ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeals of --	)	
	)	
Lockheed Martin Tactical Aircraft Systems	)	ASBCA Nos. 49530 and 50057
	)	
Under Contract No. F33657-90-C-2002	)	

APPEARANCES FOR THE APPELLANT: W. Stanfield Johnson, Esq.
W. Jay DeVecchio, Esq.
Edward Jackson, Esq.
Ariel R. David, Esq.
Crowell & Moring, LLP
Washington, DC

APPEARANCES FOR THE GOVERNMENT: COL John M. Abbott, USAF
Chief Trial Attorney
Richard L. Hanson, Esq.
Deputy Chief Trial Attorney
Michael D. McGrath, Esq.
MAJ Timothy D. Matheny, USAF
Trial Attorneys

OPINION BY ADMINISTRATIVE JUDGE DELMAN

Lockheed Martin Tactical Aircraft Systems (appellant)[1] disputes the Government's disallowance of costs in the amount of $17,091,316 that were incurred in connection with co-production efforts under its contract with the Air Force to produce F-16 aircraft under the foreign military sales (FMS) program. A hearing was held on entitlement and quantum under the Contract Disputes Act (CDA), 41 U.S.C. §§ 601-613, as amended. We sustain ASBCA No. 49530. We sustain ASBCA No. 50057 in part.

FINDINGS OF FACT[2]

I. Overview of Foreign Military Sales

1. Pursuant to statutory authority, the Department of Defense is authorized to sell certain types of military equipment to eligible foreign countries. The foreign country purchases this equipment with its own national funds, but under certain circumstances the United States may finance the sale through military assistance grants or loans. FMS contracts are generally priced using the same cost principles as other defense contracts, DFARS 225.7303.

2. The Department of State, as the agency responsible for the execution of United States foreign policy, typically determines which countries are eligible to receive specific military equipment. Upon receipt of the requisite approvals, the Department of Defense executes the program on behalf of the foreign customer. The Defense Security Assistance Agency (DSAA) has the overall management responsibility for the foreign acquisition, and that responsibility is further delegated to the military department involved, in this case the Secretary of the Air Force, International Affairs (SAF/IA) and the Air Force F-16 System Program Office (AFSPO). SAF/IA was responsible for directing all Air Force military assistance and sales programs. The AFSPO was responsible for F-16 sales and provided the regular interface between the foreign customer and the Air Force.

3. In brief, a foreign country initiated the FMS process by submitting a letter of request (LOR), advising of its military requirements and seeking pricing and other relevant data for planning purposes. After the LOR is approved by appropriate authority within the United States Government (USG) and after consultation with the foreign customer, the Government prepares a Letter of Offer and Acceptance (LOA) defining program requirements, estimated costs and projected delivery schedule. The execution of the LOA by the foreign customer manifests its intention to have the USG, as its agent, enter into a contractual relationship with a United States contractor to produce the item on its behalf. Under the LOA, the USG commits to use its best efforts to deliver the equipment for the amount and under the delivery schedule provided. Notwithstanding, the foreign customer is obligated to pay the total costs of the USG for the equipment even if the LOA cost estimate and delivery schedule are exceeded.

4. During the 1980s and early 1990s, a number of foreign countries invoked the above-referenced FMS procedures to obtain F-16s. Appellant and the Air Force implemented the buys of each foreign country through the execution of bilateral modifications to their existing contract for F-16s. The foreign country had no privity of contract with appellant.

5. Under the FMS program, the USG commits to obtaining reasonable prices for its foreign customer in accordance with the FAR, not unlike its commitment to its own domestic customers. However FMS customers may request that a particular article or service be obtained from a specific source or subcontractor. DFARS 225.7304(a). For example, it was not uncommon for foreign countries to seek to have its own country "co-produce" certain portions of the military equipment in order to enhance its own economic development and national prestige. While the costs of co-production varied depending on the co-producer, typically the costs of a new co-production would be materially higher than the costs to perform the same work by the original American manufacturer or the established producer (ex. A-8 at 13). It was important for the foreign country to understand this since it was ultimately responsible to pay the bill. For obvious

reasons, it was important to document a co-production effort. Such documentation could be in the LOA itself, or through other written direction. FAR 6.302-4(a)(2), (b)(1); DFARS 225.7304(a). Under the LOA, the USG may select sole source contractors and need not have the approval of the foreign customer to do so (tr. 9/45).

II. Historical Backdrop – United States' Efforts to Forge Military Cooperation Between Turkey and Egypt

6. In the 1980's, the Government of Turkey (GOT) had entered into a LOA with the Air Force to purchase F-16 aircraft, to be manufactured by appellant under the FMS program. This program was entitled "Peace Onyx," and was implemented by bilateral contract modification to appellant's Air Force contract at the time.

7. In conjunction with this program, the GOT sought and obtained co-production of certain elements of the F-16 in Turkey. Co-production was maintained at a number of Turkish sites, the most prominent being at "Tusas Aerospace Industries" (TAI). TAI was a venture jointly owned by Turkish national interests, appellant and General Electric Corporation, with Turkey retaining majority control. Among other things, TAI performed final assembly of the F-16s, known as "mate through delivery" or MTD.

8. TAI co-production under Peace Onyx was a technical and political success. The President of Turkey established a national objective to expand F-16 co-production at TAI on future programs, including the performance of additional and more technically complex work on the F-16, and to perform such work not only for itself but for other countries. However by 1990, there was no funding available within Turkey for additional F-16 buys, nor was there available any interested and funded third-country customer.

9. The Iraqi invasion of Kuwait on 2 August 1990 brought changed circumstances and new military procurement opportunities. The USG sought and obtained the support of the governments of Turkey and Egypt (GOE) as part of an alliance against Iraq. Among other things, Turkey provided convenient fly-over access to the military theater from its military bases, and also curtailed the flow of Iraqi oil through its country.

10. The USG sought ways to reward its allies for their support of American foreign policy objectives in the Gulf region. For Turkey, the USG promoted the creation of a "Turkish Defense Fund," funded by Saudi Arabia and other Arab nations. In return for Egypt's support, the USG forgave certain Egyptian debt obligations. As a result, Turkey now had a long-term funding source for additional F-16 buys – to be called "Peace Onyx II." Egypt had additional funds freed-up to be a potential third-country customer for Turkey's planned new co-production program.

11. It was in this time frame that Turkey reiterated to the USG its desire to expand F-16 co-production in Turkey. In November 1990, a Turkish delegation visited Egypt to

present the possibility of TAI producing Egypt's F-16s under Egypt's then F-16 program, called "Peace Vector IV." (Tr. 1/88, 99-100) The delegation also toured the facilities of the Arab Organization for Industrialization (AOI) in Egypt, a government-controlled industrial complex owned by a number of Arab nations.

12. On 20 December 1990, the U.S. Ambassador to Egypt reported to the State Department as follows (AR4, tab 278):

> Egyptian-Turkish discussions on possible F-16 sales have made no discernible progress. We have seen no Egyptian enthusiasm . . . .
>
> . . . .
>
> In private exchanges with ambassador and other officers in this mission, the Egyptians have signaled a distinct lack of interest in the deal and a preference for continued Fort Worth product.

13. As the air war against Iraq became imminent, the USG's need to meet Turkey's needs and to bring its allies together became more compelling. (Tr. 5/42-46) On 1 January 1991, U.S. Secretary of State Baker cabled the U.S. Ambassador in Cairo, requesting his advice as to what it would take to persuade the Egyptians to accept F-16s co-produced in Turkey (AR4, tab 277):

> 2. An interagency group is currently considering the issue of how and whether the U.S. should attempt to exert pressure on the Egyptians to buy F-16s produced in Turkey. This is a matter of great importance for the Turks and has taken on increased significance to the USG in light of our desire for increased, extraordinary military cooperation with Turkey in the next two months.
>
> 3. Using the above as a backdrop, Ambassador is requested to provide his ideas on how such an approach to the Egyptians might best be made . . . .

14. On 7 January 1991, President Bush, having had discussions with Turkey's President Ozal, wrote a letter on the subject to President Mubarak of Egypt, stating as follows (AR4, tab 279):

> As you know, Turkey is a valued and trusted ally of the United States, and has played a pivotal role thus far in our common effort to resist Iraqi aggression in the Gulf. It has

> done so, as has Egypt, at significant economic cost and potential threat to its national security.
>
> President Ozal has asked me to raise with you directly his interest in having Egypt purchase its next tranche of 40 F-16 aircraft from Turkey.
>
> My government believes that Turkish-made F-16s meet all requirements and are equal in quality to those produced in the United States. I am certain that President Ozal is willing to work with your government to make the necessary arrangements to ensure that this program would meet your own essential requirements.
>
> I am confident that this joint effort would also serve to cement the close security relationship among our three countries and would help to provide for long-term stability in your region. I strongly encourage you and your military advisors to accept the Turkish proposal.

15. On 8 January 1991, the U.S. Ambassador in Cairo responded to the Secretary of State's request for advice. In assessing the chances for GOE agreement, he responded "no counter-purchase, no deal; the greater the counter-purchase, the greater the chances for a deal." (AR4, tab 283)

16. The bombing of Iraq began on 16 January 1991. The USG, through its ambassadors in-country, began an intensive diplomatic effort to persuade GOT to offer counter-trade acceptable to GOE in return for Egyptian F-16 co-production in Turkey. The U.S. Ambassador to Turkey prodded and pushed GOT officials to make a "quid-pro-quo" proposal (ex. A-10 at 63, 70-71). On 24 January 1991, our Turkish ambassador cabled to the State Department as follows (AR4, tab 292):

> JUSMMAT Chief General Farmen and I had a long discussion with SSM Director Vahit Erdem and F-16 project manager MG Utkun to review possible sales to Egypt. . . .
>
> . . . [A]fter much prodding by Farmen and myself, they realize they have to do something to present a special package to the Egyptians if they have any hopes of getting the sale. They have agreed to work out with GD [appellant] a package which goes beyond giving Egypt offset with Turkey's additional production of F-16s. They also agreed to get Ozal to send a letter to Mubarak inviting a senior Egyptian Air Force

> delegation to visit the plant and to listen to the new Turkish offer.
>
> We hope this can get off the ground next week but don't bet on it. We will continue to push.

