

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeals of --)
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ITT Avionics Division) ASBCA Nos. 50403, 50961, 52468
)
Under Contract No. N00019-89-C-0160)

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OPINION BY ADMINISTRATIVE JUDGE HARTY

These appeals concern a contract to produce and provide continuing reliability assurance and service of Airborne Self-Protection Jammer units. The contract was terminated for the convenience of the Government. Following termination, the Government made a claim, under the Progress Payments clause, for approximately \$2.7 million for materials purchased by ITT, but not included in ITT's termination inventory schedules. Both parties claim ownership of this material and ITT has appealed (ASBCA No. 50403). In a final decision the Government denied in part ITT's termination settlement claim for \$11,444,943; ITT appealed (ASBCA No. 50961). In a second final decision the Government denied ITT's claim in its entirety and asserted a \$6,258,179 overpayment claim, which was also appealed (ASBCA No. 52468).

Only entitlement is before us. We sustain the appeal in ASBCA No. 50403. We sustain the appeals in ASBCA Nos. 50961 and 52468 to the extent indicated and remand the matter to the parties to negotiate quantum.

FINDINGS OF FACT

The Contract

On 6 October 1989, the Naval Air Systems Command (NAVAIR) awarded Contract No. N00019-89-C-0160 to ITT Avionics Division (ITT), for Lot 1 production of an Airborne Self-Protection Jammer (ASPJ) (AR4, tab 30). A similar contract was issued to Westinghouse Electric Corporation (Westinghouse) which had worked together with ITT and the Government to develop the ASPJ. ITT's contract contained three separate work elements. The first was to produce 50 ASPJ units and selected spares on a fixed-price incentive basis totaling \$170,318,418. The second element was to provide additional spares on a firm fixed-price (FFP) basis of \$28,729,200. The third element required ITT to perform warranty work under a Reliability Assurance Program (RAP) for the firm fixed-price of \$26,443,318. (AR4, tab 21 at G006934)

The contract also contained the following Federal Acquisition Regulation (FAR) clauses: FAR 52.216-16 INCENTIVE PRICE REVISION - FIRM TARGET (APR 1984); FAR 52.215-33 ORDER OF PRECEDENCE (JAN 1986); FAR 52.243-1 CHANGES - FIXED PRICE (AUG 1987); FAR 52.232-16 PROGRESS PAYMENTS (AUG 1987); and, FAR 52.249-2 TERMINATION FOR CONVENIENCE OF THE GOVERNMENT (FIXED PRICE) (APR 1984). (AR4, tab 30 at 7-12 through 7-16, 8-7, 8-21, 8-24, 8-29)

The RAP required ITT to repair ASPJ units that failed in the course of operational usage. The failure rate and resulting need for repairs could be reduced during the RAP performance period by building reliability into the ASPJ systems during initial production. The contract also allowed for reliability enhancement during the RAP period by permitting engineering changes to the unit, as long as the changes did not impact the higher level module in the system. ITT incorporated several engineering change proposals (ECPs) into the units to improve reliability. In order to perform any necessary repairs in a timely fashion, it was necessary for ITT to purchase and stock materials in advance, known as "lay-in material." Both the type and quantity of lay-in material was left to the discretion of ITT. ITT also planned and implemented an asset tracking and warranty conformance process. (AR4, tab 30 at attach. 3; tr. 2/188-97)¹

Two miscellaneous contract provisions, pertinent to the RAP, provided:

J. MISCELLANEOUS

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7. To meet Reliability Assurance Program obligations the Contractor is granted an exception to the Federal

Acquisition Regulation 52.210-5 “New Material” Clause as specified in Special Contract Requirement H-21.

8. The Government will have no right to, or property interest in any residual material procured by the Contractor as part of the repair material lay-in.

