

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeals of --)
)
Todd Pacific Shipyards Corporation) ASBCA Nos. 55126, 56910
)
Under Contract No. N00024-01-C-4115)

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OPINION BY ADMINISTRATIVE JUDGE SCOTT

Appellant Todd Pacific Shipyards Corporation (Todd) appealed under the Contract Disputes Act (CDA), 41 U.S.C. §§ 7101-7109, from the contracting officer's (CO) denial of its claims under its subject contract (Contract 4115) with the United States Navy for advance planning for repair and alteration of Auxiliary Oiler Explosive (AOE) ships, which included repair and alteration options. Todd seeks to charge its Dry Dock No. 3, or "Emerald Sea," repair, upgrade and Naval Sea Systems Command (NAVSEA) certification costs directly to Contract 4115 instead of treating them as indirect costs allocated to several government and commercial contracts, as was its established practice. In March 2010 the Board held a nine-day hearing on entitlement and quantum. Briefing was complete on 15 February 2011.¹

¹ Evadne Sanichas, Esq., the Navy's Senior Trial Attorney responsible for these appeals through the filing of its principal post-hearing brief, passed away in January 2011.

PROCEDURAL BACKGROUND

The Board docketed Todd's first appeal, from the CO's denial of its \$5.99 million claim for Emerald Sea costs, as ASBCA No. 55126. In *Todd Pacific Shipyards Corp.*, ASBCA No. 55126, 06-2 BCA ¶ 33,421 (*Todd I*), we denied the Navy's motion to dismiss portions of the appeal for lack of jurisdiction and, in *Todd Pacific Shipyards Corp.*, ASBCA No. 55126, 08-2 BCA ¶ 33,891 (*Todd II*), we granted the Navy's motion for summary judgment in part, identifying the question remaining for resolution as:

[W]hether the accounting change appellant sought was warranted, prospective, allowable, and unreasonably denied, as it asserts, or was unjustified and impermissibly inconsistent and retroactive, as the Navy contends.

Todd II at 167,758. In ASBCA No. 55126, Todd has withdrawn all but its certification cost claims (R4, tab 556 at T26364 n.1).²

During discovery, Todd increased its claim to \$10.952 million. After the Navy moved to dismiss on the ground that it was a new claim not submitted to the CO, Todd submitted a protective claim. The Board docketed its appeal from the CO's deemed denial as ASBCA No. 56910 and consolidated it with ASBCA No. 55126. The Navy next moved to dismiss ASBCA No. 56910 on the ground that the claim was time-barred. Todd then conceded that its revised claim was a "new" CDA claim. *Todd Pacific Shipyards Corp.*, ASBCA Nos. 55126, 56910, 10-1 BCA ¶ 34,368 (*Todd III*) at 169,713. In *Todd III*, we dismissed claims abandoned by Todd; we dismissed the portion of ASBCA No. 55126 that pertained to Todd's new claim because, at the time, it had not submitted it to the CO; we noted that Todd's \$4.502 million certification cost claim was still before us under that appeal; and we denied without prejudice the Navy's motion to dismiss ASBCA No. 56910 on timeliness grounds, pending fact development at hearing.

FINDINGS OF FACT

Todd and The Emerald Sea Dry Dock

1. Todd, a small business under Small Business Administration shipyard standards, is headquartered in Puget Sound, with locations in Seattle, Bremerton, and Everett, Washington. Its principal customers are the Navy, the United States Coast Guard, Washington State Ferries, and smaller maritime operators. The contractor's fiscal year (CFY) essentially runs from 1 April through 31 March. The years covered by Todd's

² "R4" refers to the supplemental Rule 4 files that replaced the original Rule 4 file.

claims, CFYs 2002-2005, remain open for accounting purposes. Its indirect rates have not been finalized. (Tr. 1/33-35, 2/184, 3/40-41, 8/72)

2. During much of the period in question Todd had three dry docks—the Emerald Sea steel dry dock, which it owned and was its largest dry dock; the YFD-70, a large steel dry dock that Todd leased from the Navy; and the YFD-54, a smaller wooden dry dock, also leased from the Navy, which sank in CFY 2004 and was dismantled by Todd on the Emerald Sea pursuant to a contract with the Navy. (R4, tab 281 at F1921, tab 591 at D1139, D1143, D1164; tr. 6/179, 7/66-67, 76-77, 130)

3. A dry dock permits ship building or repair with the ship lifted out of the water. To receive a ship for repairs, the dry dock must be submerged below the bottom of the vessel. AOEs—massive, fast, deep-draft combat support ships that carried fuel, ammunition, and refrigerated and dry goods—required a very large dry dock like the Emerald Sea. The AOEs were about 800 feet long, 107 feet wide, and weighed over 20,000 long tons (LT) unloaded, and about 50,000 LT loaded. A “long ton” is 2,240 pounds. (Tr. 1/37-38, 42, 45, 165-69, 171; R4, tab 142 at TODD5494, tabs 1142, 1149)

4. The Emerald Sea, built by another Todd division starting in 1967 or 1968, was relocated to Todd’s Seattle facilities in 1982 and certified by NAVSEA. It was 800 feet long, with a hollow steel structure and a base of eight pontoons covered with deck plating. There were two side walls or “wing walls,” with 32 wing wall tank units, 16 on each side of the dry dock, that were 14 feet wide, 40 feet high, and ran the dock’s length. The wing walls and pontoons, with internal truss bracing, were essentially water tanks filled to submerge the dock and emptied to bring its deck back above water level. (R4, tab 260 at TODD14697, tab 1036 at GOV176, tab 1142; tr. 1/38-39, 44, 164-68)

5. The Emerald Sea was the only private dry dock in the Puget Sound area able to lift AOEs as well as certain commercial and other ships. However, the Puget Sound Naval Shipyard had one or more dry docks that could have accommodated the AOEs. (R4, tab 591 at 1163, tab 1015 at NS17; tr. 4/153-54)

AOE Contracts and Events Preceding Contract 4115

6. Todd had been working on AOEs since 1986. Prior to Contract 4115, it had had three five-year contracts with the Navy to maintain the vessels, two of which are of record—one awarded on 23 November 1990, and one on 20 May 1996. The 1990 contract referred to MIL-STD-1625B, an apparent predecessor to the certification standard at issue. Like Contract 4115, the 1990 contract contained contract line item number (CLIN) 0002 non-scheduled repair and alteration requirements. The 1996 contract contained the same certification standard at issue, MIL-STD-1625C, the Safety Certification Program for Drydocking Facilities and Shipbuilding Ways for U.S. Navy Ships, and also included

the CLIN 0002 requirements. The final scheduled AOE “availability” on the 1996 contract was from 14 May 2001 through 17 August 2001, two months after Contract 4115’s award. The parties executed bilateral contract modifications to the 1996 contract through September 2001. (R4, tab 64 at GOV3654, -3674, -3675, tab 101 at GOV3748, -3788, -3816, -3829, tabs 209, 215, 216, 226, 227, 244, 271; tr. 1/46-47)

7. MIL-STD-1625C’s purpose is to assure that vessels can be safely docked, lifted, and returned to the water without damage to them or the dry dock. The Navy certifies a floating dry dock, like the Emerald Sea, for maximum “operational displacement,” or vessel weight, allowed at dock positions. Its certification requirements do not apply to non-Navy vessels. (R4, tab 1 at GOV57; tr. 1/169-73, 195, 223)

8. The Navy and Todd determine a dry dock’s condition through inspections, with emphasis upon steel portions, which are affected by rust or wastage. In about 1999 Todd began using finite element analysis (FEA), a computer-generated model showing the results of different loading stresses upon a structure. (Tr. 1/173-75)

9. On 3 December 1999, subject to analyses, structural repairs and replacements, the Navy’s Supervisor of Shipbuilding, Conversion, and Repair (SUPSHIP), Puget Sound, certified the Emerald Sea for a maximum docking capacity of 30,000 LT, as it had done since Todd’s acquisition of the dry dock. NAVSEA conducted maintenance audits every two years. (R4, tab 142 at TODD5494, tab 1005 at TODD1, -5; tr. 1/176, 4/131)

10. Todd’s internal procedure for authorizing a dry dock expenditure called for a Request for Expenditure for Plant (RFE). Todd’s then facilities manager, Jim Anderson, who left Todd in about 2008, executed an RFE on 23 June 2000 for Emerald Sea steel repairs and upgrades, expected to be complete by 15 September 2000. In July 2000, Todd’s then chief financial officer (CFO), Scott Wiscomb, who retired from Todd in 2006 but continued to consult for it at times and who testified at the hearing, and its chief operating officer (COO), Roland Webb, approved the RFE. (R4, tab 142 at TODD5491; tr. 1/76, 163, 2/21, 103, 105-06) It proposed: (1) replacement and repair of corroded parts of the dock, considered to be “Maintenance and Repair [M&R], a shipyard overhead cost”; (2) installation of anodes to retard hull corrosion, also an M&R cost; and (3) new x-braces, deemed to be a capital expense, based on the need to increase the original design and current strength of the most heavily loaded sections of the dock. Capital and MRE costs totaled an estimated \$879,626. The RFE stated: “*After studying a number of the vessels we dock, and where their weight is supported by the dock structure, the number of x-braces is tailored to provide the necessary support to all the vessels we typically lift.*” (R4, tab 142 at TODD5493) (emphasis added). It stated that a dock survey, required by the Navy’s certification process, had revealed the extent and location of steel wastage due to corrosion and that, regarding x-braces, considering the wastage

found, the Navy and Todd had agreed to an FEA by a third party to assess the Emerald Sea's structural capability. The RFE continued in part:

The FEA revealed considerably less capability for load carrying capacity than expected from this dock, not only in the present wasted condition, but also in the like-new condition.... Since this dock was built in the 60's, ship design ha[s] evolved such that for a given length, *much heavier vessels are now the norm. This increased weigh[t] per foot of length has compounded the problem of the original underdesigned dock.*

....

The actual lift capacity of the dock calculated by theoretical formulas will not be increased as a result of the expenditure. *The effect will be to compensate for an inherent design weakness in the most heavily loaded areas of the dock as determined by the weight distribution of the modern vessels that are regularly available for Todd to dry-dock. By doing this work an inevitable downrating of the dock, affecting cruise ship and AOE Class vessel work is avoided.*

The simplest and least cost approach to reclaiming otherwise lost lift capacity, is the proposed x-braces.

The proposal includes x-braces customized to locations actually loaded heavily by AOE's, TOTE^[3], various cruise ships, icebreakers, naval vessels, and others that we routinely docked in the past and expect to dock again....

Continuing to dock these vessels without upgrade poses a serious risk of structural failure, potentially including catastrophic results.

(R4, tab 142 at TODD5494-95) (Emphasis added)

11. David R. Anderson, Todd's chief dock master since 1977, who testified at the hearing, had been involved with the Emerald Sea since 1981. He opined, contrary to the RFE, that an Emerald Sea downrating would not affect Todd's ability to dry dock cruise

³ TOTE was a freighter company (tr. 7/69).

ships there. It was lifting cruise ships that weighed about 28,000 LT and did so even when the Navy reduced the Emerald Sea's certified weight limit (below). The only relevance of the Navy's certification requirements to commercial vessels was that, when a docking exceeded the Navy's certified weight limits, Todd had to perform a post-docking inspection to demonstrate to SUPSHIP and NAVSEA that the dock had not been damaged, and it ran an FEA analysis. He also opined, contrary to the RFE, that x-bracing, located under the pontoon deck inside the pontoons, to strengthen the dry dock, was required to dock AOE's, not other vessels. (Tr. 1/162, 164, 181-83, 185-86, 195, 199)

12. Todd reported to SUPSHIP on 5 October 2000 that it had completed its FEA and most structural repairs called for, including certain x-bracing. On 7 November 2000 Todd conveyed its FEA findings, including that wing walls had received reduced ratings. Todd stated that upgrade repairs were planned for CFY 2001. (R4, tabs 144, 149, 153 at TODD8629; tr. 1/191-92) The Emerald Sea's x-braces at issue were in service on 1 March 2001 (R4, tab 556 at TODD16518, tab 591 at D1156; tr. 2/191, 3/44, 7/113).