17. USG officials in Washington and in Turkey also sought the assistance of appellant to help GOT formulate a quid-pro-quo. As stated by appellant's manager of international program development in the Middle East (tr. 5/42-45):

> The Embassies . . . wanted to make sure that we understood that President Bush wanted this to happen. And so they shared a lot of things that were not directly available to us. But when a U.S. Ambassador says President Bush wants this to happen, this is President Bush's representative. I have to take him at his word.
>
> I don't challenge his word. So suddenly, we find ourselves in the middle of U.S. government foreign policy and preparation for this war.
>
> . . . .
>
> *The message . . . to us from both Ambassadors, their military advisors, the State Department was to go to Turkey, help the Turks figure out how to create a quid. The assessment was no quid, no agreement.* [Emphasis added]

18. Appellant acceded to the USG's requests. Appellant explained to the Turkish System Program Office (SPO) how an exchange of equivalent labor hours between F-16 programs could be structured, and what work could be diverted from GOT co-production at TAI to AOI in Egypt. Such a diversion was a major challenge for appellant. The AOI work package had to be labor intensive, not unduly complex, yet large enough in scope to approximate the equivalent manhours – roughly 427,000 manhours –to be performed by TAI on behalf of Egypt. The GOT further restrained appellant's options by insisting that the diverted co-production not be work that TAI had performed in the past. (Tr. 5/46-60)

III. <u>The USG-Brokered F-16 Counter-trade Agreement</u>

19. In late February, 1991, Turkish and Egyptian delegations met in Turkey and progress towards a counter-trade agreement was made, with both parties agreeing to hold a follow-up meeting in May, 1991 in Cairo.

20. Appellant continued to play an active, but behind-the-scenes role as requested by all the relevant parties. In early 1991, appellant developed a co-production package that called for the diversion from TAI to AOI of some of the new expanded co-production work which, consistent with President Ozal's objective, was then planned for TAI on Peace Onyx II. The key elements were: (a) diversion of work from TAI to AOI; (b) necessary tooling, training, and technical assistance of AOI; and (c) rough equivalence in cost between doing the work at AOI or TAI. (Tr. 1/131-35, 5/47-50, 122-28) This AOI co-production plan was briefed to officials of the GOE, GOT and USG. The Turkish SPO was briefed on the key elements, including the competitive cost comparison between TAI and AOI. (Tr. 1/133-35) As both TAI and AOI would have required considerable co-production support for this work, the non-recurring costs for doing the work at either facility would have been roughly the same. Appellant specifically briefed the Turkish SPO on the overall technical assistance required for co-production at AOI (tr. 5/117-26).

21. On 18 March 1991, the U.S. Office of Military Cooperation in Cairo cabled the State Department and DSAA as follows (AR4, tab 309):

> *At the request of the USG, General Dynamics has helped negotiate a cooperative F-16 coproduction deal between Turkey and Egypt in exchange for Egypt buying Turkish produced F-16's* [sic]. This deal is contingent upon a Peace Onyx II program buy of at least 80 F-16's [sic] and USG license and contract approvals for the Arab Organization for Industrialization's (AOI) coproduction of F-16 sub components. Who in the USG makes this happen? What kinds of documents/agreements need to be signed by TU and EG and to what extent should the USG be involved? . . . [Emphasis added]

22. On 25 March 1991, the Defense Department, through DSAA, provided this response (AR4, tab 310):

> Determination of documentation required for a GOT/GOE agreement is a matter for those governments to decide. Appropriate implementing instructions, such as place of assembly (PV IV) or AOI workshare (Peace Onyx II) will be written into LOA's [sic] as and when necessary.

23. By letter dated 3 April 1991, the GOE Minister of Defense and Military Production advised our Egyptian Ambassador that "with the encouragement of the American Government," GOT and GOE have reached a F-16 quid-pro-quo agreement

between their two FMS programs (AR4, tab 22). The USG agreed to finance Egypt's purchase through FMS grant funds appropriated by Congress (tr. 6/181).

24. On 21 April 1991, our Egyptian Ambassador responded to the GOE Defense Minister's letter, pledging USG support of the two countries' agreement (AR4, tab 24).

25. Between 6 May and 9 May 1991, representatives of GOE and GOT met in Cairo to formalize their Peace Onyx II/Peace Vector IV reciprocal agreement. Appellant was not present (tr. 5/69-70). The agreement was documented in the "Minutes of Meeting of the Third Session of the Egyptian-Turkish Military Cooperation Committee," signed by authorized officials on behalf of the Egyptian Ministry of Defense and the Turkish Ministry of National Defense. The agreement stated in pertinent part as follows (AR4, tab 26):

> a. TURKEY submitted her application to USA, expressing her request to provide ARE [Egypt] 46 F-16 C/D aircraft under the agreed compansation [sic] provisions such as sharing manufacturing and assembling labour hours depending upon the previous Cooperation Committee Minutes between TURKEY and ARE.
>
> b. The EGYPTIAN side emphasized the fact that PV IV project's direct factory man/hour work for the Turkish industry should be determined, and that an equivalent compensation should be contracted with the EGYPTIAN defense industries.
>
> . . . .
>
> d. As part of the compensation, *TURKISH side agreed to request formally from GD [appellant] to determine AOI as subcontractor for manufacturing some parts for the TURKISH PEACE ONYX II F-16 PROJECT*. In accordance with the foregoing agreement, GD submitted to AOI a contract proposal comprising an equivalent compensation of 427000 direct man/hour [sic] work to be used in the TURKISH PEACE ONYX II F-16 Project. [Emphasis added]
>
> e. The TURKISH side is requested to coordinate with GD and USA government for approving 427000 direct factory man/hour [sic] work production activities from PEACE ONYX II Project to the EGYPTIAN industry (AOI).

> f. The TURKISH side accepted ARE request concerning a prompt coordination with GD to expedite its agreement with AOI, as mentioned in (e-) above, taking into consideration AOI remarks.

In brief, the GOT was to perform MTD on F-16s under Egypt's FMS program (Peace Vector IV) at Turkey's facility at TAI, and the GOE was to perform an equivalent number of manhours of work on F-16s under Turkey's FMS program (Peace Onyx II) at Egypt's facility at AOI.

26. The GOT/GOE co-production exchange agreement brought benefits to both countries. The agreement allowed the GOT to achieve its policy objective of having its growing aerospace industry at TAI assemble F-16 aircraft for third countries. The agreement also reduced a production gap at TAI between the end of the Peace Onyx I program and the beginning of the Peace Onyx II program which kept labor costs low, and also caused Egypt's Peace Vector IV program to absorb a portion of the cost of appellant's resident office in Turkey. (Tr. 1/83-86, 105, 110-12, 2/25-28, 7/154-55)

27. As for Egypt, they were to obtain quality F-16 aircraft assembled at TAI in a timely fashion under Peace Vector IV, without expending national funds. This agreement also opened the door for additional future military cooperation between the two countries, including the possible export of M-IAI tanks from Egypt to Turkey. Egypt also obtained F-16 work for its fledgling aerospace industry at AOI, which provided internal economic benefit as well as national prestige.

IV. <u>The LOA Between the Air Force and Turkey – Peace Onyx II</u>

28. On 18 February 1991 the GOT, through its F-16 SPO program manager, issued an updated LOR to DSAA for 160 F-16 aircraft and requested "Price and Availability" (P & A) data in LOA format for Peace Onyx II. (GR4, tab 93) This request was routed through appropriate USG channels for approval, and as far as this record shows, no political or other objections were offered to the sale. The AFSPO was delegated the responsibility to process and implement the Turkish request, in coordination with DSAA and SAF/IA.

29. In accordance with Turkey's request, the AFSPO requested P & A data from appellant. Appellant provided the data by letter dated 25 July 1991. Through discussions with appellant, the AFSPO program manager learned of the GOT/GOE agreement and the exchange of F-16 work between the Peace Vector IV and Peace Onyx II programs (tr. 7/93). Appellant's 25 July data presentation specifically included the costs of co-production work at AOI (AR4, tab 28):

7. The cost data includes consideration for the following coproduction plan:

- Final assembly off production line in-country
- Continuation of Peace Onyx II industry participation in fabrication and assembly of their current components (center fuselage, aft fuselage, and wing).
- Phase into manufacture of the forward fuselage, vertical fin and ventrals
- European participating industry (EPI) entitlements are included.
- *AOI (Egypt) entitlements (forward fuselage side panels) as a result of the Peace Vector IV program are included*. [Emphasis added]

30. Although the AFSPO program manager was aware that AOI was to perform certain F-16 work for Turkey under Peace Onyx II, it was not sure how to document this fact. The AFSPO thought to include the AOI effort in the "designated work" portion of the proposed LOA for Peace Vector IV (tr. 7/141-42) or in the proposed LOA for Peace Onyx II (AR4, tab 33). DSAA rejected these approaches. Apparently unaware of the extent of the State Department's efforts to broker the counter-trade deal, the Deputy Director, DSAA believed that there was no FMS linkage between the proposed co-production in the two countries. He believed that AOI co-production under Peace Onyx II was merely a commercial "offset" deal between appellant and Turkey (ex. G-17 at 4), and should not be included as directed co-production in the LOA (tr. 7/99-100). Neither DSAA nor the AFSPO sought the assistance of the State Department at this time to better understand the USG role in the facilitation of the GOT/GOE agreement.

31. It appears that the view of the Deputy Director, DSAA carried the day within the AFSPO. As of September 1991, the LOA documentation to be prepared by the Air Force for GOT's signature was not to expressly include AOI as a designated co-production source (tr. 7/106), although the AOI effort was to be identified in the LOA as "direct offset activities stemming from this LOA" under Paragraph 22, "OVERSEAS CONTRACT ADMINISTRATION SERVICES." As far as the AFSPO program manager was concerned however, AOI co-production could have been properly documented in the Peace Vector IV LOA, the Peace Onyx II LOA, or in some other fashion (tr. 7/144). We find that the manner in which AOI co-production was to be documented was pro-forma; all the relevant parties were fully aware of this co-production under Peace Onyx II at this time.