(AR4, tab 30 at 299-300)

The RAP began for each unit either upon installation and deployment in aircraft or 90 days after delivery of the system, whichever occurred first. The RAP repair period ended 15 months after delivery of the last ASPJ system or after the accumulation of 24,000 system flight hours on Lot 1 units, whichever occurred first. (AR4, tab 30 at attach. 3; tr. 2/188-97, 285-86)

Termination of the Contract

Before the ASPJ units could be installed and used in Government aircraft, the systems had to pass an independent operational test and evaluation (OPEVAL). The Navy announced that the ASPJ had failed the operational test and evaluation in August 1992 (AR4, tab 139 at E-3; ex. A-4). The ASPJ failed the operational test and evaluation for reasons unrelated to this appeal, which prevented the system from being immediately installed upon delivery (tr. 1/145-46; ex. A-4). While ITT was aware that the ASPJ units would be subjected to an OPEVAL, there is no evidence that the OPEVAL testing requirements or standards were part of the Lot I contract specifications (tr. 2/287, 3/73-74, 115).

Section 122 of the National Defense Authorization Act for Fiscal Year 1993, effective 23 October 1992, provided that “[n]one of the funds available to the Department of Defense for fiscal year 1993 or any fiscal year before fiscal year 1993 may be used for the procurement of the Airborne Self Protection Jammer system except for the payment of the costs of terminating existing contracts for the procurement of the Airborne Self Protection Jammer system.” This limitation of funding was to take effect upon the Secretary of Defense’s submittal to Congress of notice that the ASPJ was not operationally effective or not operationally suitable in operational tests. National Defense Authorization Act for Fiscal Year 1993, Pub. L. No. 102-484, § 122, 23 October 1992, 1992 U.S.C.C.A.N. (106 Stat. 2315, 2334). The then Under Secretary of Defense for Acquisition, Mr. Donald Yockey, gave a certified notice on 11 December 1992 that the ASPJ was not operationally effective. The same day Mr. Yockey also directed the Secretary of the Navy to comply with section 122. (AR4, tab 112) On 15 December 1992, the Government terminated the subject ASPJ contract, giving no other reason than for the convenience of the Government (AR4, tab 114).

At the time of the termination, all fixed-price incentive ASPJ units and spares had been delivered, and almost all of the firm fixed-price spare units. Essentially, the only portion of the contract which remained to be completed was the RAP. At the time of the contract termination, the initial phase of the RAP—involving the set-up of a logistics tracking system, ordering the lay-in material, and performing certain engineering change proposals—was essentially complete. (Tr. 1/36-37, 2/196-99, 201, 233-35, 241)

ITT's Settlement Proposals

ITT submitted a termination settlement proposal, dated 29 March 1994 (the first settlement proposal), in accordance with the contract's Termination for Convenience clause (AR4, tab 145). ITT's settlement proposal analyzed the information it had available at the time of the termination to develop a cost estimate to complete (ETC) for the remainder of the contract. ITT added its costs-to-date to the ETC to arrive at an estimated total cost for the contract. It then subtracted this sum from the fixed price to arrive at an estimated profit. ITT used the estimated profit to calculate the rate of profit it would have achieved if the contract had been fulfilled as planned. ITT then applied this rate of profit to the cost of the work that had been completed. (AR4, tab 154; tr. 1/36-37, 2/295-97) In its settlement proposal, ITT liquidated payments made by the Government to ITT under the Progress Payments clause, as indicated on line 18 of Standard Form 1436, SETTLEMENT PROPOSAL (AR4, tabs 145, 195 at G003454).

ITT's ETC on the RAP portion of the contract was developed by predicting the number of failures that could be expected in the ASPJ system installed on F/A-18 aircraft during the RAP repair period. The failure rate was predicted by assuming the number of ASPJ systems installed on F/A-18 aircraft from a Navy-provided asset utilization schedule, extrapolating the predicted reliability for the ASPJ systems on F/A-18 aircraft from information already existing on ASPJ systems flown on F-14 aircraft, and evaluating the predicted reliability of individual component parts of the ASPJ. ITT predicted that there would have been 147 failures during the RAP and estimated a cost of \$5,242,096 to make the repairs and complete the contract. (AR4, tabs 77, 116, 121-26, 145; tr. 2/242-48)

ITT did not include the RAP lay-in material in its 29 March 1994 termination settlement proposal termination inventories on the basis that upon termination the material became the property of ITT under clause J.8 (tr. 2/354).