13. On 31 January 2001, on the basis of its maintenance audit and the FEA, NAVSEA issued a safety certificate, to expire on 1 August 2002, reducing the Emerald Sea's maximum docking capacity to 24,361 LT, somewhat more than the weight of an AOE emptied of most of its fuel, ammunition, groceries, etc., and the number deemed necessary to lift an AOE in this "lightship" condition. NAVSEA required that, to sustain the certification, Todd must demonstrate that the dock was safe for Navy ships and provide the results of an independent structural survey. Repairs identified in the FEA and other repairs and replacements were also required. The 24,361 LT rating hampered the docking of, and work on, AOE's while the former 30,000 LT rating had allowed for about 5000 LT of flexibility. (R4, tab 160; tr. 1/48-49, 171-73, 192, 195-98, *see* tr. 6/93-95)

14. In about March 2001 the Navy sought to negotiate with Todd on a sole source basis for the next AOE contract. This was a critical period for the Emerald Sea. A wing wall tank failed that month and the condition of the dock's steel imperiled its ability to function. It had been degenerating, with its steel corroding in saltwater, for years. (Tr. 1/46-47, 49, 134, 190-91)

15. Jim Anderson issued an RFE on 23 March 2001, which Messrs. Wiscomb and Webb approved on 27 March 2001 (R4, tab 214 at F2829). The RFE sought a capital expenditure of \$418,459.72 because a wing wall tank had failed and needed to be renewed, as did others. It was the first of four tanks critically deteriorated due to age, high differential head pressures,⁴ lack of an initial paint job and high stress. In July 2001

⁴ "Differential head" pressure is the pressure of water on the tank when the external water level is deeper than that inside the dry dock. When the dock is submerged and a vessel moved onto it, the outside and inside water levels are both very high.

Todd amended the RFE to \$150,526, reflecting a change from capitalization of the wing walls to an expense treatment. (R4, tab 214 at F2828, F2830)

16. Todd commissioned a structural analysis by Elliott Bay Design Group, Ltd. to determine if the Emerald Sea required repairs to provide adequate strength to lift Statendam Class Cruise Ships. Elliott Bay's 25 April 2001 report concluded that the dry dock, with recommended repairs, had adequate strength to lift such a cruise ship with a lift weight of 28,091 LT and other criteria. On 28 September 2001 Elliott Bay augmented its report considering additional corrosion wastage and isolated replacement of certain wing walls. (R4, tab 186 at TODD5883, -5886, -5888, tab 240 at TODD10589, -10591)

17. Under Todd's predecessor contracts, per its standard accounting procedures, it allocated dry dock costs as indirect costs based upon dry dock usage, with a factor for vessel weight and, for AOE's, a special "multiplier." For at least 12 years prior to its 28 March 2005 claim, this was Todd's method of allocating its general Emerald Sea costs to individual contracts, both government and commercial. *Todd II*, 08-2 BCA ¶ 33,891 at 167,736. (See, e.g., tr. 1/57, 63, 85, 2/30-31, 33-34, 48, 53, 197-98)

18. Todd realized that it needed massive dock renovation to keep the Emerald Sea certified. Replacement of an entire wing wall unit was unprecedented. Stephen Welch, Todd's chief executive officer (CEO), asked Mr. Wiscomb to talk to Daniel Orcutt, who worked under CO Douglas Throckmorton (hereafter "the CO"), about Todd's need for a different cost accounting method. Mr. Orcutt was Todd's "primary interface" at SUPSHIP, through whom Mr. Wiscomb had negotiated two advance cost agreements with the Navy, unrelated to these appeals. (R4, tab 382; tr. 1/30, 48, 56-57, 165, 194, 2/27-28, 38, 6/189; see *Todd II*, 08-2 BCA ¶ 33,891 at 167,737)

19. The CO, chief of the contracting office at SUPSHIP Puget Sound until he retired in July 2009, testified at the hearing. He was the administrative CO under Contract 4115. He was not responsible for negotiating it, but had assisted the negotiators. (R4, tab 1 at GOV6, -99; tr. 4/128-29, 134, 136, 147-49, 178, 5/241-42)

20. Mr. Wiscomb, who participated in the contract negotiations, was the lead financial liaison between Todd and the Navy. He said the March 2001 wing wall failure in the Emerald Sea, a "major asset" (tr. 2/26), was of great concern to Todd, which wanted to use the dry dock to perform the new contract. It assessed that it had to replace

There is little differential head. As water is pumped out of the dock, the water level drops very quickly in the wing walls, causing great pressure against them and potential failure if they are not strong enough. The larger the vessel, the greater the differential head. (Tr. 1/49, 187-91; see R4, tab 1036 at GOV178)

most, if not all, of the wing walls, which was not comparable to anything Todd had done under its prior Navy contracts. Mr. Wiscomb was to develop a plan for Navy reimbursement of Todd's Emerald Sea costs, which Todd realized "early in 2001" were going to be substantial (tr. 2/23). (Tr. 1/51, 2/23-26, 4/147)

21. Mr. Wiscomb spoke with Mr. Orcutt at the end of March or during the first two weeks of April 2001 and a month later about Todd's wish for a new cost reimbursement mechanism. Mr. Wiscomb believed, and reported to Mr. Welch, that he and Mr. Orcutt had reached an understanding that Todd would use the existing approach provisionally and would "true-up" any amounts owed Todd after the contract was signed, once a new approach was in place. There is no documentation of the discussions. (Tr. 1/57-58, 95, 112, 2/29-33, 42, 53-54, 124-25)

22. Messrs. Wiscomb and Orcutt did not address whether any new cost reimbursement mechanism would involve direct, rather than indirect, cost allocation; an accounting change was not part of Todd's contract negotiations with the Navy, including dry dock option pricing; and the contract documents did not mention any potential change (R4, tabs 1, 2, 591 at D1165; tr. 1/59, 101, 2/32-33, 4/148). Mr. Wiscomb states that the discussions involved "an accounting change that really wasn't directly related to the contract," which was why it could be "put it off" until after the contract was signed (tr. 2/33, *see also* tr. 2/115 (accounting change under discussion "had no direct bearing on contract negotiations"), 2/116 (given other priorities, there was no time to devote to accounting change until after contract in place)).

23. By the end of May 2001 the Emerald Sea was in "dire need" of steel working. Virtually the entire wing walls needed to be reconstructed. The rust was "running away" from Todd. (Tr. 1/200) In consultation with David Anderson, Jim Anderson prepared a "#3 Dry Dock Repair Analysis" dated 29 May 2001, which stated that its purpose was to record M&R and capital costs, estimated at \$16.2 million over the next five years, to maintain NAVSEA certification to lift the two classes of AOE's based in Puget Sound and that, even with that expenditure, it was unlikely that the Emerald Sea's service life could be extended much longer economically. It continued:

This dock has spent its whole life of just over 30 years in seawater. There are not that many docks that have survived that long in such an environment.... It is believed that a marginal coating system was applied to the steelwork when it was first fabricated however that system has totally failed many years ago. The dock was also built without cathodic protection for the external shell and only marginal protection for the internal structure.

....

In recent years we have not been able to meet straight NAVSEA guidelines for correction of deficient steel. The small amount of repairs undertaken in the past have left us with a situation that the great majority of the steelwork in the dock is approaching unsatisfactory status in a very few years....

....

“Emerald Sea” has been the most heavily utilized of the three dry-docks. In the last few years the dock has been occupied the equivalent of 87% of the year. The extensive repairs required in the future will impact the available dry-dock days where large ships can be docked.

Recent events in Portland leading to the predicted departure of their largest dock should provide greater opportunity for utilization of Emerald Sea or a similar but larger replacement. The size of Emerald Sea is such that very few of the new cruise ships can be lifted in the dock, nor can any of the projected 14 new US Flag Jones Act tankers for the Alaska trade. The two new ships for TOTE would require upgrades to the dock.... Preliminary evaluation is that the dock can accommodate these new vessels with some reasonable approach that is yet to be determined.

....

Our repair strategy has been to address the most severe and critical structural members until available funds were expended each year. The backlog of needed repairs has increased, as corrosion accelerates, *and as new ships impose higher loading.* The diverging trend between capacity and demand is expected to accelerate, unless an increased rate of repairs is applied to narrow this gap.

Until recently we have been directing repair efforts to pontoon truss members that are critical to lifting large vessels that represent concentrated loads up to the size of the smallest Holland America cruise ships in local service.... This past

year we have added extra structure to the pontoons to help support higher concentrated keel loading, but *more is required for the new class of icebreakers (Healy), TOTE's new ships, and the current generation of cruise ships....*

(R4, tab 203 at GOV176-78 (emphasis added); *see also* tr. 1/75) David Anderson acknowledged that not all of the repairs the analysis discussed were required for NAVSEA certification (tr. 2/7).

24. CEO Welch identified changed circumstances from Todd's prior AOE contracts as the Emerald Sea was not imperiled previously, it underwent normal repairs and maintenance, and expenditures were relatively consistent. Now, it required significant work at four times the total maintenance costs during the prior five years. In some contrast to Todd's superior knowledge claim in *Todd II*, 08-2 BCA ¶ 33,891 at 167,756, Mr. Welch also stated that Todd was aware that dry dockings might not occur and that the Navy referred to the contract as the "Sunset Contract" (tr. 1/61). It was presumed that older AOE's would be retired, with Contract 4115 being their final maintenance contract. It was also possible that newer AOE's would go to the Military Sealift Command (MSC). Moreover, any AOE dry dockings under the contract were not expected until 2004 and 2005. Under Todd's existing accounting method, it was compensated only when the Navy dry docked a vessel—an incentive to postpone repairs. (R4, tab 1036 at GOV177 (chart); tr. 1/40, 48, 55, 60-64, 222, *see also* tr. 2/25 (never had anything approaching this scope of work (Wiscomb)), tr. 3/7-8 (costs and their nature extraordinary (Dodge))

25. David Anderson admitted that the needed Emerald Sea work was foreseeable, it did not surprise him in 2001 and, if more maintenance and repairs had been performed in prior years, dry dock areas would have deteriorated more gradually (tr. 2/17-18).

26. CEO Welch prepared and submitted an "Executive Summary AOE Contract Renewal" dated 1 June 2001 to Todd's board of directors seeking authorization to enter into Contract 4115, intended to cover government fiscal years (GFY) 2002-2007 (R4, tabs 205, 1038; tr. 1/62-63, 145, 147). It stated that, as of 22 May 2001, "agreement in principle was reached on all significant issues" (R4, tab 205 at F2824). It also noted planned AOE retirements and transfers. However, the Navy estimated the contract's value at \$180 million in GFY 2000 dollars "assuming all the overhauls are actually performed" (*id.*) and this was potentially the largest naval contract awarded to Todd since the 1970's. The summary noted that, of 13 overhauls under the contract, 4 required dry docking and Emerald Sea use, and that 2 of the dry dockings were scheduled for 2004 and 2 for 2005. It recognized that the 13 overhauls and related work were options that the Navy unilaterally exercised and were not guaranteed. It identified three "abnormal risks" in executing the contract. (R4, tab 205 at F2825) One pertained to attaining approval of

Todd's business systems. The second was that "Todd will have to commit in advance to operating a fully certified & capable shipyard during the life of this contract in anticipation of the work, which then may not be exercised" (*id.* at F2826). This risk was said to be mitigated by other cost-type contracts and, should the Navy cancel AOE work, some of the negative economic impact would be absorbed by other Navy contracts. The report signaled the third and "most significant" area of risk as:

To perform this contract Todd is required to have a certified dry-docking facility capable of lifting the two classes of AOE's. *This means the "Emerald Sea" must be kept in service and capable for the next six years, or an alternative dry-dock be obtained.*

(*Id.*) (Emphasis added) The report appended the 29 May 2001 Emerald Sea repair analysis and stated:

The conclusion is that in order to maintain a drydock capable of lifting the large ships Todd currently serves (e.g. in order of load, certain cruise ships, AOE's, Tote's current ships, Healy, DDGs), we would anticipate spending over \$16 million in the next five years. These costs would be incurred on the premise that we would be keeping the dock in use indefinitely. (Repair and modifications would be done with intent to last 20 years, for example, rather than five.) If an alternative dock was purchased, if we knew we were sun-setting the dock, or if a different complement of ships were targeted, these costs may be reduced in various ways.