32. On 6 August 1991, the GOT's Ministry of Defense wrote appellant about a problem between Egypt and appellant on the definitization of the 427,000 manhour

exchange pursuant to the GOT/GOE counter-trade agreement. The GOT requested appellant to take the necessary action for a solution and to keep the GOT informed. (AR4, tab 31)

33. In September 1991, AFSPO representatives traveled to Turkey to brief the Turks on the pricing data presented by appellant under Peace Onyx II and on related issues. The briefing material reflects that GOT was fully aware that AOI was a proposed co-producer on Peace Onyx II (AR4, tabs 39, 40). The Turkish SPO did not question AOI's involvement (tr. 7/130-31).

34. On 26 March 1992, GOT executed the LOA for Peace Onyx II. Insofar as pertinent, the LOA provided for the delivery of 40 F-16 aircraft in accordance with a prescribed delivery schedule, plus long lead support for an additional 40 units, for the estimated cost of $1,514,544,092. (GR4, tab 225)

35. In the designated work section of the LOA, Turkish industrial participation and European participation were generally identified, but no particular contractor or co-producer was specified. AOI also was not included in this section, but AOI was identified in paragraph 22 of the LOA as stated above. Interestingly, the LOA also did not identify appellant as the designated source for the F-16 airframe. Turkey provided this designation to the Air Force in a telegraph message dated 18 September 1992 (AR4, tab 68).

V. Contract Implementation of the LOA

36. On 28 May 1992, an Air Force acquisition strategy panel was convened for the contract implementation of the LOA with appellant. The AFSPO program manager and the procuring contracting officer (PCO) briefed the Air Force F-16 program director. The briefing expressly identified AOI as a co-producer under Peace Onyx II, along with TAI and KIBM, two Turkish co-producers (AR4, tab 56, Bates No. 412538). The Air Force's acquisition strategy was approved shortly thereafter (AR4, tab 57). At this time, a new AFSPO program manager was chosen to run the Peace Onyx II program (tr. 8/193).

37. AOI's co-production status was also recognized by SAF/IA. By letter to appellant dated 11 June 1992, SAF/IA advised appellant as follows (AR4, tab 58):

> *We are aware there is an agreement to provide work from PO II to the Arab Organization of Industrial States (AOI) and keep getting asked when the work will be turned on.* [Emphasis added]
>
> I would appreciate your timely response as we attempt to respond on the AOI issue.

Appellant advised the Air Force in writing on 26 June that "[w]e have completed considerable advanced planning for PO II coproduction at AOI and are ready to execute the coproduction program upon PO II program implementation" (AR4, tab 61).

38. In accordance with the Air Force's acquisition strategy, the State Department also approved a foreign license for the manufacture of components at AOI on 22 June 1992 (AR4, tabs 60, 83).

39. By issuance of Advance Change Study Notice (ACSN) 4996 dated 25 November 1992, the Air Force sought from appellant a contract proposal for Peace Onyx II in accordance with certain defined program requirements. These program requirements were coordinated amongst appellant, GOT and the Air Force. The ACSN, in attachment 3, specified AOI co-production. The ACSN directed appellant to put together its proposal based on AOI co-production (AR4, tab 75). The GOT signed off on these documents prior to their issuance (tr. 2/70-71, 9/80-81). We find that the GOT's approval of these documents was an acknowledgment of AOI co-production.

40. On 24 December 1992, Turkish General Canova, a participant in the GOE/GOT meetings in 1991, wrote to appellant expressing concern that appellant had not identified sufficient hours for AOI to satisfy the GOT's obligation under the co-production exchange agreement. General Canova asked appellant to provide information about its plan to "solve this problem and fulfill the gap" (AR4, tab 76).

41. On 29 January 1993, appellant responded to General Canova's 24 December 1992 letter by reiterating appellant's commitment to implement the GOT/GOE co-production exchange agreement (AR4, tab 79):

> As a result of the industrial cooperation agreement reached between the Governments of Turkey and Egypt in 1991, General Dynamics agreed to facilitate a Government of Turkey requested placement of 427,000 manhours of PO II coproduction work at AOI to meet Turkey's commitment to Egypt. . . .
>
> Our ability and commitment to place the required Peace Onyx II coproduction manhours at AOI on your behalf has not changed. . . . Now that Peace Onyx II is underway, we are in the process of implementing coproduction at AOI and remain fully confident that the required AOI participation in PO II coproduction will be met through the authorization of an 80 aircraft program.

42. In early 1993, appellant, the AFSPO and the GOT participated in meetings related to the submission of updated cost figures for the LOA. The Air Force specifically requested that appellant provide more detailed information about the recurring and non-recurring costs for AOI co-production. Appellant provided this information, and the Air Force used this information to brief the Turks. The non-recurring costs were estimated at roughly $50 million. (Tr. 2/185-86)

VI. The Air Force Provides Long Lead Contract Authorization to Appellant

43. The contract between appellant and the Air Force awarded August, 1991 (GR4, tab 143) contemplated use of long lead contract authorization of work to meet the delivery schedule in the LOA prior to the definitization of appellant's contract price (tr. 10/54). By letter to the AFSPO and the PCO dated 3 March 1992, appellant submitted a long lead proposal in the amount of $316,265,000 for long lead effort through July 1993. This proposal included costs for the co-production plan identified by appellant in its P & A data submission of 25 July 1991, including AOI participation. (AR4, tab 52)

44. On or about 17 February 1993, the Air Force issued bilateral contract Modification No. P00050 to appellant's contract, which authorized appellant to incur costs up to $77,065,340 to protect the Peace Onyx II delivery schedule, in accordance with an attached Statement of Work (SOW). This SOW was approved by the GOT (tr. 2/17). Insofar as pertinent, the SOW authorized appellant to provide the following (AR4, tab 237):

> 4.9 (WBS 1900) COPRODUCER TOOLING
>
> The contractor shall provide all control tooling to allow the coproducer to fabricate, assemble, and deliver any new or revised tooling required by the coproducers.
>
> . . . .
>
> 4.18.1 General Dynamics In-Country Production Management
>
> The contractor shall effectively manage primary international production facilities with sufficient functional expertise to facilitate the implementation of methods and procedures at a coproducer's plant to ensure on-schedule production of high-quality, correctly configured components, system items, and/or aircraft. The contractor shall be responsible for reporting program status, progress payments to the

> coproducers, items related to F-16 production in-country and support to and from Fort Worth.
>
> 4.18.2 International Coproduction Management (Peace Onyx II Only)
>
> The contractor shall be responsible for the international coproduction of F-16 aircraft. The contractor shall be responsible for program integration at Fort Worth of all functions required to support coproduction. The contractor shall plan coproduction, maintain status, schedule coproduction commitments and provide the primary interface to ASC/YPXI and ASC/YPXB [Air Force office symbols] for coproduction activities.

On 30 April 1993, under bilateral contract Modification No. P00090, the Air Force extended long lead authorization for Peace Onyx II by increasing the obligation to $308,921,690 (AR4, tab 238).

45. Appellant's program manager understood, and we find that the long lead contract modifications obligated appellant to perform, within the long lead funding constraints, those activities and tasks necessary to meet the LOA delivery schedule, including the tooling and training of co-producers like AOI. (Tr. 2/160-62) The AFSPO was of a similar view (tr. 9/84, 132, 200-01). As a result of these contract modifications, appellant commenced work and incurred cost related to AOI co-production (tr. 6/95). These are the costs that were later disallowed by the Air Force and are the subject of this dispute.

46. As far as this record shows, Modification Nos. P00050 and P00090 were never canceled or rescinded. These contract modifications also provided for progress payments, and, until July 1994, appellant incurred and was paid for long lead costs incurred in connection with co-production at AOI. (AR4, tabs 237, 238; tr. 9/104-05) The nature of the co-production support provided to AOI – training and tooling – was similar to the type of co-production support provided to any new co-producer. (Tr. 5/125-28, 6/46-47, 102-07)

VII. Air Force Revises ACSN; Long Lead Contract Modifications Remain In Place

47. On or about 14 June 1993, appellant advised the PCO that AOI's co-production price would not be "fully competitive" (tr. 10/88), that is, equal to appellant's domestic price to perform the work. This was consistent with appellant's revised co-production allocation plan dated 28 April 1993 (*see* findings 50-51 *infra*). The PCO reviewed the LOA and discovered, apparently for the first time, that AOI was not

identified in the co-production section of the LOA. As a result, she believed that the GOT had never formally directed AOI co-production, and hence the ACSN that had directed appellant to prepare its proposal based on AOI co-production was improper. The PCO was unfamiliar with the details of the GOT/GOE agreement and the USG's role in promoting it. Also, she was unaware of, or gave little weight to the GOT's approval of the ACSN which provided for AOI co-production.

48. In any event, a request for written clarification from Turkey would have resolved the matter. The Air Force did not seek written clarification. Instead, by e-mail transmission to appellant dated 21 June 1993, the Air Force revised attachment 3 to ACSN 4996 to delete reference to AOI. Insofar as pertinent, the Air Force provided as follows (AR4, tab 98):

> If GD plans to coproduce any part of the Peace Onyx II aircraft at a subcontractor other than a Turkish facility, the contractor must certify the non-Turkish coproducer as:
>
> a. Fully competitive; or,
>
> b. Provide a comparison between the fully competitive cost and the non-Turkish coproducer cost of the work to be accomplished. [Emphasis in original]

49. The revised ACSN was not intended to, and did not revoke the long lead contract authorizations, nor was it intended to preclude co-production at AOI. The plain language of the revision merely stated that if a co-producer, like AOI, was not fully competitive, then appellant was to provide cost comparisons between the "fully competitive" cost and the co-producer cost. A PCO letter to appellant dated 26 July 1993 further clarified the significance of this latter cost comparison, stating that any overage or "premium" must be clearly identified in appellant's proposal and "will be evaluated and appropriately addressed during factfinding and negotiations." The PCO's letter of 26 July also stated that the program was to comply with "the fully competitive conditions for 3rd country coproducers, as established by the Coproduction Allocation Plan, 16PP841." (AR4, tab 99)

50. The F-16 co-production allocation plan (CAP), was an appellant-generated document which reflected the contractor's intentions or plans at a given point of time regarding the identity of co-producers, and the competitive status of each co-producer under all FMS programs. Co-producers were identified as fully or strictly competitive; reasonably competitive or without competitive price limitations. These categories were not defined or mandated by statute, regulation, contract or FMS rule; they were defined by appellant. According to the CAP, in order for a co-producer's price to be "fully competitive," it "must be equal to or less than the U.S. price paid by the United States

Government" (AR4, tab 249 at 1-3, 1-4). The fully competitive price (FCP) was not defined in the CAP but was defined in appellant's internally-generated "estimating standard operating practice" (ESOP). The ESOP dated 21 April 1993 provided as follows (GR4, tab 314):

> The FCP is the maximum purchase order value which may be paid to a coproducer. It is that value which, when added to procurement loadings and peculiar shipping costs, equals the domestic cost to produce a like item . . . .