After considerable negotiations concerning the ownership of the RAP lay-in material, the Government issued a final decision dated 30 September 1996. The final decision was signed by a termination contracting officer, Mr. Adolf Muenker. The Government asserted title to the RAP inventory of lay-in material, valued at approximately \$2,700,000, citing both the Termination for Convenience clause and the Progress Payments clause (AR4, tab 185). ITT filed a timely appeal (ASBCA No. 50403) from the decision.

After the Government issued its 30 September 1996 claim for the RAP lay-in material, a new termination contracting officer, Ms. Irene Kowalski, assumed the responsibility for the termination settlement process (tr. 4/5-6).

At the request of Defense Contract Management Area Operations, Springfield, Massachusetts, the Defense Contract Audit Agency (DCAA) issued a report, dated 28 October 1994, concerning ITT's first settlement proposal. The report stated that the contractor submitted adequate cost or pricing data, but that a technical evaluation of the overall proposed ASPJ settlement hours by the Defense Contract Management Command, now Agency (DCMA), would be required before a conclusive statement could be made by the audit agency. (AR4, tab 150) There is no evidence that the DCMA ever developed its own ETC for the RAP.

The dispute over the RAP lay-in material prompted ITT to submit an "updated final proposal" (the second settlement proposal), dated 22 January 1997 (AR4, tab 195). As directed by the Government, the new proposal changed the profit calculation methodology by separating the fixed-price incentive contract line item from the firm fixed-price contract line items and calculating the two profit rates differently (tr. 1/39-40).

The update also changed the estimated number of repairs that ITT would have made under the RAP from 147 to 34, thus substantially reducing the cost of completing the RAP from \$5,242,096 to \$1,364,985, with a corresponding increase in the profit rate (AR4, tabs 145, 195). ITT's second settlement proposal calculated its cost estimate on the assumption that because of the failed OPEVAL, there was no deployment of the ASPJ, and there was no termination (AR4, tab 172 at ITT 00025). ITT's reduced estimate of 34 repairs during the RAP period came from information gathered from 5 ASPJ units that were in use after termination.² (AR4, tab 172 at ITT 00025, 00027, tab 110 at 4) The ASPJ units that were used following the termination were installed prior to termination on a test basis. Prior to the termination, NAVAIR installed two ASPJ units on F-14D aircraft for testing. Another two units were tested in laboratories at Point Mugu, California. NAVAIR tested one unit, at the Navy's China Lake facility, on an F/A-18C test bed. The repair records that were used to extrapolate the 34 repairs do not establish the exact dates of the reported equipment failures. (AR4, tab 155; tr. 2/270-71)

By letter dated 15 April 1997, ITT submitted its final settlement proposal (the third settlement proposal) which incorporated "the cost impact of the Government taking title to the RAP inventory" ITT valued this cost impact at \$3,009,332, which included \$2,616,810 for the cost of the acquired material plus a 15% profit of \$392,522. As directed by the Government in its claim of 30 September 1996, this proposal included termination inventory schedules which listed the RAP lay-in materials. (AR4, tab 209)

By letter of 29 April 1997, the Government rejected this final settlement proposal as it "incorporat[ed] a cost impact for RAP inventory" to which the Government had

asserted title in the contracting officer's final decision of 30 September 1996, including ITT's right to appeal the decision with this Board (AR4, tab 213).

By letters of 30 May and 25 June 1997, ITT submitted its certified claim in the amount of \$51,211,212, less payments made, for a net payment request of \$11,444,943 (AR4, tabs 221, 223). By letter dated 1 August 1997, the termination contracting officer, Ms. Kowalski, issued her final decision. In making her decision she considered not only ITT's certified claim, she also considered information contained in the three prior settlement proposals. The final decision denied the claim and reduced the net amount due ITT from its claimed amount of \$11,444,943 to \$1,447,058. (AR4, tab 234) Ms. Kowalski explained that in an attempt to avoid litigation she issued a final decision which compromised the difference between ITT's two different estimates to complete (tr. 3/241). When asked if the Government "performed an independent technical analysis of what the ETC should be," Ms Kowalski stated that she was "not aware of an independent review" (tr. 4/27-28).