(*Id.*) (Emphasis added)

Regarding risk three, the report stated that wing wall tank replacement and most other costs should be expensed in the year incurred; the risk of maintaining the Emerald Sea could then be mitigated by Todd's cost-type contracts; and alternatives were to:

1. Retain existing drydock overhead allocation practices and concentrate costs to the extent possible for maximum recovery.
2. Alter our drydock overhead allocation practices to spread drydock overhead over all facility costs, not just dockings, recovering a portion of the costs each year. (This would require a change in practice with the Navy and would be subject to negotiations.)

3. Approach Holland America and/or Tote with a proposal requiring docking commitments on their part in exchange for dock refurbishment on our part.
4. Find a replacement dock, the cost of which can be justified...on an ROI basis through reduced maintenance costs and/or higher gross profit volume.

(R4, tab 205 at F2827) Todd unsuccessfully pursued Nos. 3 and 4 (tr. 1/70-72, 82-84, 2/39). Mr. Welch asked Mr. Wiscomb to press for a new accounting method (tr. 1/84).

27. Mr. Wiscomb tried, near the end of June 2001, to reach Mr. Orcutt, who did not return his calls and soon retired. Joseph Fallica, who did not testify at the hearing, was a cost/price analyst and contract specialist who reported to the CO's deputy. Mr. Fallica replaced Mr. Orcutt, who died in 2003. (Tr. 2/34-36, 5/11, 15, 18, 89; *see Todd II*, 08-2 BCA ¶ 33,891 at 167,737)

28. Todd does not now claim that any Orcutt discussions resulted in a legally enforceable agreement (tr. 2/30). The Board held they did not in *Todd II*, 08-2 BCA ¶ 33,891 at 167,754-56. Todd stipulates that there was "no formal written, signed advance agreement related to the Emerald Sea drydock costs" (tr. 6/190-91).

29. There is no evidence that Todd informed the government during contract negotiations of its \$16 million Emerald Sea plan (R4, tab 591 at D1165; tr. 8/153).

30. Prior to contract award, Todd had commitments for non-AOEs to use the Emerald Sea after award. Many non-AOEs used it during Todd's claims' period, but Messrs. Welch and Wiscomb assert that Todd would not have committed the claimed funds but for Contract 4115, and Todd's commercial business, said not to be large enough or predictable, and to involve only brief docking periods, was never a factor. (Tr. 1/59-60, 87-88, 97, 103, 105-06, 108, 110, 148, 2/27, 136-37, 174, 3/14-15, 7/80-81)

Contract 4115 and Regulatory Provisions

31. On 14 June 2001 NAVSEA and Todd entered into cost-plus-award-fee Contract 4115. The base period included five CLINs. CLIN 0001, the only priced CLIN at the time of contract award, at \$794,726, was for FY 01 advance planning for FY 02 repair and alterations to the USS SACRAMENTO. CLIN 0002 pertained to non-scheduled, emergent, repair and alteration requirements between scheduled availabilities for AOE 1 and AOE 6 class ships. The Navy reserved the right to order the CLIN 0002 emergent work services elsewhere at its discretion. CLINs 0003, 0004, and 0005 pertained to provisioned item orders, data, and technical documentation for the base period CLINs 0001 and 0002 and for FYs 02-07 option CLINs, if the options were

exercised. All options involving dry dock availability were unpriced. (R4, tab 1 at GOV6, -7, -32, -59; tr. 4/156, 8/80, 128, 9/61)

32. Of 24 option CLINs at contract award, 13 were for AOE repair, alteration and advance planning. Of the 13, 4 included dry docking, with none during the first two years. The dry dock option CLINs were CLIN 0017 (USS SACRAMENTO, FY 04); CLIN 0020 (USS BRIDGE, FY 05); CLIN 0021 (USS CAMDEN, FY 05); and CLIN 0025 (USS RAINIER, FY 06). (R4, tab 1 at GOV7-31; tr. 4/155, 5/229) Todd does not claim that the Navy had to exercise the options (tr. 8/81; app. br. at 4).

33. The contract contained the DRYDOCK CERTIFICATION (NAVSEA) (MAY 1993) clause, requiring vessel dry docking in dry docks certified per MIL-STD-1625C (SH) dated 25 August 1987, the standard governing the contract's technical requirements. Options required that, for designated dry docking availabilities, the contractor was to make certified dry docking facilities available for work below the ship's waterline. (R4, tab 1 at GOV57, -67, -75) The contract did not require use of the Emerald Sea or specify a dry dock cost recovery method.

34. The contract incorporated by reference the FAR 52.232-20, LIMITATION OF COST (APR 1984) clause (LOC), to apply if the contract contained fully funded line items. It contained contractor notice requirements about potential cost overruns and provided that the government was not obligated to reimburse costs exceeding the Schedule's estimated cost. (R4, tab 1 at GOV116)

35. The contract incorporated by reference FAR 52.216-7, ALLOWABLE COST AND PAYMENT (MAR 2000) (R4, tab 1 at GOV113), which provided in part:

(a) *Invoicing.* The Government shall make payments to the Contractor when requested as work progresses...in amounts determined to be allowable by the [CO] in accordance with Subpart 31.2 of the [FAR] in effect on the date of this contract and the terms of this contract.

The government was to reimburse "allowable costs," including for items or services "purchased directly for the contract" (¶ (b)(i)), and for properly allocable and allowable indirect costs (¶ (b)(ii)(F)). Within six months after the expiration of each CFY, the contractor was to submit a final indirect cost rate proposal, which the parties were to negotiate. They were to incorporate the final rates into the contract. Failure to agree was a dispute under the contract's Disputes clause (¶ (d)(2)-(5)). Until final annual indirect cost rates were established for any period, the government was to use billing rates the CO or authorized representative established (¶ (e)). They could be "prospectively or

retroactively revised by mutual agreement, at either party's request, to prevent substantial overpayment or underpayment" (§ (e)(2)). See *similarly* FAR 42.704, Billing rates.

36. FAR Subpart 31.2's following provisions were in effect as of Contract 4115's 14 June 2001 date. Unless otherwise stated, the current ones are the same or similar.

FAR 31.201-2, Determining allowability, provided in part:

(a) The factors to be considered in determining whether a cost is allowable include the following:

(1) Reasonableness.

(2) Allocability.

(3) Standards promulgated by the CAS [Cost Accounting Standards] Board, if applicable; otherwise, generally accepted accounting principles [GAAP] and practices appropriate to the particular circumstances.

(4) Terms of the contract.

(5) Any limitations set forth in this subpart.

FAR 31.201-4, Determining allocability, provided in part:

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it—

(a) Is incurred specifically for the contract;

(b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or

(c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

A "cost objective" includes a contract. FAR 31.001.

FAR 31.202, Direct costs, provided in part:

(a) A direct cost is any cost that can be identified specifically with a particular final cost objective. No final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose in like circumstances have been included in any indirect cost pool to be allocated to that or any other final cost objective. Costs identified specifically with the contract are direct costs of the contract and are to be charged directly to the contract. All costs specifically identified with other final cost objectives of the contractor are direct costs of those cost objectives and are not to be charged to the contract directly or indirectly.

FAR 31.203, Indirect costs, provided in part:

(a) An indirect cost is any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective. It is not subject to treatment as a direct cost. After direct costs have been determined and charged directly to the contract or other work, indirect costs are those remaining to be allocated to the several cost objectives. An indirect cost shall not be allocated to a final cost objective if other costs incurred for the same purpose in like circumstances have been included as a direct cost of that or any other final cost objective.

(b) Indirect costs shall be accumulated by logical cost groupings with due consideration of the reasons for incurring such costs. Each grouping should be determined so as to permit distribution of the grouping on the basis of the benefits accruing to the several cost objectives.

....

(d) The contractor's method of allocating indirect costs shall be in accordance with standards promulgated by the CAS Board, if applicable to the contract; otherwise, the method shall be in accordance with [GAAP] consistently applied. The method may require examination when—

(1) Substantial differences occur between the cost patterns of work under the contract and the contractor's other work;

(2) Significant changes occur in the nature of the business..., fixed-asset improvement programs...or other relevant circumstances....^[5]

FAR 31.205-23, Losses on other contracts, provided in part that “[a]n excess of costs over income under any other contract...is unallowable.”

FAR 31.205-24, Maintenance and repair costs, provided at paragraph (b) that expenditures for plant and equipment, including rehabilitation which should be capitalized and subject to depreciation, according to GAAP as applied under the contractor's established policy, were allowable only on a depreciation basis. This provision was removed from the current FAR and reserved.

FAR 31.205-32, Precontract costs, described such costs as incurred before a contract's effective date pursuant to negotiation and in anticipation of award when the costs were necessary to comply with the contract's delivery schedule.

37. FAR 31.109, Advance agreements, provided in part:

(a) ...[COs] and contractors should seek advance agreement on the treatment of special or unusual costs. However, an advance agreement is not an absolute requirement and the absence of an advance agreement on any cost will not, in itself, affect the reasonableness, allocability or the allowability under the specific cost principles at subparts 31.2...of that cost.

(b) Advance agreements may be negotiated either before or during a contract but should be negotiated before incurrence of the costs involved. The agreements must be in writing....

⁵ After 2001, FAR 31.203 was revised. Some of former paragraph 31.203(d)'s provisions are now in 31.203(e), which states that the “method of allocating indirect costs may require revision when there is a significant change in the nature of the business” (continuing as in former 31.203(d)(2)). The expert reports refer to 31.203(e), rather than 31.203(d), but this is immaterial to our decision.

38. The contract was not CAS-covered and did not contain any CAS provisions (R4, tabs 1, 591 at D1133; tr. 3/89, 6/211).

Events Following Execution of Contract 4115

39. By letter to SUPSHIP dated 9 October 2001 Todd asked for an increase in the Emerald Sea's rated lift capacity from 24,361 LT to 31,200 LT, stating:

[It] will allow for the docking of several classes of ships common to this region. This group of ships were analyzed for maximum loading and position on the dry-dock. The group is known as the "Notional Ship". Included are government vessels; DD-963's, AOE-1, AOE-7, Polar WAGB10, 11 and Healy WAGB20.