51. The record reflects that appellant revised its CAPs roughly three times a year (AR4, tabs 243-53). The CAPs, as revised, stated that they were coordinated with the AFSPO. CAP revisions were authorized by Clause H-045 of appellant's contract (GR4, tab 143 at 50), but it is unclear on this record whether the parties processed these revisions under this contract provision. From time to time, the Air Force incorporated appellant's then-current CAP in the contract but for reasons unclear it did not incorporate every update. In February 1993, when the Air Force issued its long lead contract authorization, appellant's 1 September 1990 CAP was part of the contract. This CAP predated the counter-trade agreement and provided no information about AOI (GR4, tab 34; tr. 10/146). When a long lead contract authorization for a Greek acquisition of F-16s, known as Peace Xenia II, was issued in July 1993 the Air Force incorporated into the contract appellant's revised CAP of 4 January 1993 (AR4, tab 249), which listed AOI on a chart as "F" or fully competitive (tr. 10/73), although it does not appear that AOI performed any work on this program. Appellant updated its CAP on 28 April 1993 (AR4, tab 250), which was the current CAP as of the date of the Air Force's letter of 26 July above. This CAP indicated that AOI had no competitive price limitations, although for reasons unclear the Air Force did not put this CAP on the contract (tr. 10/187-88). Appellant's 2 November 1993 CAP (AR4, tab 251) also designated AOI as without competitive price limitations but was also not placed on the contract by the Air Force (ex. A-7 at 32). Appellant's 11 February 1994 CAP also identified AOI as without competitive price limitations (AR4, tab 252 at 3-7). This CAP was made part of appellant's contract pursuant to bilateral contract Modification No. P00261 under Peace Onyx II in June 1994 (GR4, tab 549).

52. Appellant advised the Air Force that it would comply with the ACSN as revised but sought meetings to clarify the situation. Appellant did not believe that it had competitively selected AOI as a co-producer under Peace Onyx II, or that AOI's price was fully competitive with local production in Fort Worth. Appellant was implementing a GOT/GOE agreement brokered by the USG that required Egyptian co-production of Turkish F-16s, and AOI was the only viable location in Egypt for this work.

53. The Air Force did not direct appellant to stop incurring AOI costs. The long lead contract modifications remained in place. Appellant continued to incur AOI-related

costs. The AFSPO program manager understood that appellant continued to incur AOI-related costs to protect the LOA delivery schedule (tr. 9/132).

54. By letter to the Air Force dated 9 September 1993, appellant provided comparative cost data. This letter and its accompanying chart were not a model of clarity, but it appears that appellant estimated that there would be roughly $50 million of non-recurring cost (tooling, training, in-country office support) to support AOI co-production. However the overall program cost to the GOT under Peace Onyx II would be much less, since Turkey would realize savings of roughly $26 million from its own co-producer – TAI – due to the fact that its work on the Egyptian aircraft under the counter-trade agreement would keep labor costs lower for the follow-on Peace Onyx II program, which lower cost would not be realized if TAI did not have the Egyptian work and had to remain idle (tr. 3/28). The "fully competitive" cost calculation – if the work was done by appellant in Fort Worth – was roughly $10.1 million. (AR4, tab 105)

55. In September, 1993, Turkey's new SPO program manager was briefed by TAI and appellant's program manager about the nature and size of the AOI premium (tr. 3/47).

56. Turkey had a reputation in the FMS program as a cost-conscious customer and as a consummate negotiator. Earlier, it had decided to forego the production of the F-16 forward fuselage as part of its co-production at TAI under Peace Onyx II because of its expense to the program. (Tr. 2/64-65) The new Turkish SPO program manager had no great desire to foot a large bill to enable co-production of AOI in Egypt. While he was generally aware of the need for training and tooling at AOI pursuant to the manhour exchange agreement with Egypt, and that AOI co-production work would cost more than work done in Fort Worth, it appears that he did not fully appreciate the magnitude of this undertaking until this date.

57. The new Turkish SPO program manager refused to approve the premium costs projected by appellant in September 1993. He demanded more cost information. He advised appellant that Turkey would not pay a premium to have work performed at AOI.

58. The Air Force position now changed. In a letter to appellant dated 14 September 1993, the PCO no longer focused on the competitive cost of the AOI work; rather she questioned appellant's authority to use AOI as a co-producer in the first instance (AR4, tab 107):

> The USAF requires written direction from MOD-TU [Turkey] directing Peace Onyx II coproduction to AOI. To date, we have not received this direction. Until we do, we will not authorize any coproduction at AOI . . . .

While it is technically correct that the Air Force had not received a writing from Turkey specifically directing AOI co-production, AOI was identified in the LOA as performing work "stemming from this LOA" (finding 31), and the GOT had approved in writing the ACSN of November 1992 which included AOI co-production (finding 39). Since July 1991, the Air Force was fully aware that AOI was to participate as a co-producer in Peace Onyx II at Turkey's request (finding 29), and acted upon this knowledge in the preparation and implementation of its acquisition strategy (findings 36 through 39). The State Department and DSAA were aware of AOI co-production months earlier (findings 21, 22).

59. A meeting was held on 24 September 1993 between the AFSPO, appellant, and the Turkish SPO. Appellant explained the historical background and explained that AOI preparatory and tooling work were ongoing and that it would be necessary to issue a purchase order or subcontract to AOI in the near future to maintain the LOA delivery schedule. The Turkish SPO did not direct that AOI costs be discontinued but reiterated that it would not agree to pay the projected premiums. He also stated that he needed additional cost information before Turkey could make a final decision. Appellant promised additional data. Appellant stated that it would continue with AOI co-production unless advised in writing to stop so as to maintain the program delivery schedule. The Turkish SPO program manager did not object. By letter to appellant dated 30 September 1993, the PCO confirmed the positions of the parties, and formally requested additional pricing data to assist Turkey in making its final decision (GR4, tab 410).

60. The Air Force, however, pushed Turkey for that final decision. On 29 September 1993, the AFSPO issued a letter to Turkey's senior national representative in the United States on the subject of "AOI Stop Work." The AFSPO stated as follows (AR4, tab 112):

> I know that General Mete [Turkish SPO Program Manager] said he does NOT want to incur any more costs for AOI. **However, if you want us to tell Lockheed to stop incurring costs, you need to give me a letter telling me to stop the AOI effort.** This letter will stop the Egyptian training and force the Lockheed Representative Office (LRO) in Egypt to possibly shut down. **If you do not give me this letter, LFWC [appellant] will continue to accrue costs associated with AOI training and LRO and PO II [Turkey] will pay them.** [Underlining in original; bold emphasis added]
>
> . . . Please give me written direction on 30 Sep 93 as to what you want us to do.

From this letter, it is clear that the AFSPO understood that AOI co-production was in fact authorized, albeit the GOT retained the prerogative to discontinue it.

61. On or about 30 September 1993, the GOT replied to the AFSPO's 29 September letter (tr. 2/51). The letter stated in pertinent part as follows (AR4, tab 112, second letter):

> . . . As you know, we have been waiting for the pricing information related to AOI coproduction which was requested from LFWC . . . . After having received and reviewed this information, MOD-TU will immediately inform you of the decision in this matter.
>
> **Therefore, request ASC/YPXI [AFSPO] not to stop AOI effort** until we receive the pricing information for AOI coproduction, reviewe [sic] it and make final decision on this matter. However, <u>please take necessary measures in having LFWC not to sent [sic] purchase order to AOI without having MOD-TU consent</u>. [Underlining in original; bold emphasis added]

We find that Turkey's letter directed two basic points: (1) it directed the Air Force to allow continued AOI co-production support cost ("not to stop AOI effort") until it made a final decision, and (2) it directed the Air Force to notify appellant not to issue a purchase order or subcontract to AOI pending that final decision. This all-important written directive from Turkey was lost or misplaced by the AFSPO. Neither the AFSPO program manager, nor the PCO was aware of the GOT's directions (tr. 9/149-51, 10/205). Accordingly, the GOT's directions were not passed on to appellant.

