. Appellant's cross-motion is denied.

Dated: 7 April 2009

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

I concur

I concur

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

RICHARD SHACKLEFORD
Administrative Judge
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. 54550, Appeal of Southwest Marine, Inc., rendered in conformance with the Board's Charter.

Dated:

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