(R4, tab 247 at GOV199) DD-963s are destroyers; the Polar class and Healy are Coast Guard icebreakers. According to David Anderson, despite the letter's reference to other ships, that the Coast Guard also required dry dock certification and would accept a Navy certification, and that the higher level would cover any ship requiring certification, higher certification would not be necessary absent AOE's. The Emerald Sea, certified at 24,361 LT, could still dock AOE's, which were about 24,000 LT, but he stated that the increase to 31,200 LT was to resolve Navy docking preparation difficulties at the lower level. He acknowledged that, after an increase, Todd could dock non-AOE's under 31,200 LT in the Emerald Sea without additional inspections and follow-on repairs that might have been necessary at the 24,361 LT level. (Tr. 2/8-9, 11-12, 6/63-65)

40. By e-mail of 26 November 2001, which COO Webb forwarded with approval to Messrs. Welch and Wiscomb, Todd's Naval architect, Dave Bergey, questioned an Emerald Sea upgrade as short-sighted because the dry dock would remain limited. With maintenance, it was suitable for medium commercial ships up to 28,000-30,000 tons, tankers, AOE's, Navy DDG's, and large barges, but not for new cruise ships above 28,000-30,000 tons, Navy TAKR's, large container ships, and certain tankers. He advised committing minimum resources for the Emerald Sea's continued accommodation of medium ships and significant resources to build or buy a dry dock capable of accommodating the larger ships. (R4, tab 256 at T0017348; tr. 1/76)

41. As of November 2001 Todd was considering Emerald Sea modifications for TOTE Orcas, but the parties did not reach an agreement (tr. 1/76-77). Regardless of Mr. Bergey's view, Mr. Welch stated that medium commercial vessels and the tankers, with exceptions, went to Southeast Asia for their work; the DDG destroyers fit in Todd's medium-sized dry dock; and the large barges fit in the Emerald Sea but Todd need not

rebuild its wing walls for them. Thus, the “one and only one reason” to rebuild the Emerald Sea was “for the AOE contract.” (Tr. 1/82, *see also* tr. 1/138)

42. Mr. Wiscomb described Todd’s consideration of expending significant sums to refurbish the Emerald Sea as being “to support the AOE contract, and to take advantage of that investment to bring in opportunistic business,” but he added that Todd expected to have the \$16 million reimbursed by a commercial customer or the Navy, so it was not viewing it as an investment “per se” (tr. 2/96-97).

43. From fall, 2001, through early 2002, Todd sought unsuccessfully to purchase or lease an Emerald Sea replacement. Its final effort, in December 2001, was to acquire Seaspan’s North Vancouver Dry Dock (NVD) and to market the Emerald Sea. Todd’s 11 December 2001 executive summary identified, among other advantages, significant reduction in financial and operational risks from unexpectedly high maintenance costs and, among other disadvantages, purchasing a dry dock, in part for AOE’s with uncertain futures and unknown future Navy asset locations. The estimated cost of Emerald Sea “required capital life extensions”, plus maintenance, was \$45.6 million with a present value of \$28.6 million (R4, tab 260 at TODD14697). It would still be unable to lift newer cruise ships and large MSC vessels. To dock the new TOTE ships, an additional \$500,000 was required. The summary stated that Todd must ensure that the Emerald Sea or the NVD was available for critical docking, “especially AOE’s” (R4, tab 260 at TODD14699). Todd deemed it feasible to “continue to patch” the Emerald Sea, maintaining certification for not more than a year (R4, tab 260 at TODD14700). It expected revenue from the Navy for the first five years of a ten-year period, starting 15 January 2003, to be \$4.4 million, with a total of \$6.15 million. Seaspan withdrew from negotiations in January 2002. (R4, tab 260 at TODD14692, 14694-95, 14697, 14699-701, tab 591 at D1142, tab 1053 at TODD14701; tr. 1/82-84, 2/39, 7/71-75)

44. Todd’s Emerald Sea rebuild plans called for escalation as of CFY 2003. Mr. Wiscomb had been occupied with the “very high priority” (tr. 2/36) of obtaining approval of Todd’s business systems, tied to its award fee, and with other matters. On the eve of big steel orders, he refocused on a new cost reimbursement method. He had previously communicated with DCAA’s auditor assigned to Todd, who had not been encouraging, and he had tried unsuccessfully to meet with the CO. (Tr. 1/73-74, 84, 86, 120, 153-55, 2/34-40, 53, 159, 162-65; *see also* R4, tab 1071 at TODDSUPP119)

45. Mr. Wiscomb prepared an internal “white paper”, “[Todd] Under Applied Dry Dock Cost Allocation Alternative Methods for Cost Recovery,” dated 12 February 2002, addressing three cost recovery alternatives: (1) a manufacturing overhead allocation method, under which the residual dry dock over or under-applied costs would be reclassified to the manufacturing overhead pool and allocated to all jobs through the manufacturing overhead rate; (2) a general and administrative (G&A) allocation method,

under which the residual costs would be reclassified to a new account that would become part of the G&A expenses pool and allocated to all jobs through the G&A overhead rate; and (3) an advance agreement under which the government would pay “for a portion of the unique dry dock renewal costs.” (R4, tab 331 at GOV232-33; tr. 2/42)

46. On 21 March 2002, Mr. Wiscomb and Todd’s comptroller met with the CO, his boss, and SUPSHIP’s commanding officer. They discussed Todd’s \$16 million Emerald Sea plan and its position that the current cost reimbursement method would damage it financially. Todd submitted a PowerPoint slide “Proposal to Eliminate Drydock Multiplier Discussion Outline,” which advanced the manufacturing overhead allocation method, to be effective 1 April 2002, and under which Todd expected to recover most of its Emerald Sea costs, including from its commercial work, Contract 4115, and other Navy work. Todd would change its accounting system to combine unrecovered dry dock overhead costs under its owned and leased dry docks into its company-wide manufacturing pool. It would allocate its dry dock costs as indirect costs across all of its jobs, regardless of whether they used the dry dock. (R4, tab 1057 at 6, tab 1110 at TH664; tr. 2/45-54, *see* tr. 9/75-76)

47. The 21 March 2002 meeting was the first time the CO learned that Todd wanted to change the accounting treatment of its Emerald Sea dry dock costs. Todd did not mention any Wiscomb/Orcutt agreement. The CO was noncommittal but Mr. Wiscomb believed he was willing to work with Todd to find a new cost reimbursement mechanism and so reported to Mr. Welch, who then authorized the steel order, and Todd committed resources to start rebuilding the Emerald Sea’s wing walls. Thereafter, Todd and the Navy met over nine months but did not agree upon a new reimbursement method. (Tr. 1/85, 119, 2/48, 2/56-57, 4/175-78, 5/254-55)

48. During Contract 4115’s period, Todd did some Emerald Sea repairs specifically for non-AOEs. A 5 July 2002 RFE sought \$194,667.36 to strengthen the dry dock for cruise ships. David Anderson opined that some of the work would also benefit AOEs. (R4, tab 214 at F0002847-49; tr. 1/219-21)

49. The Emerald Sea costs at issue were not all unusual. NAVSEA’s 11 July 2002 audit report identified needed repairs to sustain certification. Some were similar in type to those in a 1 August 1997 SUPSHIP report. (R4, tabs 111, 308; tr. 6/73-78)

50. By letter to the CO of 24 December 2002, Mr. Wiscomb enclosed his internal 12 February 2002 paper, asking: “As is the case with all other maintenance costs that Todd incurs on its other facilities, why shouldn’t the government be paying its pro-rata share of these costs under our cost-type contracts?” (R4, tab 1067 at TODDSUPP146) He mentioned an issue of whether wing wall replacement would extend the Emerald Sea’s useful life, with costs capitalized, as DCAA and the Navy asserted, or would not,

with costs expensed, as Todd advocated. In about 2003 Todd's external auditors ceased to support its expensing treatment and advised capitalization. Todd complied. (*Id.*; tr. 1/90-91, 2/57-58, 114, 190-91, 3/16)

51. On 4 March 2003, Mr. Wiscomb gave the CO projections of net unrecovered expenses for Todd's three dry docks of about \$6.6 million for the five years ending in CFY 2006, with most related to the Emerald Sea, stating that "[a]s legitimate overhead costs of Todd's business, it is these costs that we feel should be shared with the government under our three cost-type contracts." (R4, tab 1071 at TODDSUPP 118) Projected revenue assumed continued pricing for non-Navy vessels on an incremental basis that did not recoup, on a fully-loaded basis, all Emerald Sea costs. Todd asserts that it charged as much as it could and that servicing non-Navy vessels increased its business base, reducing overhead the Navy had to absorb. (Tr. 1/86-90, 2/62-64, 202)

52. In about June 2003 dry docking was added to CLIN 0013 (USS CAMDEN), which occurred in August 2003, with the CAMDEN's displacement level at 22,900 LT. This was the only dry docking Todd performed under the contract. (R4, tab 2 at G1044, G1188; tr. 6/64; *see Todd II*, 08-2 BCA ¶ 33,891 at 167,741)

53. In August 2003 the Navy moved the USS RAINIER to MSC (R4, tab 1082).

54. On 22 September 2003, after Todd completed structural repairs and an FEA, the Navy certified the Emerald Sea at the requested 31,200 LT. The certification expired on 31 December 2005. (R4, tabs 383, 384; *see* tr. 6/62)

55. In a 10 October 2003 letter to the CO, Mr. Wiscomb stated that Todd had \$1,576,634 in unreimbursed dry dock costs for CFY 2002, and \$2,578,249 for CFY 2003; it was planning to spend about \$8.6 million over the next three years for Emerald Sea repair and maintenance; current costing methodology would continue to yield significant under-applied dry dock costs for which Todd would not be reimbursed; and:

[Y]ou said that you were open to the idea of discussing alternative costing methodologies for use on Todd's drydock number 3. Once a new mutually agreeable costing methodology had been determined, you also mentioned that you would allow Todd to retroactively apply this new costing methodology to any open rate years (i.e., this currently includes Todd's CFY 2002 and 2003), provided funding was available.

Todd wishes to propose a new costing methodology for use on Todd's drydock number 3 that would include the following

elements. In line with our earlier discussions, Todd also proposes that this new costing methodology would be retroactively applied to CFY 2002 and CFY 2003.

- Costs that are directly in support of maintaining drydock number 3 to Navy standards would be charged directly to the Navy....

....

- All remaining costs (i.e., those not charged direct to the Navy) would be allocated to jobs using drydock number 3 based on a new usage rate that would represent the average daily rate per displacement ton. This new usage rate would be in lieu of the current lift and lay day rates specified in the...lease agreement for Navy drydock number 1....

(R4, tab 1074 at TH171-72; *see* tr. 2/65) Todd estimated that direct charging of Emerald Sea costs, such as preventative maintenance exceeding what it would do normally, more inspections, administrative effort, and non-recurring costs, would result in an additional \$1.2 million charged to the contract from 2002-2007 (R4, tab 1074 at TH171).

56. The CO denied that he had agreed to any retroactive change. He had communicated to Mr. Wiscomb many times that his consideration of Todd's proposals would be based upon a conclusion that complied with the FAR, other applicable regulations and law, and GAAP. (Tr. 4/182-83)

57. Effective 4 December 2003, in bilateral Modification No. A00398, the Navy provisionally exercised dry dock option CLIN 0017 for the USS SACRAMENTO. It cancelled the dry docking, changing it to pier-side, effective 27 February 2004 through bilateral Modification No. A00427, which contained a release of claims. (R4, tabs 398, 407 at GOV278, -1082) The Navy has not pursued any release defense.

58. In 2004 the Navy transferred the USS BRIDGE to MSC and decommissioned the USS SACRAMENTO. *Todd II*, 08-2 BCA ¶ 33,891 at 167,742.

59. On 5 March 2004, Todd submitted an \$8.9 million "Drydock # 3 Settlement Proposal" to the CO, seeking settlement, such as by an advance agreement, of the Emerald Sea issues. It alleged that it would have received \$8.9 million under Contract 4115 but for the Navy's AOE actions. This included \$3.8 million from four scheduled AOE dry dockings and \$5.1 million, said to be the Navy's allocable share of unrecovered

Emerald Sea maintenance and operating costs during CFYs 2002-2006. Todd stated that, at the end of contract negotiations in June, 2001, it had undertaken a \$16 million 5-year Emerald Sea project; it was clearly understood that the Navy would pay for the costs through direct charges or overhead; and, since nearly all of Todd's non-Navy customers could use a mid-sized dry dock, its need for the large Emerald Sea was driven by Contract 4115's requirements and Navy representations concerning work. (R4, tab 409)

60. On 21 April 2004, the CO notified Harold Hanson, NAVSEA's executive director for contracts, and others, that, on 20 April 2004, he, Mr. Fallica, and DCAA had met with Mr. Wiscomb and another Todd representative about its 5 March 2004 proposal. The CO stated that legal review was required and that "[o]ur combined approach has been and will continue to be to find ways in which the Navy can participate in these costs consistent with applicable regulations and the law." (R4, tab 1094 at TH479; tr. 1/96, 2/73; *see Todd II*, 08-2 BCA ¶ 33,891 at 167,744-745)

61. On 10 May 2004, after DCAA had reviewed Todd's proposal and considered it to lack current actual costs for CFYs 2002-2004 and current forecasts for CFYs 2005 and 2006, the CO requested more information from Todd and a certified CDA claim (R4, tab 419; tr. 4/197-98, *see* tr. 2/70-71).