62. On 1 October 1993, appellant responded to the PCO's 30 September letter by providing the specified cost information in two charts, both of which showed an additional cost at AOI, when compared to Fort Worth, of approximately $50 million. The requested comparison of AOI and TAI costs was also provided. Both charts also reflected the trade-off benefits to Turkey from the Peace Vector IV work at TAI. Appellant authorized disclosure to the GOT of the chart with the bottom-line premium and trade-offs, but not the chart reflecting a breakdown of costs for AOI. This limited disclosure was consistent with AFSPO policy. As a general rule, the AFSPO respected a contractor's designation of certain pricing data as proprietary and did not provide the details of such data to foreign governments. (Tr. 7/136) The Turkey SPO also understood that the disclosure of a contractor's detailed cost information to a foreign customer was contrary to AFSPO policy. (Tr. 1/149-52, 2/57-58)

VIII. The Air Force Recommends That Turkey Continue With AOI, Notwithstanding the Cost

63. The AFSPO reviewed all of appellant's cost data. By letter dated 1 October 1993, the Air Force issued a recommendation to Turkey, with copies to appellant and interested Government offices. The Air Force's recommendation was summarized as follows (AR4, tab 116):

> [A]cting as your agent and looking out for your best interests; and, *having reviewed, in detail, the LFWC cost figures; we feel your program is best served by continuing the AOI coproduction in support of PO II*. [Emphasis added]

The AFSPO was of the view that co-production at AOI, even with roughly a projected $50 million co-production premium, was warranted and reasonable (tr. 9/171). In this letter the Air Force explained in great detail why it believed AOI co-production should be maintained. We cite the Air Force's reasoning in detail below, because on appeal the Air Force distances itself from its contemporaneous recommendation, and takes the position that it made no economic sense for the GOT to proceed with AOI because these costs were unreasonable (AR4, tab 116):

> [2]a. Cancellation of AOI coproduction would, most likely, result in the Government of Egypt removing Peace Vector IV (PV IV) mate-thru-delivery from TAI. This would result in a loss of almost $38 million in savings (partial filling of the TAI production gap plus the Egyptian contribution to keep the Turkish Lockheed Representative Office (LRO) open). In addition, loss of PV IV business at TAI may significantly hinder TAI's ability to attract additional third country coproduction in the future.
>
> b. The cost of having this work performed at TAI or LFWC is significantly higher than at AOI when you take into account the savings in paragraph 2.a.
>
> c. The production tools and control tools will become the property of the Republic of Turkey at the conclusion of the PO II coproduction effort at AOI. The total LFWC-proposed price of the production and control tools is estimated at $27 million. If your government and AOI can reach agreement, you may be able to sell this tooling to AOI and recoup all or part of your investment.

> d. . . . [A]ll prices concerning PO II coproduction are proposed prices. We anticipate a rigorous factfinding period with fruitful contract negotiations in which we will make every effort to achieve significant reductions in the proposed price of PO II coproduction.
>
> e. If you cancel AOI coproduction, the value of Amendment #1 to the PO II Letter of Offer and Acceptance (LOA) (FMS case TK-D-SLA) would have to be increased by approximately $26 million. This assumes moving the work to Fort Worth, paying for a larger TAI production gap, and your program being the sole source of funding for the Turkish LRO.

The AFSPO then advised what it expected from Turkey (*id.*):

> 3. LFWC has also confirmed that your decision to authorize/move the AOI coproduction must be made by 11 Oct 93. LFWC must send a purchase order to the AOI or move the coproduction to Fort Worth by this date or the aircraft delivery schedule will be impacted. *Therefore, if we receive nothing from you by 11 Oct 93, we will assume you have authorized AOI coproduction of certain PO II aircraft components and we will authorize LFWC to continue their AOI coproduction implementation.* [Emphasis added]

IX. The Contracting Officer's Notice to Proceed to Appellant

64. The GOT received the above letter and did not respond. By letter dated 13 October 1993 from the PCO to appellant, the PCO stated as follows (AR4, tab 122):

> . . . To date, the Government of Turkey has not requested any stoppage in the coproduction efforts.
>
> . . . .
>
> *You are directed to continue implementation of the Peace Onyx II program, in accordance with subject contract*. We are not specifically directing you to contract with AOI. As you are aware, there is a great deal of concern on the amount of coproduction support planned for this program. *All costs incurred and proposed in support of this program must be allowable, reasonable, and allocable as defined by FAR Part 31.2 and are subject to negotiation*. [Emphasis added]

65. Upon receipt of this notice to proceed from the contracting officer appellant believed, and we find that it was authorized to move forward with contract performance, including the issuance of a purchase order to AOI, and that all costs incurred would be subject to normal fact-finding and negotiation as per the FAR. (Tr. 3/96-102) On 28 October 1993, the administrative contracting officer (ACO) issued to appellant a written consent to the placement of appellant's purchase order/subcontract with AOI (AR4, tab 124). Appellant placed the contract on 12 December 1993 (AR4, tab 232 at 4). The AFSPO knew that the AOI work was proceeding and advised Turkey of this fact (tr. 9/201).

66. On 31 January 1994, appellant submitted to the Air Force a revised co-production support proposal, ECP-2035-5. (Ex. A-7) Appellant cited therein to its 2 November 1993 CAP which designated AOI as having no competitive price limitations (ex. A-7 at 32; tr. 6/99-102). This proposal, *inter alia*, described (a) the manufacturing tasks to be performed at AOI; (b) the training plan appellant would implement at AOI; and (c) the co-production support and technical assistance support appellant would provide to AOI.

67. In February 1994 the LOA was amended to reflect the delivery of 80 F-16s to Turkey (AR4, tab 127).

68. In March and in April 1994, Air Force representatives visited Egypt to conduct technical fact-finding on that portion of the co-production proposal involving AOI. The Air Force team included a Turkish military officer who was employed by DCMAO in Turkey as a F-16 technical consultant. AOI authorized the Air Force employees to tour its facilities, but denied access to the Turkish military officer. The Americans were angered by what they believed to be discriminatory and unjustified treatment of one of their team members. The Air Force team was also unimpressed with the condition of the physical plant of the aircraft facility at AOI where the proposed F-16 work was to be accomplished. The Air Force pointed to portions of appellant's AOI site survey report, which appeared to paint a more rosy picture of AOI and its capabilities.

69. Appellant's representatives stated, and we find that the AOI site survey report had to be read as a whole, and that the attachments to the report (which the Air Force team apparently failed to read) accurately depicted the current situation and the support necessary to assure successful F-16 co-production. Appellant believed that with the necessary support, AOI could successfully perform. As to the condition of the AOI facilities, we find that the Air Force overreacted. The facility was not unlike third world facilities used for successful co-production in Indonesia, Korea and Singapore (tr. 6/111).

70. The AFSPO went into fact-finding with the expectation that it could substantially reduce the costs of AOI to the program. Based upon discussions with

appellant during technical fact-finding, it became evident that appellant was standing on its estimates as a realistic projection of necessary support cost. (Tr. 8/263-64)

71. The PCO took steps at this time to move the negotiation process forward. On or about 10 May 1994, the PCO signed off on a request to redelegate business clearance authority for purposes of negotiating ECP-2035-5, appellant's co-production support proposal (tr. 10/247). This document left no doubt as to whether appellant was authorized to proceed with this work (AR4, tab 140):

> ECP 2035-5 has been *authorized* under the Peace Onyx II long lead in Feb 1993, and will be definitized on the same contract, Contract F33657-90-C-2002. [Emphasis added]

72. As a result of the fact-finding trips however, the AFSPO program manager became of the view that AOI should be eliminated from the Peace Onyx program, notwithstanding the Air Force's prior letter recommending AOI co-production, the PCO notice to proceed and the ACO written consent to the purchase order (tr. 8/264):

> So, at that time, I started forming the opinion of *I don't care what agreement there is or how much this costs, whether it be a big premium, or a little premium, or no premium, AOI is not good business for this program*. These guys may not be able to produce and Lockheed had made it clear to us that they had tried to give AOI the most simple parts to manufacture, the easiest parts to manufacture that they possibly could. But my fear was, a Peace Onyx II jet being assembled down the TAI line would have to stop and wait from AOI because the Egyptians could not produce. [Emphasis added]

The AFSPO program manager internally sought to stop the AOI effort, but was overruled by superiors in the program office (tr. 9/220). It was decided to take a different approach which nonetheless would achieve the AFSPO's objectives.

73. By letter to appellant dated 13 May 1994, the AFSPO expressed a number of technical concerns about AOI's capabilities. Of greater significance to the subject dispute was the AFSPO's resuscitation of its pre-1 October 1993 position (finding 58) regarding the need for "fully competitive" pricing and the lack of Turkish authorization of AOI co-production beyond competitive prices (AR4, tab 142).

74. By letter to the AFSPO dated 27 May 1994 (AR4, tab 147) appellant addressed the AFSPO's technical concerns with AOI and revisited the historical background, emphasizing that the AOI effort was implemented to satisfy:

> a USG brokered Egyptian/Turkish Government-to-Government agreement . . . .
>
> We believe the Government of Turkey must understand that although placing work at AOI carries with it a cost, Lockheed has strived to provide the most cost-effective program possible given Turkey's agreement with Egypt. Turkey has received significant benefits from having the Peace Vector IV mate-through-delivery in Turkey.

Appellant's response attached a fully competitive price evaluation. (*Id.*) It also stated appellant's belief that with respect to the issue of Turkey's payment of premiums, "[O]ur records indicate that this issue was settled long ago," (*id.*) referring to the contracting officer's notice to proceed dated 13 October 1993 (findings 64, 65).

75. At appellant's request, representatives of appellant and the Air Force met to further discuss AOI-related issues. When appellant's program manager described the GOT/GOE agreement and the USG role in brokering it, he was challenged to produce documentary "proof" of these matters. (Tr. 3/141-43, 9/233). Appellant was unable to do so. However, the proof of the USG role was established in State Department cables which were classified and unavailable to appellant. Most of these cables were declassified during Board proceedings on these appeals. The AFSPO did not seek the assistance of the State Department to learn of its own Government's involvement (tr. 9/233-36).