ITT subsequently filed a timely appeal (ASBCA No. 50961) from the termination contracting officer's 1 August 1997 final decision.

While the appeals in ASBCA Nos. 50403 and 50961 were pending, a third termination contracting officer, Mr. Wade Harmon, assumed authority for the settlement. Mr. Harmon modified Ms. Kowalski's final decision on the basis that it was "erroneous and excessive" and issued a new final decision on 5 November 1999. The final decision of 5 November stated that ITT had been overpaid profit and made a Government demand for payment of \$6,258,179. Mr. Harmon did not rely on the contractor's ETCs, as calculated in the second and third proposal, because he had no confidence in either and he did not develop one of his own (tr. 4/97-99). Instead, he applied FAR 49.202(b)(8) to establish a profit based on "[t]he rate of profit both parties contemplated at the time the contract was negotiated." (AR4, tab 240; tr. 4/51-52) On this basis, the Government agreed at the hearing that it would "defend on a single profit rate of 15 percent" (tr. 1/8).³ ITT filed a timely appeal (ASBCA No. 52468) on 22 November 1999.

ASBCA No. 50403--OWNERSHIP OF THE RAP LAY-IN MATERIAL

Supplemental Findings of Fact

Prior to contract award, the Government prepared a business clearance memorandum. In analyzing the proposals submitted by the contractors for the RAP portion of the contact, the Government stated that "the Rap is innovative and very risky to the Contractors" Further, "[t]he complexity and uncertainty of the program made it extremely difficult to calculate an accurate and reliable Government estimate." The difficulty in predicting the cost of the RAP was further illustrated by the wide disparity in the Government's estimates, which varied from \$12 million to \$55 million. (AR4, tab 21 at G006943)

Mr. Richard Findley, the director of the product integrity division for NAVAIR, testified that the RAP was more than a warranty or repair contract, it was designed to motivate the contractor to achieve “29 mean flat hours” between failures or make engineering changes to achieve that goal. The contractor did not receive additional compensation for these changes, which were not mandatory, but could make a business decision to implement the change and reduce the amount of repairs and the associated cost. (Tr. 3/43-45) By the time of termination, ITT had made several engineering change proposals that had been implemented long in advance of the systems being delivered (tr. 2/186).

There was credible testimony that during negotiations leading up to the RAP portion of the contract, both ITT and Westinghouse expressed the desire that the Government purchase and supply the lay-in materials (tr. 2/322-23). However, the Government wanted no responsibility for the RAP lay-in material. The Government wanted to be able to disclaim liability in the event the material was not available to meet the specified turnaround times and encouraged the contractors to lay-in RAP material to protect the turnaround times. (Tr. 2/178, 3/34-35, 46-48) Mr. Findley and Mr. Thomas Mason, the procurement contracting officer during negotiations, both of whom assisted in drafting the RAP provisions, testified that the Government’s main concern with the RAP was that the contractor meet the turnaround times for repairs and keep the ASPJ units operational, not the types and quantity of material purchased (tr. 3/46-47, 72).

Mr. Mason stated that the RAP contained incentives so that the contractor would meet the reliability requirements of the ASPJ specification and ensure that the Government had fixed costs for repairs during the RAP period (tr. 3/70-71). Mr. Findley testified that one of the purposes of giving the contractor title to the RAP material at the end of contract performance was that it was an incentive for the contractors to make their own decisions to be able to meet the 45-day turnaround time for the repairs (tr. 3/47-48). The RAP portion of the contract contained a formula by which the warranty period would be extended, without additional compensation to the contractor, if ITT failed to meet repair turnaround times. Likewise, if the ASPJ systems provided under the contract proved to be unreliable during the RAP period, ITT had to provide the Government with settlement spares, the number of which was also determined by a formula based on reliability factors. (AR4, tab 30, attach. 3 at 5-14) When Mr. Findley was asked if there was a specific understanding that clause J-8 did not apply in the event of a termination, he stated that he “had no understanding one way or the other with respect to the termination for convenience” (tr. 3/42-43).