62. Through 31 May 2004 Todd made 14 of 29 planned Emerald Sea wing wall replacements. It put its 5-year plan on hold and minimized repairs when dry dockings under Contract 4115 did not occur. Per David Anderson, the x-bracing and wing wall work did not extend the dry dock's useful life. (R4, tab 1119 at TODD16520, tab 1146, RFE No. PS05-69 at 2; tr. 1/207-08, 228)

Todd's 18 June 2004 CDA Claim and Subsequent Events

63. On 18 June 2004, Todd submitted a certified "Drydock No. 3 Settlement Proposal (Revised)" to the CO in the amount of \$9,318,462, which superseded its 5 March 2004 proposal and was said to be the Navy's allocable share of its reasonable, reimbursable Emerald Sea contract costs from CFYs 2002-2006. Among other things, Todd cited the Allowable Cost and Payment clause as a basis for recovery and sought an advance agreement. Todd alleged that its claimed costs were necessary to perform Contract 4115 and allocable to it. (R4, tab 429 at GOV315, -316) It stated that "[a]bsent the Navy's agreement to reimburse these costs directly," Todd's recovery could be based "alternatively," on other theories (*id.* at GOV317). DCAA issued a 29 October 2004 audit report on the claim. Mr. Mullen concluded that the proposed accounting method detailed in the claim charged Emerald Sea costs as indirect costs to the Navy's three main cost-type contracts. (R4, tab 455; tr. 6/138-40)

64. In early December 2004 Mr. Hanson met with Todd and government personnel, including the CO, in Seattle. He asked the government to work with Todd on what might be a feasible changed accounting method, legal and consistent with GAAP, to replace the multiplier system. Thereafter Todd had numerous meetings with the government concerning cost reimbursement mechanisms, until 21 January 2005, when the CO had to leave for surgery. (R4, tab 1106; tr. 2/73-77, 5/16, 51-54) While negotiations were pending, the CO did not issue a decision on Todd's 18 June 2004 claim.

65. In December 2004 Todd was awarded the lease of the Navy's medium-sized AFDM 10 Resolute steel dry dock, which the Navy was relocating to Puget Sound. It was placed into service in December 2005. (Tr. 1/143-44, 4/73, 7/67, 77, 164-65)

66. By memorandum of 11 January 2005, the CO formally notified Todd that it would not exercise contract options covering the USS CAMDEN for FYs 2004 and 2005 because it was scheduled to be deactivated in early FY 2006 (R4, tab 473).

67. In an 11 January 2005 meeting, Todd identified tasks to maintain Emerald Sea certification. The Navy and Todd agreed that Paul Noel, SUPSHIP's General Engineer and Docking Observer, who began work there in February, 2002, and David Anderson and Jim Anderson, would develop a percentage of each work order related to certification. DCAA auditor Vonda Kelsey checked that the numbers tied to work authorizations and financial records. Mr. Wiscomb identified the associated direct costs and G&A, which ultimately were included in Todd's 28 March 2005 claim. DCAA confirmed in connection with its audit of Todd's 4 June 2009 claim that the reported costs were incurred. (R4, tab 498 at GOV515, tabs 501, 595 at 64-69, tab 1105 at S171; tr. 2/79, 82, 146, 168-69, 4/183-89, 5/78-81, 6/28-29, 37, 65-70, 107-09, 111-13, 115, 192, 194-95, 7/184-85; *see* R4, tab 497 at GOV513-14)

68. Per Mr. Noel, Emerald Sea improvements, such as work beyond that identified in NAVSEA's audit letters, were not all required to sustain NAVSEA certification, and Todd's requested certification increase to 31,200 LT benefitted the Navy but was not necessary to dock AOE's (tr. 6/64, 80-82, 87, 93-94).

69. A 19 January 2005 internal "POINT PAPER" prepared by Mr. Fallica of SUPSHIP addressed discussions with Todd about Emerald Sea cost compensation. He stated that a breakthrough had occurred in January 2005 and that Todd had demonstrated a sound basis for a \$5.4 million equitable adjustment for certification costs, unabsorbed overhead, dry dock cost allocation method, and correction of prior billing errors. The government had introduced the four categories. He qualified that it was the government's position that, apart from billing errors, there might be no contractual reimbursement requirement. (R4, tab 1110 at TH664-65, -671; tr. 2/76, 79, 93-94, 122) Concerning certification costs, estimated at \$4.2 million, the paper stated:

After in-depth technical discussions about usage of the dry dock by other vessels, and level of certification capacity (which could be debated to be in excess of AOE minimum requirement), Todd's underlining [sic] premise was accepted by the Government. That is to say, the AOE program directly benefited from costs incurred from compliance with Navy dry dock certification requirements. Government dry dock engineers concurred with Todd's fundamental position that Navy dry dock certification requirements were up and beyond commercial practices.

... Most of the identified inspection effort could clearly be linked to compliance with Navy dry dock certification requirements. However, repair and replacement activities represented a more difficult task, since work effort related to equipment...and structural components...would have likely been performed to some extent, regardless of compliance with Navy dry dock certification requirements.

(R4, tab 1110 at TH665-66) Mr. Fallica opined that Todd was seeking retroactive changes to which there was no entitlement but that the government had discretion and, for settlement purposes, it had accepted Todd's position that certification costs were incurred solely for Contact 4115 and those pertaining to equipment and structural enhancements had no immediate economic value to Todd. He recommended an advance agreement concerning those costs that called for some recovery by the government in the event of a contemplated Emerald Sea sale or if Todd kept it for an indeterminate period, which would undermine the direct charging premise. (*Id.* at TH670-71)

70. At the hearing, the CO stated that he did not agree with the point paper, but on 19 January 2005 he had e-mailed a copy to Mr. Hanson as a proposed settlement, noting that \$4.2 million in certification costs was a much larger number than the government had expected, and that using funds for this purpose was under legal review. By e-mail of 20 January 2005, the CO noted his medical leave and advised Mr. Hanson that, in his view, the Navy should pursue only the certification cost part of the proposed settlement and that, once Mr. Hanson agreed on a settlement approach, Mr. Fallica could finalize negotiations and the CO's deputy could authorize the resultant action. (R4, tab 1110 at TH663, tab 1106; tr. 5/124, 137, 139, 141, 145-46, 163, 6/19)

71. On 26 January 2005 Mr. Fallica and DCAA's Ms. Kelsey met with Mr. Wiscomb. Todd now estimated its costs at \$6 million, of which certification costs were \$4.5 million. Mr. Fallica stated that SUPSHIP had reiterated that while the

government had provided guidance, it should not be interpreted as a payment commitment. He asked Todd for a formal proposal. (R4, tab 1111 at S956; tr. 2/86-87)

Todd's 28 March 2005 Claim (Alternative Claim)

72. By letter to the CO of 28 March 2005, which referred to its 18 June 2004 claim, Todd submitted its \$5.99 million certified "Drydock # 3 Settlement Proposal (Revision 2)" to the CO for unrecovered Emerald Sea costs, including \$4.502 million in incremental certification-related costs for CFYs 2002-2005, which Todd sought as direct costs under Contract 4115 (R4, tab 497 at GOV512-13, tab 506 at R15718; tr. 2/143-45, 152-53, 176-77). This claim is an "alternative" to Todd's "primary," \$10.113 million claim (app. proposed findings at 42, ¶ 99).

73. Mr. Fallica concluded in a 4 April 2005 briefing paper that there was no valid basis to pay any of the 28 March 2005 claim, except possibly \$580,000 in inspection costs, and that retroactive direct charging of those costs to Contract 4115 could conflict with Todd's cost and pricing representations during contract negotiations (R4, tab 601).

74. DCAA did not formally audit the 28 March 2005 claim, but by memoranda to the CO of 14 April 2005 and 12 May 2005, it opined, regarding certification costs, that \$3.922 million were not direct contract costs because they benefitted more than one cost objective, and that they were capital improvement costs. It did not object to Todd's charging inspection costs directly to Contract 4115, subject to deduction for costs of normal inspections necessary absent Navy requirements. DCAA calculated \$598,960 in inspection costs, more than Todd's claimed \$580,000. (R4, tab 502 at GOV550-51, tab 505 at GOV553-54; tr. 8/33-36, 45)

75. Ultimately, as the Board held, there was no agreement between Todd and the government on Todd's claim. *Todd II*, 08-2 BCA ¶ 33,891 at 167,754-56.

76. In his 31 May 2005 final decision, the CO denied Todd's claim. With regard to the \$4.502 million claim for certification costs, he stated, among other things, that: (1) it sought a retroactive accounting change that conflicted with its CFYs 2002-2005 incurred cost submissions, because the proposed direct costs had been included in overhead; (2) Todd did not raise its direct cost claim during contract negotiations, did not then request an advance agreement, and was now re-negotiating the contract; (3) Todd started its improvement program knowing that exercise of the contract's four dry dock options would only yield about \$3.8 million in revenue; (4) AOE's and Contract 4115 were not the only reasons for the improvements and the Emerald Sea was fully utilized, including in Todd's commercial business, to dock other large heavy ships; (5) one main reason for Todd's unrecovered dry dock costs was that it did not charge its commercial customers a realistic rate; (6) the improvements benefitted Todd due to the dry dock's

increased life and lift capacity, as evidenced by its capitalization and depreciation of a significant amount of the costs over several years beyond CFY 2005; and (7) the claimed costs were not properly chargeable as direct costs under the contract's Allowable Cost and Payment clause. (R4, tab 506 at R15718, R15721-24; *see also* tr. 4/204-16) Mr. Wiscomb was incredulous. The government had fashioned the method by which Todd would be paid and he believed that the CO had committed orally to payment. (Tr. 2/93-94)

77. Todd asked the CO about relieving it of its obligation to maintain the Emerald Sea to NAVSEA standards. On 16 June 2005 the CO responded that Todd had no obligation to spend money for any potential Navy work and that all maintenance efforts particular to the Navy had been accomplished long before the current year. (R4, tab 509 at F3046)

78. On 24 August 2005 Todd timely appealed to the Board from the CO's denial of its claim and the Board docketed the appeal as ASBCA No. 55126.