76. Notwithstanding the Air Force's recommendations and approvals of AOI heretofore stated, the AFSPO returned to its pre-1 October 1993 position that it needed clear written direction from the GOT to authorize the AOI effort and it did not have it. The AFSPO program manager urged his superiors to approve and to issue a letter to appellant unequivocally setting forth the Air Force position. His reasoning was telling (AR4, tab 157):

> *Our program is incurring charges on the AOI operation because we have never told LFWC that we will not recognize their costs. I believe our inaction will come back to haunt us.* Everyone (Turkey, SAF/IA, LFWC, and DLA) know [sic] our position and are [sic] awaiting action by us. [Emphasis added]

77. By memorandum to appellant dated 21 June 1994, the Air Force advised appellant that as far as it was concerned, AOI co-production was nothing more than a "commercial agreement" and that the USG was not bound thereby. We find that this characterization totally ignored the State Department's active role in promoting the

counter-trade agreement and its commitment to support it (findings 13-24), as well as the Air Force's own acquisition strategy which acknowledged AOI co-production (findings 36, 37). The Air Force memorandum also provided as follows (ex. A-165):

> . . . The F-16 Program Office has no written authority or direction from the [GOT] to direct coproduction to AOI. We are, however, sending a letter to SAF/IA requesting they obtain direction on the AOI coproduction from Turkey.
>
> . . . .
>
> . . . The USAF is forced, at this time, by the lack of AOI coproduction direction in the PO II LOA, to only recognize recurring manufacturing costs that are fully competitive.
>
> . . . .
>
> . . . Based upon the fact we have no written guidance directing AOI coproduction, the requirements for fully competitiveness and reasonableness as defined by [the contract and FAR] prevail. Therefore, at this point in time, the USAF cannot recognize any financial premium associated with AOI coproduction.

While this memorandum suggested that the Air Force would seek direction from GOT to keep the AOI program alive, the AFSPO had no desire to keep the AOI program alive. In fact, the AFSPO program manager discouraged Turkey from seeking an LOA amendment (tr. 10/9). And while this memorandum cited to appellant's CAP dated 4 January 1993 identifying AOI as fully competitive, at this very time the PCO was circulating for appellant's signature contract modification P00261 which incorporated into the contract appellant's revised CAP dated 11 February 1994 and which provided that AOI had no competitive price limitations (GR4, tab 549 at 3-7). This modification was signed by appellant and the PCO on 22 June 1994 and 27 June 1994 respectively.

78. On 22 June 1994, the GOT provided written guidance to the Air Force on AOI co-production. This letter sent conflicting messages. The Turkish SPO did not order a stop to AOI co-production but insisted upon a fully competitive price. On the other hand, he did not close the door on the payment of any co-production premiums, stating that the issue was "a matter of discussion between LOCKHEED and the Government of TURKEY" (AR4, tab 162). Again, by letter dated 12 July 1994, the Turkish Ministry of Defense advised appellant that while it would not assume the "entire" premium, it was open to any reasonable compromise or equitable solution (AR4, tab 175).

79. By memorandum to appellant dated 28 July 1994, the Air Force provided its decision on AOI co-production, in pertinent part as follows (AR4, tab 185):

> . . . Without a request for directed coproduction by our customer, and any subsequent amendment signature by all concerned parties, LFWC may not expend LOA funds for anything other than competitive pricing on the parts AOI was to have manufactured . . . .

The Air Force concluded that all of appellant's costs for the training and tooling of AOI were above the fully competitive price and were unreasonable and unallowable under FAR 31.201-3. The contracting officer stated that appellant's continued implementation of the AOI subcontract was "non-contractual" and was at appellant's "own cost risk." (*Id.*)

80. In determining the costs to be unreasonable the contracting officer did not consider the GOT/GOE counter-trade agreement and the practical restraints it placed on appellant's co-production options (tr. 10/259). The contracting officer also did not consider that as of the date of the disallowance letter, the contract provided that AOI had no competitive price limitations (finding 77).

81. As a result of the Air Force letter of 28 July 1994, appellant issued a stop work order to AOI on 1 August 1994 (tr. 3/172-73). On 12 August 1994, appellant canceled the subcontract (tr. 3/172-73). This was consistent with what appellant had been advising the Air Force all along – it would cancel the AOI contract and move the work out of AOI if the Air Force did not recognize its AOI costs. By the middle of 1994, appellant had completed all control tooling necessary for co-production, and AOI had completed much of the production tooling (tr. 4/170). The quality of AOI's work was as good as any other co-producer, and in certain instances as good as appellant's facility in Fort Worth (tr. 6/52).

X. <u>The Air Force Rebuffs Turkey's Written Direction For AOI Co-Production</u>

82. After appellant's cancellation of the AOI purchase order, Egypt was upset and communicated to Turkey its displeasure that Turkey had failed to live up to its counter-trade agreement (tr. 1/205). As a result, the GOT sought a way to restart AOI co-production in order to fulfill its obligations to the Egyptians (tr. 2/93-94).

83. In September 1994, appellant's program manager met with the Turkish SPO at an executive program management meeting in Turkey. They discussed whether Turkey would agree to pay AOI's non-recurring co-production costs subject to a not-to-exceed amount, in return for a formal LOA amendment clearly directing AOI co-production. The Turkish SPO agreed. Appellant's program manager invited the AFSPO program manager

to join in these discussions. The latter not only declined to participate, but advised that by entering into what he considered to be contract price negotiations, appellant and Turkey had forever lost the option of obtaining an LOA amendment under the FMS program, and that a direct commercial sale between the parties would be the only viable option. The weight of the evidence does not support the AFSPO's view that the parties' discussions precluded the use of FMS procedures (tr. 10/31; *see* finding 85, *infra*).

84. Appellant and Turkey reached a firm agreement: Appellant agreed to place 585,000 manhours of work at AOI pursuant to the GOT/GOE agreement (the revised equivalent number of manhours to be performed for GOE at TAI) at a not-to-exceed cost of $24.1 million for non-recurring costs. In return, the GOT agreed to expressly direct AOI co-production in writing in a LOA amendment. (AR4, tab 196; tr. 2/93-95, 3/179-81)

85. Appellant's program manager conferred with SAF/IA on the wording of a proposed LOA amendment. (Tr. 3/181) He was informed that if the GOT sent in a properly worded request with the above provisions, it would be acceptable to the Air Force under the FMS program for Peace Onyx II. (Tr. 3/181-82; AR4, tab 203)

86. In early October 1994, SAF/IA and DSAA favored an amendment to the LOA in accordance with Turkey's written direction ("the correct approach . . . is to do whatever the Republic of Turkey wishes") (AR4, tab 201). They believed that such an approach would not violate any FMS rules or regulations (tr. 10/31). The AFSPO program manager also did not contend that an LOA amendment would be a violation of law, but nonetheless objected to the GOT's direction of AOI. According to him, for the Air Force to now flip-flop on AOI after its campaign against it would set a bad precedent and also be an "embarrassment" to the AFSPO (tr. 10/30):

> Q Well, they [the Turks] changed their mind and said they were prepared to pay a premium of nonrecurring costs of $24.1 million.
>
> A I also believe that –
>
> Q Why does that embarrass you?
>
> A It embarrasses me, because the way that it was set up was that Lockheed basically did an end run around SPO. That was my feeling on it – by who they talked to in the U.S. government and their dealings with the Turks.
>
> Q What end run? They're just getting what you said and Colonel Kenney said she needed, which was direction

> from the Turks, and what Secretary Bauerlein anticipated they would do?
>
> A Well, that was the way that I felt about this matter.

The AFSPO program manager traveled to Washington to change the view of DSAA and SAF/IA. (Tr. 10/37)

87. An internal Government compromise was reached – the Air Force would split the AOI effort, the recurring costs under FMS and the non-recurring costs as a directed commercial sale (tr. 10/37-38). This compromise was acceptable to the AFSPO. The AFSPO program manager knew that Turkey needed special internal government approvals for a commercial sale which would imperil the F-16 delivery schedule. The AFSPO believed that this "AOI hybrid" would kill AOI co-production once and for all. (Tr. 10/43) The AFSPO was correct.

88. By memorandum to the Air Force dated 24 October 1994, the Government of Turkey formally requested an LOA amendment directing AOI co-production, and directed the Air Force to recognize as allowable all AOI co-production costs to date, with non-recurring cost not to exceed $24.1 million (AR4, tab 208). This LOA documentation was what the Air Force had stated it required in order to recognize AOI co-production (findings 58, 79).

89. Under DFARS 225.7304(a) the contracting officer "shall honor" the foreign customer's request for a directed subcontract when the "written direction sufficiently fulfills the requirements of FAR 6.3." Insofar as pertinent, FAR 6.302-4(a) allows for other than full and open competition pursuant to the "written directions of a foreign government reimbursing the agency for the cost of the acquisition . . . ." We find that the GOT's written direction of 24 October 1994 materially complied with these regulations.

90. However, DSAA replied to GOT on 9 November 1994, stating that the Air Force was unable to grant Turkey's request, and that its new "commercial agreement" with appellant would have to be handled separate and apart from the FMS program. The letter inexplicably stated that the Air Force could not grant Turkey's request because the Air Force was not a "party" to the new agreement. However, it was the AFSPO that declined the opportunity to become a party when it rebuffed appellant's invitation to enter into the discussions some weeks earlier. (AR4, tab 215)

91. The DSAA reply angered the GOT. By letter dated 15 November 1994, the Turkish SPO stated, in pertinent part as follows (AR4, tab 217):

> . . . [I]t is MOD-TU's understanding that U.S. Government should not relieve itself in the middle of this issue and should not negate its PO II program management responsibility.
>
> . . . .
>
> *The USAF has repeatedly stated that they require written authority from MOD-TU to direct coproduction to AOI. This direction has been provided by the MOD-TU, but the response is now that this cannot be part of the FMS contract.* MOD-TU cannot enter into a commercial contract with Lockheed because there isn't sufficient time to establish a contract, and approvals in the commercial side of the Turkish Government will be very difficult, if not impossible, to obtain. [Emphasis added]

The Turkish SPO sought a meeting with Department of Defense representatives to discuss the matter further. A meeting was held but the Air Force's position did not change. The Air Force position was classic "Catch-22." It had consistently demanded written direction from the GOT to authorize AOI, but it did not seek such direction, nor did it allow appellant to obtain it or the GOT to provide it.

92. By letter to Turkey dated 22 December 1994, SAF/IA advised, without explanation that "production of parts at AOI must not be part of the FMS case" (AR4, tab 229). Turkey's and appellant's effort to proceed with AOI co-production was dealt its final blow.

93. The Government has not shown any statutory, regulatory or contractual provision, or any FMS rule or executive order or policy that justified the Air Force's failure to recognize its customer's direction to use AOI under the LOA. Appellant's expert (ex. A-8 at 6-7) and the Air Force's expert (ex. G-25 at 120) testified, and we find that the use of AOI under the FMS program was not inconsistent with any executive policies or orders regarding offsets. If anything, the Air Force's failure to honor Turkey's direction was inconsistent with the DFARS (finding 89).