Mr. Harvey Bloom, the ITT vice-president responsible for the contract, testified that clause J-8 was added during negotiations and was founded on the assumption that the RAP portion of the contract would be fulfilled and the residual lay-in materials were materials left over at the end of the contract. He testified that in order to get the contractors to assume the risk of the lay-in material, as opposed to the Government providing it, clause J-8 was added to

provide the contractor with a property interest in the lay-in material in the event that more materials were purchased than were actually necessary to perform the contract. It was considered prudent to err on the side of caution and lay-in excess quantities of materials in order for ITT to meet the Government's need for quick turnaround times for the ASPJ units. Since this was a firm fixed-price contract, ITT tied up valuable assets by laying in excess materials, but did so with the understanding that ITT would have ownership of the material and could resell any that was not necessary to complete the contract. He acknowledged that the issue of who had ownership of the residual lay-in material in the event of a termination for convenience was not discussed during contract negotiations. (Tr. 2/274, 322-23, 336)

Mr. Muenker testified that he issued his final decision, demanding that ITT account for the lay-in material, because clause J-8 only gave ITT title to "residual" RAP lay-in material. Mr. Muenker explained that he looked to Webster's Dictionary for a definition of "residual" as something that is left at the end of a process, which he equated with completion of the contract. Based on the definition, he reasoned that the material that remained at the termination was not "residual" since the contract was never completed. He also cited the Progress Payments clause in support of his position. (AR4, tab 185; tr. 3/193-97)

DISCUSSION

The Government argues that the Progress Payments clause gives title of the RAP lay-in material to the Government. Moreover, the Termination for Convenience clause, which determines the disposition of material in the event of a termination, takes precedence over contract clause J-8, which only applies upon contract completion. The Government also argues that the term "residual" in clause J-8 refers only to materials left at the end of the completed contract. Therefore, because the contract was terminated prior to completion, the material that remained at the termination was not "residual."

ITT argues that the Government intended the "RAP to be a contractor-provided full service warranty for the ASPJ systems." In order to incentivize ITT to meet repair deadlines, the contract directed that a failure to meet turnaround deadlines would result in an extension of the RAP performance period without an increase in the contract price. Further, if individual systems did not prove to be reliable, ITT would also be required to provide the Government with settlement spares, also without a price increase. ITT could reduce the chance of financial penalties by increasing the ASPJ systems' reliability, laying in substantial quantities of repair materials to meet any demand, or both. In exchange, the Navy had to assure that ITT would own any material it did not use for repairs because "if the Navy could claim ownership of any unused material, there was far less incentive for ITT[AV] to convert part of its firm fixed price into material." The result of this negotiation was clause J-8 which stated that "[t]he Government will have no right to, or property interest in any residual material procured by the Contractor as part of the repair material lay in." (App. br. at 52)

We agree with ITT's position. The testimony was clear that the Government did not want to bear any of the responsibility for servicing the ASPJ units. However, the Government did want operational units without extended delays. As a result of the Government's needs, the parties developed the RAP. For a firm fixed-price, the Government was gaining a greater assurance that it would have operationally ready ASPJ units available without extended turnaround times and without any of the responsibility or liability for delays in repairing the units. The trade-off for ITT was that it assumed all responsibility for repairing the units in a timely fashion. In order to do that, ITT had to be free to lay in repair material as it felt necessary to meet any repair demands, even while tying-up funds from the fixed-price contract. In return, the parties agreed to clause J-8.