79. On 1 October 2005 the Navy decommissioned the USS CAMDEN. *See Todd II*, 08-2 BCA ¶ 33,891 at 167,742.

80. Todd tried unsuccessfully to sell the Emerald Sea, then broke it into two parts. In 2006 it leased a 500-foot part to Kiewit-General, very profitably according to DCAA. The remaining 300 feet was used for storage. After Kiewit finished, Todd used the larger part for barges and small boats. As of the hearing, Todd had depreciated the smaller part to scrap value and was still depreciating the larger part as a capital asset. (Tr. 1/42, 155-56, 92, 98-99, 158, 160, 226-27, 2/59, 3/20-21, 6/226, 7/77-79)

81. Contract 4115's total obligated amount was \$98,292,010. Todd's certified incurred cost submission reflected a 2007 total of \$85,849,419. (R4, tab 591 at D1165, tab 605; tr. 7/150-51, 174, 8/80-81, 83, 194; app. resp. at 58, ¶ 131)

Todd's 4 June 2009 Claim (Primary Claim)

82. On 4 June 2009 Todd submitted a \$10.952 million certified CDA claim to the CO for Emerald Sea costs chargeable directly to Contract 4115 for CFYs 2002-2005 under the contract's Allowable Cost and Payment clause. Mr. Berger Dodge, who testified at the hearing, had been Todd's CFO since July 2006. He prepared the claim, assisted by expert Patrick A. McGeehin's office. Todd later reduced it to \$10.113 million, removing some pre-contract costs and revenues, but not \$495,872 for CFY 2001 pre-contract x-bracing. Those expenditures ended by 1 March 2001 and Todd began to recognize associated depreciation expense, totaling about \$4,000 during that closed CFY. Messrs. Dodge and McGeehin understood from David Anderson that the x-bracing was in

the family of capital improvements made for Contract 4115. (R4, tabs 376, 1119 at TODD16516, tabs 1120, 1122 at 4; tr. 2/179-80, 182-83, 185, 191-92, 204-06, 208, 215, 3/38-39, 44-45, 4/20-21, 29-30, 6/165-66, 7/112-13)

83. The 4 June 2009 claim included all of Todd's Emerald Sea costs from CFYs 2002-2005, before G&A and a mitigation credit. DCAA's audit opinion on the claim, including certification costs, also applies to the 28 March 2005 claim. (Tr. 3/11, 7/174, 181-82) The CO did not issue a decision and on 20 August 2009 the Board docketed Todd's appeal from his deemed denial as ASBCA No. 56910.

DCAA Audit of 4 June 2009 Claim

84. DCAA requested technical assistance to determine the requirement for and extent of Emerald Sea dry dock improvements. Mr. Noel submitted a 25 January 2010 technical advisory report (TAR), which senior lead DCAA auditor Ken Welch evaluated. In one of its responses to DCAA's questions, the TAR stated that NAVSEA had not asked for replacements, it had directed Todd to fix identified issues, and Todd had not replaced everything (R4, tab 1147, TAR at 1). Mr. Welch interpreted this as a TAR conclusion that Todd did not go "overboard" (R4, tab 1147 at first page). DCAA found the TAR to be incomplete and did not rely upon it (R4, tab 591 at D1132-33, tab 1147; tr. 6/102-03, 205, 8/89-90, 92, 96, 104-06, 188-89).

85. DCAA issued a 12 February 2010 audit report on Todd's \$10.952 million claim. Keith Mullen, DCAA's supervisory auditor, who testified at the hearing, was significantly involved in reviewing Todd's claims and other auditors' work on them. DCAA questioned all of Todd's claimed direct costs from CFYs 2002-2005. It found that, during the claim period, 91 commercial, state and federal government ships used the Emerald Sea, with only one AOE under Contract 4115, including many that could not reasonably have been docked in Todd's smaller dry docks because they were too big or the docks were in use. Todd also used the Emerald Sea to dry dock the YFD-70, which was fully utilized from CFYs 2002-2005. DCAA concluded that the Emerald Sea was an intermediate cost objective; the claimed costs were indirect costs to be allocated to all ships using the dry dock; and charging them directly to Contract 4115 was inconsistent with Todd's disclosed accounting practices, which required allocation based upon ship weight and the number of days each ship was in the dry dock. (R4, tab 591 at D1131, D1136-37, D1139-41, D1164, tab 602; tr. 6/123-24, 204-05, 8/153)

86. Mr. Mullen acknowledged that DCAA used gross tons, a measure of volume, in analyzing the number of ships that could not reasonably have been docked in other than the Emerald Sea during CFYs 2002-2005, whereas long tons measure displacement weight, but he deemed the beam or width of the ship to be the primary limiting factor. By width alone, 34 of the docked ships could not have used Todd's other dry docks. Todd's

list of ships that could not use them was smaller than DCAA's. However, unlike DCAA, which had based its analysis upon Todd's logs, Todd had not taken recorded scheduling conflicts and other docks' availability into account. DCAA did not consider possible revised scheduling, acceleration, overtime or other speculative factors. (R4, tab 591 at D1139-40; tr. 7/58, 61, 8/110-14, 116, 129, 135-36)

87. The parties now appear to agree that Todd docked 89 non-AOEs on the Emerald Sea from 2002-2005. Per David Anderson, four in 2002, two in 2003, one in 2004, and one in 2005, benefitted from the x-bracing and wing wall replacements. Lack of total replacements and differential head issues made lifting large ships risky. After FY 2005 Todd docked only light draft vessels there. (Tr. 1/224-26; app. resp. at 55, ¶ 121; gov't reply br. at 30, ¶ 121)

88. DCAA found that Todd's practice was to keep two or more dry docks to maintain its business base and support all of its ship repair work, citing Todd's five-year Resolute lease and a recent YFD-70 purchase (R4, tab 591 at D1142-43; tr. 7/76-77).

89. DCAA noted that Todd's RFEs disclosed that many Emerald Sea improvements and repairs in CFYs 2002-2005 were for commercial and government ships other than AOEs, or benefitted more vessels than just the AOEs, and that the repairs complied not only with Navy standards but with American Board of Shipping and Todd's standards (R4, tab 591 at D1142, D1150-52; tr. 7/96-101).

90. DCAA questioned Todd's method of crediting the Navy with net revenues from other contracts involving Emerald Sea use. DCAA asserted that profits from government firm fixed-price and commercial contracts were not relevant to Contract 4115; Todd's claimed losses on such contracts were unallowable under FAR 31.205-23; and measuring profits and losses, which are due to many factors, was not an equitable allocation method. Moreover, if profits were used as a credit, profits from all ships that used the Emerald Sea to date were relevant because Todd has continued to use it. (R4, tab 591 at D1146-47, D1166; tr. 7/117-22, 159-63, 8/179, 184-85)

91. DCAA assessed the Emerald Sea's work level and concluded that Todd would have continued using it even if it were not awarded Contract 4115. It did not address whether Todd would have done so without a rebuild plan. (Tr. 7/86-89, 8/125-28, 135)

92. Without any claim reservation, in CFYs 2002-2005, Todd's various pricing rate and incurred cost submissions and the like showed that it collected maintenance, repair, and depreciation costs in a dry dock cost pool and charged them to the contracts using its dry docks based upon its traditional indirect method. It also used this method to price dry dock costs in its firm fixed-price government and commercial contracts. (R4,

tabs 174, 262, 353, 382, 418, 591 at D1142; tr. 2/139-40, 6/167-70, 174-83, 186, 7/46) Todd stipulates that it used this method pending claim resolution (tr. 6/184).

93. Upon analysis of the Emerald Sea's logs for FYs 1994-2005, DCAA found that it was used for multiple contracts that benefitted from its maintenance, repairs and capital improvements; use in FYs 2002-2005 was at about Todd's historical level; Todd would not have been able to perform most of the non-AOE work on its other dry docks; and several ships that used the Emerald Sea in FYs 2002-2005 also used it in prior years. Thus, the claimed costs were not direct costs of Contract 4115. (R4, tab 591 at D1138)

94. DCAA also noted that Todd's website, as of December 2009, stated that:

Todd has undertaken significant repairs and upgrades to our two steel dry docks over the past few years.... This work will enable us to maintain the capacity within the shipyard for dry-docking a diverse group of vessels for a number of commercial and government customers.

(R4, tab 603) Referenced work pertained mainly to the Emerald Sea, supporting DCAA's conclusion that Todd's claimed costs were not just for Contract 4115 but for all of its customers (R4, tab 591 at D1141; tr. 7/63-68).

95. DCAA noted that the first Emerald Sea AOE docking during the contract period did not occur until August 2003, over a year after contract award, and that Todd used the dry dock until that time in its normal course of business. Todd continued to use the Emerald Sea after it was notified in 2005 that the Navy would not exercise more AOE contract options. It did not recognize a loss or write down the dry dock's value for financial purposes under GAAP or sell or dispose of it. (R4, tab 591 at D1143)

96. In its financial statements from CFY 2002 through the hearing, Todd capitalized and depreciated Emerald Sea capital improvement costs over ten years. DCAA asserted that Todd was now claiming \$3.23 million in unallowable and unallocable capital improvement costs, and repair and maintenance costs of \$882,922, as direct contract costs, contrary to FAR 31.205-24. Moreover, based upon Todd's RFEs, the costs were not incurred solely for AOE's and were not depreciation expenses. Todd responds that, if the government paid depreciation on the \$3.23 million in capital assets after FY 2005 through other contracts, a "true-up" would be required. (R4, tabs 358, 591 at D1131, D1152-53, D1155-57; tr. 6/150-52, 156-60; app. resp. at 62, ¶ 145)

97. Some ships that used the Emerald Sea during the claims' period were bigger than AOE's, some were smaller, and many different customers were involved. In Mr. Mullen's view, they all benefitted from the claimed costs, continuing to the date of

hearing, because Todd was still using the dry dock. He deemed Todd's existing accounting practice, based upon dock usage, to be more reasonable and equitable than its claimed "causation" method. While Emerald Sea repairs might not have been as extensive absent Contract 4115, DCAA assessed that Todd would have kept the dry dock and continued to incur insurance and many other costs regardless. Mr. Mullen opined that the circumstances, including the alleged extraordinary nature of the costs, did not warrant a change in Todd's accounting practice to charge the costs directly to Contract 4115. (Tr. 6/123-27, 209, 7/44, 46-47, 77-78, 194-95, 213, 8/52, 144, 172)

98. Among other matters that DCAA felt warranted consideration, including alleged non-compliance with the contract's LOC clause, were: (1) In FY 2005 the Emerald Sea accommodated a large commercial ship that needed emergency repairs, which it would not have been able to do if Todd had not performed the work in question. (2) The Emerald Sea's book value increased by \$2.555 million due to the claimed capital improvements. Todd retained the asset but its claim did not credit the increased book value. (3) Part of Todd's award fee was based upon cost control. Its claimed dry dock costs were not included in its award fee submissions, so a fee adjustment would be due were the costs allowed as direct contract charges. (4) The government negotiated several firm-fixed-price (FFP) contracts under Todd's existing accounting practice that included dry docking government ships in the Emerald Sea after Contract 4115's award date. Were Todd's accounting practice changed, the dry dock costs allocated to Contract 4115 would increase and the government should be credited for any FFP contract overpricing. (R4, tab 591 at D1163-65; tr. 7/128, 7/132-35)

99. DCAA's overall position was that the Emerald Sea, an intermediate cost objective, was linked to multiple cost objectives, *i.e.*, the contracts associated with each ship that used the dry dock. The dry dock costs could not be directly identified with any single ship and were not direct costs under FAR 31.202. They were indirect costs which, under FAR 31.203 and FAR 31.201-4, should be allocated to all ships that used the Emerald Sea over a beneficial base representative of that use, to include consideration of ship weight and days of use. This was Todd's practice at the time of Contract 4115 for its various dry dock contracts. It was equitable, more so than applying a causation factor. Even if the cause of cost incurrence were relevant, the cause was the Emerald Sea's state of disrepair. The decision to rebuild the Emerald Sea's wing walls and to incur those costs was managerial. Contract 4115 did not specify use of the Emerald Sea. (Tr. 6/217, 238, 7/41, 45-47, 7/75, 78, 129, 195, 199, 213, 221, 8/47, 144, 153, 169, 183-84)

Appellant's Expert Witness Patrick A. McGeehin

100. The parties' proffered experts were all well qualified experts in government cost accounting (R4, tab 1117 at 15-23; tr. 3/231-35 (McGeehin); R4, tab 550 at T21139,

21146-47, 21149-50; tr. 3/49-54 (Oyer); R4, tab 561 at JB34; tr. 8/199-207 (Brown)). There was no dispute that they so qualified (tr. 3/47-48).