XI. Appellant's Claims

94. In September 1994, appellant sent to Air Force a progress payment request that included AOI-related costs in the cumulative amount of $12,904,793. This sum consisted of appellant's co-production support costs in the amount of $9,445,495, and appellant's payment to AOI for work performed under the subcontract in the amount of $3,459,298 (GR4, tab 690 at 10). The Air Force refused to pay these costs, and executed a withholding action recouping the costs previously paid. This sum represents all

AOI-related costs incurred by appellant, with the exception of the cost incurred to settle the cancellation of the AOI subcontract, discussed below.

95. On 18 November 1994, appellant filed a certified claim with the contracting officer seeking recovery of disallowed cost in the amount of $12,904,793, plus statutory interest (AR4, tab 220). At the hearing appellant provided persuasive evidence that its co-production costs were of the type typically incurred on co-production programs (finding 46). The Air Force provided no persuasive countervailing evidence on this issue.

96. In September 1994, AOI claimed $16,364,556 from appellant arising out of appellant's cancellation of its subcontract. The proposal credited previous payments to AOI of $3,459,298. AOI sought an additional $12,905,258. (AR4, tab 232 at 1, 11)

97. In late November 1994 and early March 1995, appellant conducted audit field work on AOI's claim. Appellant questioned a large portion of AOI's claimed costs. A period of negotiation ensued. (AR4, tab 232 at 11; tr. 6/121-23)

98. In June 1995, appellant reached an agreement with AOI as a result of the cancellation of the subcontract. Appellant agreed to pay AOI an additional $5 million. This settlement obviated the need to take the parties' dispute to arbitration in accordance with their contract. (Tr. 6/168)

99. Appellant's settlement with AOI was based, *inter alia*, upon AOI's labor and indirect overhead rates as calculated by appellant's auditors. With respect to the Jigs and Tools department, appellant calculated AOI's FY 95 direct labor rates by dividing direct labor costs incurred up to and after termination by actual production hours incurred up to and after termination. Similarly, it calculated FY 95 indirect overhead rates by dividing total indirect overhead costs incurred up to and after termination by actual production hours incurred up to and after termination. (AR4, tab 232)

100. Since under Egyptian law AOI's labor costs were fixed (production employees, once hired, were required to be retained), and because production hours during FY 95 declined after termination, the claimed FY 95 rates were hugely disproportionate to those before termination. For FY 95, the average direct labor rate for the Jigs and Tools department for the month before termination was calculated at $3.51 per hour, and the average direct labor rate thereafter was calculated at $33.62 per hour, with a claimed weighted average direct labor rate for the fiscal year of $10.17 per hour, as compared to roughly $4.00 per hour for FY 94. Similarly, the average indirect overhead rate before termination was calculated at $5.01 per hour, and the average indirect overhead rate thereafter was calculated at $160.09 per hour, with a claimed weighted average indirect overhead rate for the fiscal year of $39.29 per hour, as compared to roughly $23.00 per hour for FY 94. (AR4, tab 232 at 38, 39; GR4, tab 771 at 8-12) The record does not show that AOI incurred labor cost based upon these weighted FY 95

rates. We find these weighted FY 95 rates to be excessive and unreasonable. We are also not satisfied that these rates reflect a reasonable measure of damages attributable to the Egyptian labor law, or otherwise.

101. For purposes of the AOI subcontract, AOI and appellant had negotiated direct labor and indirect overhead rates for FY 95 in the amounts of $4.70 and $26.25 respectively (AR4, tab 232 at 24). AOI and appellant used prior actual rates as a basis for this negotiation (tr. 6/155). We view these negotiated rates as reasonable. We find that these rates should have been used to calculate reasonable cancellation damages, and that AOI's recalculated direct labor and indirect overhead costs, plus related G &A and profit, must be reduced to reflect these reasonable rates as per the DCAA audit report dated 1 May 1998 (GR4, tab 771 at 6, columns 4, 5). Based upon the DCAA audit report, we find that no further reductions are required. (GR4, tab 771 at 6-12).

102. On 5 March 1996, appellant filed a second certified claim with the contracting officer, seeking claimed allowable costs of $4,596,454 out of the $5 million settlement, plus statutory interest (AR4, tab 236).

103. In 1994, the ACO audited and verified appellant's AOI-related costs to appellant's books and records as incurred under this contract through 26 June 1994 (ex. A-15 at 148). In 1997, DCAA reviewed appellant's AOI-related work orders. While DCAA did not formally audit appellant's costs, it verified AOI-related costs to appellant's books of account, in the amount of $17,113,911 (GR4, tab 770A). Thereafter, appellant reduced this sum to account for unallowable costs, and seeks recovery in these appeals in the amount of $17,091,316 (GR4, tab 770B). Of this amount, we find that $12,904,793 was incurred prior to cancellation of the AOI subcontract (finding 94), and that the balance of the costs claimed is attributable to the AOI settlement.

104. The Air Force did not adduce any evidence disputing that appellant incurred costs in the amount of $17,091,316 or that they were allocable to this contract. We find that appellant incurred these claimed costs and that they were allocable to this contract.

105. The contracting officer denied both claims, and these appeals followed. ASBCA No. 49530 involves appellant's claim for $12,904,793. ASBCA No. 50057 involves appellant's claim to recover its cancellation damages.

DECISION

Credibility of Witnesses

We have made the above findings after due consideration of the credibility of witnesses. The key witnesses for the Air Force were the second program manager for the AFSPO and the procuring contracting officer. On a number of occasions at trial these

witnesses were shown Government project records that they authored or with which they were familiar, and which on their face were inconsistent with the Air Force's litigation position. For the most part, they refused to acknowledge the clear import of these writings and characterized them as not reflecting their true intent and as "mistakes" (tr. 8/215-16, 9/123, 143, 177, 242, 245, 10/170, 246).

The Board did not find this testimony persuasive. We do not believe that the Air Force repeatedly made mistakes in the administration of appellant's contract and in the administration of the LOA, and certainly none that are subject to remediation. Even if we were to accept that these persons exercised poor business judgment in their dealings with appellant and the GOT, this fails to help the Air Force's cause. A contractor has the contractual right to rely on the representations of authorized Government employees through the contract instruments they sign and the authorized written directions they provide. If such employees in hindsight rue these business decisions, then it is the Government, not the contractor, who must assume this risk.

Appellant Was Contractually Authorized to Incur AOI Costs

There is no question that appellant and the Air Force entered into bilateral contract modifications which authorized appellant to proceed with co-production support. AOI co-production was part of this co-production effort, and the Air Force – and the GOT – were fully aware of this fact (findings 29, 32, 36-40, 42). This authority was recognized in writing by the PCO as late as May 1994 (finding 71).

Moreover on 13 October 1993, the contracting officer expressly gave appellant written notice to proceed and to continue with contract performance, which heretofore had included AOI coproduction support as the Air Force and the GOT well knew. In reasonable reliance on the contracting officer's direction, appellant prepared a subcontract with AOI and submitted it to the ACO for approval. The ACO approved the contract and AOI began co-production. (Findings 64, 65)

Notwithstanding these clear contract directions, the Air Force argues that appellant was not authorized to incur AOI-related costs without written direction from the GOT. This is not true. The authorization to contract and to subcontract comes from the Air Force, the contract party in privity with appellant, not from the Government's foreign customer. The USG generally has the right to authorize the use of contractors without the involvement of the foreign customer (finding 5). Indeed, the regulations provide that the foreign customer generally should not interfere with the placement of subcontracts. DFARS 225.7304(b)(2).

In any event, it cannot be seriously disputed that the GOT was fully aware of AOI co-production under Peace Onyx II. The Air Force, too, was well aware of AOI co-production, and acted upon that knowledge through the implementation of its

acquisition strategy (findings 36-38). Even if we were to accept the Air Force position for sake of argument, the GOT gave written direction to the Air Force relating to the authorization of AOI costs on at least three separate occasions: (1) its approval of ACSN 4996 in November 1992 which specifically included AOI co-production; (2) its letter to the Air Force on or about 30 September 1993 which the AFSPO inexcusably lost or misplaced; and (3) its letter to the Air Force dated 24 October 1994 which the AFSPO unjustifiably rebuffed (findings 39, 61, 88, 90).

Moreover, AOI was identified in the LOA by the Air Force and the GOT (finding 35). There is no question that AOI's identification in the LOA reflected the understanding and expectation of all the relevant parties – the Air Force, the GOT and appellant – that AOI was to perform co-production work under Peace Onyx II at the request of Turkey. Based upon briefing data provided by appellant in early 1993 (finding 42), there is no question that the Air Force and Turkey were, or should have been fully aware that this co-production effort would entail considerable training, tooling and overall co-production support.

Absent any contract provision or FMS regulation to the contrary, we conclude that appellant's authority to incur cost at and for AOI was derived from the long lead contract modifications issued by the Air Force, the PCO's written notice to proceed with contract performance and the ACO's written approval of the AOI subcontract. We conclude that appellant was properly authorized under its contract to incur co-production costs for AOI and to enter into a subcontract with AOI.

Whether Appellant Breached its CAPs or Mislead Turkey

The Air Force contends that appellant's AOI costs should be disallowed because appellant failed to follow its co-production allocation plan or CAP, insofar as appellant selected AOI to perform in excess of the "fully competitive price" or FCP.[3] This contention is without merit for a number of reasons.

First, appellant did not "select" AOI in any real sense. The counter-trade agreement, promoted by the USG, dictated the use of AOI for that portion of the work to be performed in Egypt (finding 25), and AOI was the only viable location for this work. Second, the Air Force has not persuaded us that appellant breached any contract obligation, through a CAP or otherwise, to price AOI's subcontract at a fully competitive price. Appellant issued a number of CAPs throughout the contract term, and these updates revised AOI's competitive status from fully competitive to without competitive price limitations. If anyone breached the contract it was the Air Force, when it determined in July 1994 that AOI was subject to fully competitive pricing, notwithstanding the contract had been modified to provide that AOI had no competitive price limitations (findings 77, 80).