The Government's argument that the Progress Payments clause directs that the lay-in material become the property of the Government is unpersuasive. It may be, as the Government argues, that the RAP lay-in materials were purchased with funds supplied under the Progress Payments clause. However, the Progress Payments clause does not prohibit the result ITT seeks in reliance on clause J-8. Paragraph (d)(3) of the Progress Payments clause explicitly states that "[a]lthough title to property is in the Government under this clause, other applicable clauses of this contract, e.g., the termination or special tooling clauses, shall determine the handling and disposition of the property." Moreover, the Government holds title as a security interest and under paragraph (d)(6) of the Progress Payments clause once:

. . . the Contractor completes all of the obligations under this contract, including liquidation of all progress payments, title shall vest in the Contractor for all property (or the proceeds thereof) not-- (i) Delivered to, and accepted by, the Government under this contract; or (ii) Incorporated in supplies delivered to, and accepted by, the Government under this contract and to which title is vested in the Government under this clause.

Thus, the Progress Payments clause is no barrier to recovery and, instead, requires a consideration of "other applicable" contract clauses for determining the "handling and disposition of the property." The Prompt Payment clause lists two examples, "e.g. the termination or special tooling clauses." This exemplification is not intended to be exclusive and we conclude that clause J-8 is another example.

Moreover, under our reading of the contract, there is no conflict between clause J-8 and the Termination for Convenience clause. The provisions are complementary and there is no need to turn to the Order of Precedence clause for guidance. FAR 49.000 establishes the policies and procedures relating to contracts terminated for the convenience of the Government. FAR Part 49.001 gives "termination inventory" the same definition as the

definition found in FAR 45.601. FAR Part 45--GOVERNMENT PROPERTY, subpart 45.6-REPORTING, REDISTRIBUTION, AND DISPOSAL OF CONTRACTOR INVENTORY, provides in paragraph 45.601 that termination inventory “does not include . . . material[s] . . . that are subject to a separate contract or to a special contract requirement governing their use or disposition.” Clause J-8 qualifies as a special contract requirement governing the disposition of the RAP lay-in material, which is permissible under the FAR.

The argument that there was no “residual” material because the contract was terminated as opposed to completed as originally planned is also unpersuasive. Clause J-8 is clear and unambiguous: “The Government will have no right to, or property interest in any residual material procured by the Contractor as part of the repair material lay-in.” The Government believes that the clause only applies when the contract has been completed and does not apply in the event of a termination. However, in our view, its argument depends on an out of context reading of the word “residual.” “Residual,” when used as an adjective, may be defined as “of, relating to or constituting a residue: remaining after a part is taken: left as a residuum.” “Residuum,” in turn, may be defined, as the Government suggests, “as something that remains behind (as after charges are met or a process completed).” WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY 1931-32 (1986). “Residual” may refer to something that remains at the end of a process, but nothing in the definition addresses how the process comes to an end. Moreover, “residual” modifies “material,” and thus refers to unused material. “Residual” in context means any lay-in material not used by the contractor in discharging its responsibilities under the RAP. The lay-in material becomes residual when the RAP ends. This is so whether the RAP is concluded by completion of the contract or termination. The purpose for which the provision was added has been served in either event.

DECISION

Because we conclude that ITT is entitled to the residual material by virtue of clause J-8 of the contract, the appeal in ASBCA No. 50403 is sustained.

ASBCA Nos. 50961, 52468--THE TERMINATION METHODOLOGY AND THE BASIS FOR THE PROFIT CALCULATION

Supplemental Findings of Fact

Mr. Harmon testified with respect to his rejection of Ms. Kowalski’s final decision. Mr. Harmon was of the opinion that the ETC used in ITT’s third settlement proposal was not accurate insofar as its handling of the RAP portion of the contract was concerned, and thus could not be used to determine the rate of profit (AR4, tab 240; tr. 4/97). He conceded that the RAP estimate to complete was used only to determine that the terminated portion of the contract was not in a loss condition (tr. 4/106-07; A-17 at 4). Instead of using an ETC to calculate profit, Mr. Harmon established what he considered a fair profit based on “[t]he