101. Although Todd had submitted Mr. McGeehin's sworn declaration in support of its 28 March 2005 claim, *see Todd II*, 08-2 BCA at 167,751, he testified at the hearing that he had read the claim and could discuss general principles, but he could not address its specific approaches or calculations. His initial expert report, dated 9 February 2009, was included with Todd's 4 June 2009 \$10.952 million claim. His supplemental report, dated 14 January 2010, addressed Todd's reduced \$10.1 million claim. Mr. McGeehin opined that Todd's method of computing the claim amounts was appropriate and reasonable and they were adequately supported. (R4, tabs 1117, 1120, 1121; tr. 4/98-100)

102. Mr. McGeehin's primary assumptions in reaching his expert opinion were: Contract 4115 was the "cost driver"; it required Todd to maintain a dry dock certified to Navy standards for both scheduled and potential AOE dry dock needs, but for which Todd would not have undertaken its extraordinary expenditures; there were early discussions with the Navy, in 2001 and/or 2002, regarding the need to change Todd's accounting method; and Todd continued to allocate costs to AOE's and other vessels under its past practice only until establishment of a more equitable method. He opined that the time of cost incurrence illustrates its causal relationship to contract requirements. Expenditures dropped in CFYs 2004 and 2005 when there were no AOE dockings. Commercial dockings, including those scheduled prior to contract award that occurred afterwards, were secondary. In his view, direct cost treatment that accounted for commercial and other non-AOE dockings, including government non-cost-reimbursable contracts, was more rational than indirect cost allocation. He stated that Todd was not asking for reimbursement for all of its Emerald Sea work, but for 64 percent. (R4, tab 1117 at 4-8; tr. 3/237-41, 244-46, 250, 254, 4/23, 28-29, 36, 59-60, 73, 103-04)

103. Mr. McGeehin found Todd's Emerald Sea dry dock expenditures to be extraordinary in amount and nature, including that wing walls were replaced rather than repaired. Moreover, in addition to rumors of AOE retirement during the contract period, no AOE dockings were scheduled in the first two contract years. Todd needed to recover its costs upon incurrence, independent of dockings. He opined that, under basic cost accounting theory, this was a different fact pattern than had led to the prior cost allocation approach and [FAR 31.203(d)] contemplated changes. He deemed that the government benefitted from Todd's Emerald Sea expenditures not merely when AOE's docked there but in having the dry dock ready to service them. Repairs specific to a cruise vessel did not change the "but for" aspect of Todd's decision at contract outset to incur the dry dock rebuilding costs, and the government benefitted by cost reductions due to commercial dockings. Mr. McGeehin found the accounting change Todd sought to be reasonable, equitable, and consistent with FAR Part 31. (R4, tab 1117 at 8-9; tr. 3/245, 252-56)

104. In Mr. McGeehin's opinion, that Todd's pricing submissions for CFYs 2002-2005 used its indirect accounting method and it now seeks a direct cost method is not an impermissible inconsistency. Those years are not closed for accounting purposes. Indirect cost rate submissions are always provisional until audit or negotiations and finalization. It is not unusual for a contractor to continue to submit under an existing accounting method, with adjustment once agreement is reached. (Tr. 4/13-14)

105. Mr. McGeehin deemed Todd's requested change to be prospective because the issue arose and the government was notified before 31 March 2002, the end of Todd's first CFY under the contract and, for a non-CAS-covered contract, there is no regulatory prohibition against retroactive changes. Even under CAS, when a fiscal year is open, a requested change for that year is not retroactive. Mr. McGeehin opined, like Mr. Oyer (below), that CAS standards can be guidance in evaluating GAAP, but CAS rules and regulations do not apply to the matters at issue. (Tr. 3/93, 201, 4/13-16, 89, 115)

106. Mr. McGeehin opined, regarding x-bracing, that the FAR allows pre-contract costs; it was reasonable for Todd to expend the \$495,872 prior to the expected contract award; and the costs were properly included in Todd's claim (tr. 4/29-30).

107. Mr. McGeehin disagreed that the claimed costs are overrun costs and that profit is not allowed, stating that, if the accounting change had been contemporaneous, profit would have been in the CLIN pricing, particularly for the options (tr. 4/37-48).

108. Mr. McGeehin opined that the parties' method of arriving at the certification cost portion of Todd's 28 March 2005 claim was reasonable (tr. 3/250).

109. He opined that it would be unusual for a contract to specify cost allocation, "unless of course you have...an advance agreement. And of course, that's why we're here, because there was no advance agreement in that contract" (tr. 3/238-39, *see* tr. 4/204-16 (per CO Todd should have raised advance agreement at contract formation)).

Appellant's Expert Witness Darrell J. Oyer

110. Darrell J. Oyer's expert report of 9 February 2009, submitted with Todd's 4 June 2009 \$10.952 million claim, addressed its \$4.502 million certification cost claim, but its concepts apply to all of Todd's claims (R4, tabs 550, 1120; tr. 3/171-72, 179-80).

111. Mr. Oyer opined that FAR [31.203(d)] contemplates that a contractor's method of allocating costs may require change under changed circumstances, such as the changes in Todd's fixed asset improvement program and in the nature and magnitude of its costs, and the parties had numerous early discussions regarding an equitable change. The circumstances were sufficiently different to justify direct cost allocation based upon

the cause of cost incurrence, in accord with the part of FAR 31.201-4 pertaining to cost allocation based upon equitable relationship. Todd incurred the claimed costs not for overall Emerald Sea improvement but for Contract 4115, their “driving force.” But for the contract, Todd would not have incurred the costs, which are properly treated as direct contract costs under FAR 31.202(a). In Mr. Oyer’s view, whether the Emerald Sea’s deterioration was foreseeable did not relate to cost accounting. The claimed costs relate to fixing the problem, not to its cause. (R4, tab 550 at T21140-43; tr. 3/61, 63-64, 68-75, 78, 126, 140, 142-46, 150, 152)

112. Regarding allocability, to expand upon the phrase “other equitable relationship” in FAR 31.201-4, Mr. Oyer cited CAS 9904.418-40(c): “Pooled costs shall be allocated to cost objectives in reasonable proportion to the beneficial or causal relationship of the pooled costs to cost objectives” (R4, tab 550 at T21141). He deemed that the Navy benefitted because the Emerald Sea enabled ship repairs necessary for the national defense and, even when the Navy elected not to service its AOE’s under the contract, it benefitted from being able to do so. He considered the most prominent equitable relationship to be causal, similar to the “but for” analysis. To him, the claimed costs were caused by Contract 4115 and not by a combination of the contract and commercial work. (R4, tab 550 at T21141; tr. 3/73-75, 78, 152-53)

113. Per Mr. Oyer, the proper way to account for Emerald Sea commercial use was to credit net revenues from those dockings against the amount charged to the Navy. Spreading the costs over all vessels that used the dry dock, the great majority of which were commercial, on a pro rata basis, would not be equitable. It would ignore the cause of the costs and eliminate any incentive for Todd to perform commercial work, which benefitted the Navy by reducing the amount Todd sought to recover from it. (Tr. 3/74-76)

114. Mr. Oyer opined that the FAR permits the cost accounting change sought and, unlike the CAS, it does not require cost disclosure statements or prohibit retroactivity, which did not apply in any case. There was early recognition that a change should be made, and Todd’s indirect rates have not been finalized since 2001. Citing FAR 42.704(c) and (d), he stated that the manner of estimating and invoicing costs does not determine how they should be treated in final cost settlement, and Todd could not have unilaterally changed its billing rates. Also, contrary to the Navy’s contention that a contractor cannot increase its reimbursable costs under a cost-type contract by changing accounting practices after award, the FAR contains no such prohibition. (R4, tab 550 at T21142-43; tr. 3/101-06, 141-43, 155-56, 181, 183-88, 4/115)

115. In Mr. Oyer’s opinion, under FAR 31.205-32, even without the government’s advance approval, Todd is entitled to recover its pre-contract x-bracing costs directly, except \$4,000 in depreciation it took in the closed CFY 2001 (tr. 3/81-85).

116. Mr. Oyer concluded that the claimed costs were allowable, allocable and warranted direct contract costs (R4, tab 550 at T21142). In reaching his opinion he accorded some weight to the alleged fact that, when the contract “was discussed initially, both [parties] had some kind of understanding that they probably would have to fix the multiplier, revise it in some way in order to achieve an equitable result” (tr. 3/57).

The Government’s Expert Witness James R. Brown

117. The government’s expert witness, James R. Brown, submitted a 7 January 2010 expert report. He assumed that Todd’s decision to spend \$16 million on the Emerald Sea was not made solely for Contract 4115 but stated that, in any case, this would not affect his conclusions. He also assumed that any Orcutt/Wiscomb discussion was immaterial. (R4, tab 561 at JB37, JB39; tr. 8/207-08, 212-13, 222, 9/37-38, 49, 56)

118. Mr. Brown agreed that the amount of Todd’s Emerald Sea costs was extraordinary compared to its past costs but he noted that they were incurred for similar reasons—to maintain the dry dock. Regardless, those who used the dry dock benefitted and the costs should not be charged directly to Contract 4115. “[M]y basic position is, benefit is the driver” (tr. 8/232). He was not aware of any other allocation method that would be equitable (tr. 8/225-26, 232, 9/20-21).

119. Mr. Brown concluded that Todd’s unrecovered Emerald Sea costs were not due to low utilization by the Navy but to the fact that Todd did not allocate the operating costs for commercial use in accordance with GAAP, which, under widely recognized and prevalent industry practices, requires full cost absorption. Rather it capped the allocation at the amount at which it priced the commercial work, which was below cost. Thus, Todd seeks Navy reimbursement for losses it incurred on commercial work, unallowable under FAR 31.205-23. Pricing should not have an impact upon cost distribution. Instead of its mitigation approach, Todd should have allocated its costs to Emerald Sea users on an equitable basis in accordance with the FAR. (R4, tab 561 at JB7, JB17-19; tr. 8/232-34, 9/26, 33-36, 76-79; *see* R4, tab 550 at T21144 (Mr. Oyer’s “House of GAAP” chart))

120. Mr. Brown noted that Todd had NAVSEA certification and emergent work obligations under its 1996 predecessor contract, still in effect at award of Contract 4115. He opined that, therefore, both contracts required allocating the Emerald Sea costs on an indirect, rather than a direct, basis. (R4, tab 561 at JB8, JB21-22)

121. Mr. Brown disputed Todd’s claim that commercial dry dockings were not a separate cost objective but were scheduled to mitigate the Navy’s dry dock costs under Contract 4115. He concluded that nothing had changed from the prior years’ mix of business and that Todd’s commercial usage of the Emerald Sea had been a consistent practice. (R4, tab 561 at JB9, JB22, JB52-53)

122. Mr. Brown opined that Todd's proposal to charge capital expenditures to Contract 4115 was in effect a mischarging of capital costs as period costs, contrary to GAAP and to former FAR 31.205-24(b), in effect as of contract award, and that it invoked issues for consideration under former FAR 52.245-5, GOVERNMENT PROPERTY (COST-REIMBURSEMENT, TIME-AND-MATERIAL, OR LABOR-HOUR CONTRACTS) (JAN 1986), also in effect as of contract award, of government ownership of material and equipment charged directly to the contract. (R4, tab 561 at JB9, JB22-24; tr. 8/235-36, 239-41; *see also* R4, tab 591 at D1147; tr. 7/131 (DCAA audit report to same effect))

123. Mr. Brown opined that Todd had sought a retroactive accounting change inconsistent with its standard practices (R4, tab 561 at JB9-10, JB27-28; tr. 8/217, 234-35, 9/54, 57-58, 75-76).

124. Mr. Brown understood that, in four years, under Contract 4115, only one AOE used the Emerald Sea, for two-weeks, at an assigned cost under the existing accounting method of about \$320,000-\$325,000. Applying common sense, for Todd to charge \$10 million to the contract for its Emerald Sea costs was not equitable. (Tr. 9/22)

125. Mr. Brown concluded that Todd's claim did not comply with acceptable government accounting principles, its "but-for" decision was not documented, and the documents were to the contrary (tr. 8/217).