The Air Force also contends that in early 1991 appellant misled GOT into believing that the GOT/GOE quid-pro-quo was a net wash and that neither country would "lose" as a result (finding 20). We do not agree that appellant misled Turkey. At this early point in the program, the GOT was planning to do certain new co-production work activities in country at TAI, and planned to effect the counter-trade deal by diverting some of that new work to AOI. This work would have cost roughly the same at either TAI or AOI, and hence appellant's representation to the GOT that it would not "lose" by diverting the work was accurate. It was only later, when GOT decided to forego this new work and return it to appellant's home base in Fort Worth that the co-production premium issue arose.

The Air Force also contends that appellant concealed the true cost of co-production; concealed the true condition of AOI's facilities, and mislead the Air Force as to the nature of the GOE/GOT agreement. The Air Force's contentions are unsupported by the weight of the evidence. Rather, the evidence shows that the level of cost detail provided by appellant to GOT was consistent with AFSPO policy (finding 62); that by October 1993, appellant provided the Air Force with detailed cost data sufficient to understand the magnitude of the co-production premium (*id.*); that appellant's site survey of AOI, including the all-important attachments, did not materially mislead the Air Force as to the support necessary to assure successful production at AOI (finding 69); and that appellant's inability to "prove" the counter-trade agreement and the USG's role therein, was not attributable to concealment but to the unavailability of the documentation to appellant (finding 75).

We are not persuaded that appellant materially mislead Turkey and/or withheld information to which it was entitled under FMS procedures. The Air Force has not shown any breach of contract or unfair dealing by appellant which would preclude the recovery of its authorized co-production costs.

The Contractual Relationship Between the GOE and the GOT

The Air Force would have us review the minutes of meetings between authorized representatives of Egypt and Turkey, as well as Turkish procurement law, to determine whether their counter-trade agreement was a binding international agreement or treaty under Turkish law. We decline the invitation. We do not have jurisdiction over these sovereign nations and their agreement under the CDA. In any event, whether their agreement was enforceable under Turkish or international law is irrelevant. For purposes of these appeals, we need only decide – and we have found – that the GOE was of the view that an agreement had been reached (finding 23); the GOT was of the view that an agreement had been reached (finding 33); the USG was of the view that an agreement had been reached (findings 21, 37); and appellant was of the view that an agreement had been reached and proceeded to implement it (finding 41).

Whether the Counter-Trade Deal Made Economic Sense

The Air Force contends that appellant's claimed costs should be disallowed because it did not make economic sense for Turkey to pay a large co-production premium under a counter-trade agreement. We are not persuaded by this argument. These appeals must rise or fall on well established contract principles, not on second-guessing a foreign sovereign nation. We cannot pretend to fully understand why nations do what they do. Policies with possible short-term negative impacts may reap political and economic gains in the long run. Indeed, it appears that Turkey was of this view here, since in late 1994 the GOT decided to remain faithful to its counter-trade agreement with the nation of Egypt, and directed the Air Force to cut an LOA amendment for AOI co-production with the understanding that the GOT was to pay up to $24.1 million in support costs that it would not have incurred if the work had been done in Fort Worth, Texas.

The Air Force's position also is belied by the facts. By letter to the GOT dated 1 October 1993, the AFSPO, with full knowledge of an estimated $50 million co-production premium, *unequivocally recommended* to the GOT, as its agent, that it proceed with AOI co-production as being in its best interests (finding 63). The Air Force has failed to persuade us why co-production costs viewed as presumably reasonable then are unreasonable today.

The Air Force also seeks to bolster its position by arguing that "never in the history" of the FMS program had a foreign customer incurred co-production premiums for co-production in a third country. Assuming, *arguendo*, that the Air Force is correct, this does little to strengthen its case. The Air Force fails to account for the unique facts at work here – specifically, the period of political and military turmoil which formed the backdrop of this case – in which the United States encouraged two allies to cooperate to help support U.S. foreign policy objectives in the Gulf region. That such a scenario had not occurred before – and may not occur again – is not a legally sufficient basis to disallow costs otherwise authorized, reasonable and allowable under appellant's contract.

Appellant's AOI-related Costs Were Reasonable

The Air Force contends that appellant's AOI-related costs were unreasonable under FAR 31.201-3, which provides as follows:

> (a) A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. Reasonableness of specific costs must be examined with particular care in connection with firms or their separate divisions that may not be subject to effective competitive restraints. No presumption of reasonableness shall be attached

> to the incurrence of costs by a contractor. If an initial review of the facts results in a challenge of a specific cost by the contracting officer or the contracting officer's representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable.
>
> (b) *What is reasonable depends upon a variety of considerations and circumstances*, including –
>
> (1) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance;
>
> (2) Generally accepted sound business practices, arm's-length bargaining, and Federal and State laws and regulations;
>
> (3) The contractor's responsibilities to the Government, other customers, the owners of the business, employees, and the public at large; and
>
> (4) Any significant deviations from the contractor's established practices. [Emphasis added]

The above regulatory definition makes clear that whether a cost is reasonable depends on the circumstances of each case. As stated in RISHE, GOVERNMENT CONTRACT COSTS (Fed. Pub. 1984) at 10-7:

> It is recognized that the amount of an expense will vary as circumstances change. Unusually high costs may be necessary where urgency is present or where no alternative sources are available. Indeed, there are innumerable events and conditions which could justify the expenditure of greater amounts. Accordingly, any examination of the reasonableness of the amount of a cost must examine the particular circumstances that prevailed. Absent that examination, there is little basis for questioning the reasonableness of amounts that were expended.

See also DFARS 225.7303 which states as follows:

> Price foreign military sale contracts using the same principles as are used in pricing other defense contracts. Application of the pricing principles in FAR parts 15 and 31 to a foreign

> military sale contract, however, may result in prices that differ from other defense contract prices for the same item due to the considerations in this section.

Based upon our review of the unique circumstances of this case and all the evidence of record, we conclude that appellant has shown that it reasonably incurred the costs in question. In reaching this conclusion we have given due consideration to the following facts: that at the behest of the USG and two sovereign nations, appellant was prevailed upon to implement a counter-trade military agreement between the Governments of Egypt and Turkey; that the agreement contemplated F-16 co-production work for Turkey in Egypt; that AOI was the only viable location for co-production in Egypt; that significant training and tooling support were necessary to insure successful performance at AOI; that appellant included these projected costs for this co-production as part of the LOA data requested by the Air Force; that appellant briefed the GOT as to the nature and magnitude of these costs; that appellant spelled out the general need for this co-production support in its AOI site survey which was provided to the Air Force; that appellant acted in accordance with AFSPO disclosure policies and did not materially mislead the Air Force or the GOT as to the nature or amount of co-production; that the Air Force, with full knowledge of the magnitude of the projected co-production costs, recommended to the GOT in writing that it continue with AOI co-production, and presumably would not have done so if the costs were unwarranted or unreasonable; that the costs actually incurred did not exceed appellant's estimates; that the costs incurred were of the type typically incurred on all co-production programs; that the costs were necessarily incurred to facilitate AOI performance so as to meet the F-16 delivery schedule in the LOA; and that the PCO's determination that these costs were unreasonable failed to consider the counter-trade agreement and the practical restraints placed on appellant's co-production options.

The Air Force's Breach and Appellant's Damages

We have found that appellant was contractually authorized by the contracting officer to incur costs for and at AOI and was authorized by the contracting officer to enter into the AOI subcontract. Notwithstanding this authority we have found that the Air Force sought, and ultimately succeeded to frustrate performance under the AOI subcontract. The Air Force's actions were wrongful as a matter of contract and wrongful under the regulations (finding 93), and constituted a breach of the Air Force's implied duty not to unreasonably interfere with appellant's performance under its contract. The consequence of the Government's wrongful action and its refusal to recognize the costs under the authorized AOI subcontract was appellant's cancellation of the AOI subcontract, which we believe was reasonably foreseeable to the Air Force. Appellant is entitled to recover damages, reasonable in nature and amount, stemming from the

cancellation of that contract. *See generally*, RESTATEMENT SECOND OF CONTRACTS, § 351, cmt. c (1981).

Appellant's settlement with AOI was based upon its audit evaluation of AOI's claim for the cancellation of the subcontract. Said evaluation used labor and indirect overhead rates that were excessive and unreasonable (finding 100). Hence, we believe that appellant's settlement damages which relied upon the legitimacy of these figures were also excessive. Appellant's costs (finding 103) must be adjusted to reflect adjustments in direct labor, indirect overhead, G&A and profit attributable to these excessive rates in accordance with the rates we have found to be reasonable (finding 101).

CONCLUSION

Appellant incurred allocable co-production costs in the amount of $12,904,793 under this contract pursuant to the Air Force's contract authorization. These costs were reasonably incurred under the circumstances of this case and are allowable in full. Appellant is also entitled to recover its damages caused by the Air Force's breach of contract, reasonably calculated in accordance with this opinion, and we remand the calculation of the final damage figure to the parties. In addition, appellant is entitled to recover interest under the CDA from the date each certified claim was received by the contracting officer.

ASBCA No. 49530 is sustained. ASBCA No. 50057 is sustained in part.

Dated: 22 March 2000

JACK DELMAN
Administrative Judge
Armed Services Board
of Contract Appeals

I concur

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

I concur

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

NOTES

1 Appellant is the successor-in-interest to General Dynamics Corporation, the contractor that entered into this contract with the Air Force.

2 We cite to the record as follows; GR4 – Government's Rule 4 supplement (the original Rule 4 file was withdrawn); AR4 – appellant's Rule 4 supplement; Government trial exhibits are "ex. G-__"; appellant's trial exhibits are "ex. A-__." The trial transcript is cited by volume and page.

3 The parties disagree over the particular costs that make up the FCP. Given our disposition of these appeals, we need not decide the issue.

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. 49530 and 50057, Appeals of Lockheed Martin Tactical Aircraft Systems, rendered in conformance with the Board's Charter.

Dated:

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