rate of profit both parties contemplated at the time the contract was negotiated.” Mr. Harmon determined that rate to have been 15%, which he then applied to both the firm fixed-price spares and RAP. (AR4, tab 240; tr. 4/74) Ms. Shari Durand, the procurement contracting officer who executed the ASPJ Lot I contract, was the source of the 15% profit figure that was used in Mr. Harmon’s decision (tr. 3/88, 4/64). She testified that 15% profit was the amount that ITT had included in its proposal for the Lot 1 production contract (AR4, tab 41 at 66; tr. 3/88, 96-97, 4/64). However, Ms. Durand also acknowledged that a 15% profit rate was stipulated in the Lot 1 solicitation as the profit rate that would be awarded to the low bidder for the fixed-price incentive portion of the contract (tr. 3/101-02).

Mr. Harmon also testified that ITT’s first settlement proposal with its estimate of 45 units installed, flying a total of 15,000 hours during the RAP period, contained reasonable projections that could have been used in an ETC calculation (tr. 4/69, 88). However, he also testified that because the ETC, which was before him in the third settlement proposal, was not credible, he did not attempt to make his own estimate. Mr. Harmon admitted he would have considered an ETC if a valid one had been submitted by ITT. (Tr. 4/84-85)

At the hearing, Mr. Brian Freck, a former Government termination contracting officer, working as a consultant for ITT, testified that when sufficient information is available to calculate an accurate ETC, then it is the most appropriate method for arriving at a fair rate of profit. Only when there is insufficient information to calculate an ETC would another method be advised. He was also of the opinion that using the rate contemplated at award would unfairly reward or penalize the contractor. (Tr. 1/30-36)

ITT’s expert witness, Admiral Albert Gallotta, Jr., (USN) Ret., was of the view that if the contract had not been terminated, the Lot I ASPJ units would not have been able to pass a second OPEVAL before the end of the RAP service period (AR4, tab 120; exs. A-4 to -8; tr. 1/142-168). Mr. Bloom also expressed the opinion that since the Government could not install the ASPJ units within the RAP service period for failure to pass an OPEVAL, had it not been for the termination, ITT’s estimated number of repairs would be very few. He opined that the estimate of 34 repairs used in the updated settlement proposal, was not truly an estimate, but could be considered the actual number of repairs that would have occurred had there been no termination. His view was that there were 5 units in post-termination use, and because of the failed OPEVAL, the remaining 45 production units would remain shelved during the RAP period and there would be no additional repairs necessitated. (Tr. 2/303-09)

DISCUSSION

Our review is *de novo* and we are not bound by either of the contracting officers’ final decisions. *E.g., Kinetic Builders, Inc. v. Peters*, 226 F.3d 1307, 1318 (Fed. Cir. 2000); *Wilner v. United States*, 24 F.3d 1397, 1401 (Fed. Cir. 1994) (*en banc*); *Space Age*

Engineering, Inc., ASBCA No. 26028, 82-1 BCA ¶ 15,766 at 78,032. We are to decide only entitlement and we consider the appropriate rate of profit to be a matter reserved for quantum.

Under the Termination for Convenience clause, FAR 52.249-2(f)(iii), a contractor is entitled to a “fair and reasonable” profit determined under FAR 49.202, unless it appears that “the Contractor would have sustained a loss on the entire contract had it been completed” FAR 49.203 requires the use of an ETC methodology for the purpose of determining whether the contract is in a loss position. There is no dispute that ITT is entitled to profit. Whether or not it is typical, once it is determined that a profit would have been earned, to also determine the rate of profit based on the ETC (*see* DCAA CONTRACT AUDIT MANUAL, ¶ 12-307, January 2002), an ETC methodology was, in fact, the approach initially followed by the parties.

Nevertheless, FAR 49.202 provides that the contracting officer “may use any reasonable method to arrive at a fair profit.” Of the nine factors listed in FAR 49.202(b) “to be considered” by the contracting officer in arriving at a fair profit, we believe the seventh factor, “[t]he rate of profit that the contractor would have earned had the contract been completed,” rests on a reasonable ETC. Mr. Harmon was not opposed to the ETC methodology. Indeed, he acknowledged the reasonableness of the ETC approach reflected in ITT’s first proposal. Instead, he had no confidence in ITT’s second and third proposals and we believe his rejection of the approach reflected in those proposals was reasonable.