DISCUSSION

The Parties' Contentions

Todd asserts that its claimed costs are proper direct charges to Contract 4115. It alleges that, "[s]hortly before" contract award it became clear that, to perform the contract, it had to rebuild the Emerald Sea (app. br. at 2). Changes in the nature of the work necessary to have the dry dock available to perform the contract and the related extraordinary expenditures required a change from Todd's prior indirect cost allocation method. FAR 31.203 allows change when there are substantial differences in the cost patterns of work under a new contract or the contract involves other changes in the nature of the business.

Todd notes that, under FAR 31.201-4, costs are allocated based upon relative benefits received or other equitable relationship and, subject thereto, are allocated to a specific contract when the costs are incurred specifically for it. Todd alleges that the most prominent equitable relationship is causal and that the evidence establishes that it would not have rebuilt the Emerald Sea but for Contract 4115. Whereas, commonly, beneficial and causal relationships are the same, here they are materially different. In any

case, the Navy benefitted by the Emerald Sea's availability to dock AOE's under the contract and equity requires assignment of the dry dock's costs directly to the contract. Todd urges that the accounting change should be effective from contract award, it is not impermissibly retroactive, and that the CO unreasonably denied its claims.

Preliminarily, the government asserts that the Board cannot have jurisdiction over both of Todd's "Factually Inconsistent" claims (gov't br. at 105), in effect a motion to dismiss one or the other. The government also renews its motion to dismiss the 4 June 2009 claim, alleging that the Board lacks jurisdiction because it was not filed within six years of accrual as required by the CDA, 41 U.S.C. § 7103(a)(4)(A).

On the merits, the government defines the central issue as whether Contract 4115's terms require it to pay more for its election not to exercise dry docking options than if it had exercised them. It asserts that the appeals are about a bad business decision—that Todd decided to spend considerable sums hoping the Navy would exercise all of its options and the newly upgraded dry dock would attract commercial work. It contends that the increased costs due to the Emerald Sea's ongoing deterioration were foreseeable, and the consequences of Todd's election to neglect the dry dock cannot be passed to the Navy; there is no changed circumstance justifying a change to Todd's long history of charging the dock costs as indirect costs, which are properly allocated to multiple final cost objectives under FAR 31.202 and FAR 31.203; Todd seeks contract reformation; the documentary record belies Todd's "but for" argument and it is estopped from raising it; and Todd's desired accounting change is impermissibly retroactive.

The government further contends that the LOC clause bars Todd's June 2009 claim; Todd improperly included amounts that it contemporaneously capitalized and depreciated beyond the claim period; the claimed pre-contract x-bracing costs are not allowable; under its theory that its Emerald Sea work was required under the contract, Todd is not entitled to profit; Todd improperly included losses on commercial contracts in its mitigation computation; and the June 2009 claim re-inserts costs that the Board denied (\$600,000 for unabsorbed overhead; *Todd II*, 08-2 BCA ¶ 33,891 at 167,759-760) and two items from Todd's 28 March 2005 claim that it withdrew (two-rate claim for \$620,000 and \$267,000 for alleged billing errors).

Jurisdiction

The government challenges the Board's jurisdiction over Todd's 28 March 2005 claim and its 4 June 2009 claim, alleging that they rely upon diametrically different underlying facts because Todd's first claim represents that only some of its Emerald Sea costs were to maintain NAVSEA certification but the second claim contends that Todd incurred all of its Emerald Sea costs solely for Contract 4115. Regardless of the government's characterization of the facts, there is no jurisdictional impediment to the

Board's consideration of Todd's alternative claims. Unlike in *Southwest Marine, Inc.*, ASBCA No. 39472, 91-3 BCA ¶ 24,126, upon which the government relies, Todd properly certified each of its claims under the CDA and submitted them to the CO for decision. Further, Todd's reduction on appeal of the amount of its June 2009 claim is not tantamount to a new claim. *Todd I*, 06-2 BCA ¶ 33,421 at 165,687.

Regarding the 4 June 2009 claim and the statute of limitations, the CDA requires that each contractor claim against the government relating to a contract be submitted within 6 years after claim accrual. 41 U.S.C. § 7103(a). Todd seeks direct cost recovery based upon the contract's Allowable Cost and Payment clause. The government can breach that clause if it wrongfully disallows allowable or allocable costs. See *ATK Launch Systems, Inc.*, ASBCA No. 55395 *et al.*, 09-1 BCA ¶ 34,118 at 168,706-707. However, there can be no breach of that clause, and therefore no claim accrual from which the limitation period is measured, until the contractor requests payment and the government fails to pay. *Todd III*, 10-1 BCA ¶ 34,368 at 169,718; *Parsons-UXB Joint Venture*, ASBCA No. 56481, 09-2 BCA ¶ 34,305 at 169,459. We noted in *Todd III* that, on the record then before us, we did not know when appellant first requested payment in accordance with the Allowable Cost and Payment clause and the government failed to pay.

Upon further development of the record, the first time that Todd even raised the prospect of direct cost recovery was in Mr. Wiscomb's 10 October 2003 letter to the CO, which proposed a new accounting methodology that also included indirect cost allocation (finding 55). Thus, Todd's direct cost claim under the Allowable Cost and Payment clause did not accrue prior to 10 October 2003 and its 4 June 2009 claim, filed less than six years later, was timely under the CDA.

We deny the government's motions to dismiss for lack of jurisdiction.

Entitlement

Cost-reimbursement contracts such as Contract 4115 provide for payment of allowable incurred costs to the extent prescribed in the contract. FAR 16.301-1. The contract did not specify a dry dock cost recovery method. Its Allowable Cost and Payment clause prescribed payment in amounts the CO determined to be allowable under FAR Subpart 31.2 in effect on the contract date (finding 35). Todd bears the burden of proof on the allocability issues. *BearingPoint, Inc.*, ASBCA Nos. 55354, 55555, 09-2 BCA ¶ 34,289 at 169,393.

Under FAR Subpart 31.2, factors to be considered in determining whether a cost is allowable include reasonableness; allocability; GAAP and practices appropriate to the particular circumstances (if, as here, the CAS is not applicable); the contract's terms; and any limitations contained in the subpart. FAR 31.201-2(a) (finding 36). A cost is

allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. FAR 31.201-4 (*id.*). Subject thereto, a cost is allocable to a government contract if it is incurred specifically for the contract, benefits both it and other work, and can be distributed to them in reasonable proportion to benefits received, or is necessary to the business' overall operation, although a direct relationship to any particular cost objective cannot be shown. FAR 31.201-4 (finding 36). A direct cost is any cost that can be identified specifically with a particular final cost objective. Costs identified specifically with a contract are direct costs of the contract and are to be charged directly to it. A cost is not to be allocated to a contract directly if other costs incurred for the same purpose in like circumstances have been included in any indirect cost pool to be allocated to the contract or any other final cost objective. FAR 31.202(a) (*id.*).

An indirect cost is one not directly identified with a single, final cost objective, but identified with two or more final cost objectives, or with an intermediate cost objective. It is not subject to treatment as a direct cost. A contractor's method of allocating indirect costs is to accord with the CAS if applicable, otherwise with GAAP, consistently applied, with due consideration of the reasons for cost incurrence. The method of allocating those indirect costs may require examination upon the occurrence of substantial differences between the cost patterns of work under the contract and the contractor's other work, or significant changes in the nature of the business, or under other relevant circumstances. FAR 31.203(a), (b), (d) (finding 36).

Todd does not seek to change its method of allocating indirect costs. Rather, it seeks to reclassify its Emerald Sea costs, categorized for many years as indirect costs and allocated to government and commercial contracts based upon dry dock use (finding 17), to direct costs chargeable to Contract 4115, on the ground that it would not have refurbished the Emerald Sea at great expense but for that contract. The following factors pertain to whether the costs may be reclassified as direct costs:

(1) During Mr. Wiscomb's oral attempts to communicate with Mr. Orcutt prior to the 14 June 2001 contract award, he did not raise changing from indirect to direct cost allocation. Mr. Wiscomb considered that the change he was discussing was not directly related to Contract 4115. The 21 March 2002 meeting with Todd, nine months after contract award, was the first time the CO learned that Todd wanted to change the accounting treatment of its Emerald Sea dry dock costs. (Findings 22, 31, 47)

(2) There is testimonial evidence that Todd would not have committed the funds at issue but for Contract 4115, and Jim Anderson's 29 May 2001 Emerald Sea repair analysis stated that its purpose pertained to maintaining AOE certification, although it discussed other vessels as well. Nonetheless, numerous of Todd's documents, its website, and its Emerald Sea logs, as evaluated by DCAA, reflect that its Emerald Sea repairs and

refurbishments were not solely for Contract 4115 and/or that they benefitted other contracts for which the Emerald Sea was used. Appellant's expert, Mr. Oyer, noted that the great majority of vessels that used the dry dock were commercial. (Findings 10, 16, 23, 26, 30, 39, 40, 42, 48, 68, 85-89, 93-95, 97, 113)

(3) Todd, and the Emerald Sea's limitations, not the Navy, were responsible for the dry dock's deteriorated condition. It was Todd's practice to perform the minimal repairs necessary from year to year. (Findings 10, 14, 15, 23, 25, 26, 43, 62)

(4) NAVSEA's certification and emergent availability requirements were not unique to Contract 4115; Todd had the same or virtually the same requirements under its predecessor AOE contracts, under which it allocated its costs indirectly (findings 6, 12).

(5) Contract 4115 did not specify use of the Emerald Sea. Todd recognized prior to contract award that it had the option to pursue an alternative dry dock and, after award, it sought to purchase or replace the Emerald Sea, evidencing that it did not require that particular dry dock to perform the contract. (Findings 26, 33, 43, 44)

(6) Todd made a business decision to pursue Contract 4115 in the hope of a \$180 million recovery, even though it recognized that there were significant risks involved, including that the limited AOE dockings were optional and not scheduled for more than two years after contract award, and that there were plans to transfer or retire the AOE's and the Navy might not exercise its options. Todd described these risks as mitigated by other cost-type contracts. (Findings 24, 26)

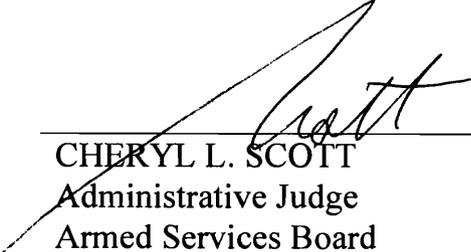
Based upon our evaluation of the governing regulations and the facts of these appeals, including the foregoing factors, we conclude that Todd did not meet its burden to prove entitlement under either of its alternative claims. Under the circumstances, we are not persuaded by the "but for" causal analyses advanced by Messrs. McGeehin and Oyer (findings 36, 102, 103, 111-13). The weight of the fact evidence establishes that the Emerald Sea costs in question were not identified specifically with Contract 4115 and were not properly classified as direct costs of the contract. Rather they pertained to more than one cost objective and, under FAR 31.201-4 and FAR 31.203(a) and (b), were to be allocated to Todd's contracts on the basis of relative benefits received.

Thus, Todd's requested change to a direct cost allocation method was not justified and the government did not breach the contract's Allowable Cost and Payment clause. Accordingly, we need not decide issues of consistency and retroactivity raised in *Todd II*, the government's other legal challenges to Todd's claims, or quantum issues.

DECISION

We deny the appeals.

Dated: 12 May 2011



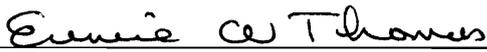
CHERYL L. SCOTT
Administrative Judge
Armed Services Board
of Contract Appeals

I concur



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

I concur



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 Nos. 55126, 56910, Appeals of Todd Pacific Shipyards Corporation, rendered in conformance with the Board's Charter.

Dated:

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