The second and third proposals are based on the assumption that the failure to pass OPEVAL would have precluded fielding the ASPJ units within the time period remaining on the RAP. The failure of the ASPJ to pass OPEVAL was the event that prompted the decision to terminate the contract. However, there is no showing that OPEVAL failure was taken into account when the RAP was agreed to by the parties. Moreover, no one has pointed to any contract provision that assigned the risk of successful passage of OPEVAL to either party. In summary, it is inappropriate to factor the failed OPEVAL into the ETC since there is no evidence that the OPEVAL test played a role in the parties’ contract negotiations over the RAP.

On the other hand, the first settlement proposal—which ITT itself advanced—is based on the assumption that the ASPJ would have been deployed. It was developed by predicting the number of failures that could be expected in the ASPJ system installed on F/A-18 aircraft during the RAP repair period. The failure rate was predicted by assuming the number of ASPJ systems installed on F/A-18 aircraft from a Navy-provided asset utilization schedule, extrapolating the predicted reliability based on existing systems flown on F-14 aircraft, and evaluating the predicted reliability. This approach seeks to evaluate what would likely have happened if the RAP had been allowed to function as intended.

The dispute over the ownership of the residual RAP inventory had a material influence on the parties' termination settlement discussions. In our view, this dispute also colored the parties' approach to the use of an ETC to determine the rate of profit, particularly in ITT's second and third proposals, and ultimately led to the Government's rejection of the methodology altogether. Since we have concluded the contracting officer erred in insisting that the Government was entitled to the RAP lay-in material remaining when the contract was terminated, ITT's termination settlement proposal must be revised and its profit calculations reevaluated in light of our decision in ASBCA No. 50403. In the circumstances, we believe a return to the approach reflected in ITT's first proposal and an evaluation of its continued viability is in order as part of the contracting officer's responsibility under FAR 49.202 for either negotiating or determining a fair profit.

Since ITT is entitled to a new profit determination based on a revised termination settlement proposal, we sustain the appeals to the extent indicated and remand the matter to the parties for the negotiation of quantum.⁴

DECISION

The appeals in ASBCA Nos. 50961 and 52468 are sustained to the extent indicated, and the matter is remanded to the parties for the negotiation of quantum.

SUMMARY OF DECISIONS

ASBCA No. 50403 is sustained. ASBCA Nos. 50961 and 52468 are sustained to the extent indicated.

Dated: 7 April 2003

MARTIN J. HARTY
Administrative Judge
Armed Services Board
of Contract Appeals

I concur

I concur

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

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

NOTES

- ¹ The four transcript volumes cited in this decision are referenced 1 through 4 corresponding to each of the four days of hearing.
- ² There are occasional references in the record to 9 ASPJ units in use following termination. From the record, we are unable to confirm the number of ASPJ units that were in use. However, in light of our decision, it is unnecessary for us to make a finding on this point.
- ³ We understand the Government's "stipulation" binds it only to the use of a single rate in the context of a 15 percent profit rate as proposed in the contracting officer's final decision (app. br. at 43; Gov't br. at 89-96; app. reply br. at 28-30; Gov't reply br. at 2, 52-53).
- ⁴ After the hearing the Government filed a Motion to Add Document Attached, which sought the admission of a 15-page document, an application for partial payment, SF 1440. ITT subsequently filed an objection. It is not necessary to rule on the motion since the document addresses a quantum issue. The parties are free to evaluate the document during their quantum negotiations. We reach the same conclusion with respect to the Government's Motion to Strike the testimony of two witnesses concerning certain aspects of the WEC termination settlement on the grounds of relevancy and materiality (Gov't br. at 85 n.2). We have not relied on the testimony in reaching our decisions in these appeals.

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA Nos. 50403, 50961, 52468, Appeals of ITT Avionics Division, rendered in conformance with the Board's Charter.

Dated:

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