ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeals of --	)	
	)	
Lockheed Martin Corporation, Naval Electronics & Surveillance Systems - Surface Systems	)	ASBCA Nos. 53032, 54064
	)	
Under Contract No. N00024-88-C-5175	)	

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OPINION BY ADMINISTRATIVE JUDGE TING

Lockheed Martin Corporation, Naval Electronics & Surveillance Systems – Surface Systems (Lockheed Martin) moves for reconsideration of the Board's decision in *Lockheed Martin Corporation, Naval Electronics & Surveillance Systems – Surface Systems*, 03-2 BCA ¶ 32,408 (Motion Papers No. 1). The government filed a response to Lockheed Martin's motion (Motion Papers No. 2). This was followed by Lockheed Martin's reply to the government's response (Motion Papers No. 3). The government thereafter filed its last reply (Motion Papers No. 4).

Brief Overview

The parties' dispute stemmed from a 1988 contract between Naval Sea Systems Command (NAVSEA) and Lockheed Martin to qualify Unisys Corporation (Unisys) and Westinghouse Electric Corporation (Westinghouse) as second source producers of the AEGIS AN/SPY-1D antenna and the AN/SPY-1D transmitter. To set the stage, it bears repeating briefly that NAVSEA only contracted with Lockheed Martin. That contract

(the 5175 Contract) was a cost plus fixed fee (CPFF) contract. Lockheed Martin, as the prime contractor overseeing the entire AEGIS Second Source Radar Qualification Program for NAVSEA, in turn entered into two separate contracts, one on the antenna side, and the other on the transmitter side. On the antenna side, it entered into a directed first-tier firm fixed price (FFP) subcontract with Unisys. Unisys then entered into a directed second-tier FFP subcontract with Westinghouse. On the transmitter side, it entered into a directed first-tier CPFF subcontract with Raytheon Company (Raytheon). Raytheon then entered into a directed second-tier FFP subcontract with Unisys.

In our decision we found certain antenna Subcontractor Data Requirement Lists (SDRLs) were delivered by Unisys and Westinghouse jointly to Lockheed Martin prior to the June 1990 termination for convenience of the 5175 Contract by NAVSEA (03-2 BCA at 160,398, ¶ 82). We also found certain transmitter SDRLs were delivered by Unisys to Raytheon prior to the termination (03-2 BCA at 160,398-99, ¶ 83). Based on the plain language of FAR 49.202(a), applicable to fixed price contracts, we held that Lockheed Martin was entitled to include the delivered antenna SDRLs in the base for determining higher-tier profit. Based on the plain language of FAR 49.305-1(a), applicable to cost-reimbursement contracts, and FAR 52.249-6, TERMINATION (COST-REIMBURSEMENT) (MAY 1986), we held Lockheed Martin was not entitled to include delivered transmitter SDRLs in the base for determining higher-tier fee. (03-2 BCA at 160,413-14)

Interpretation Of Applicable Regulations

As its first ground for reconsideration, Lockheed Martin contends that the Board "erroneously found that FAR 49.305-1(a) and 52.249-6, unlike FAR 49.202(a), do not allow higher-tier contractors to recover fee on the cost of lower-tier subcontractor work delivered prior to a termination for convenience." Lockheed Martin says that the "novel result" reached by the Board of "allowing recovery of higher-tier profit on lower-tier deliveries in the fixed-price context but disallowing higher-tier fee on the same deliveries in the cost-type context – is at odds with the clear language of the FAR and the Board's decision in *Kollmorgen Corp., Electro-Optical Division*, ASBCA No. 28480, 86-2 BCA ¶18,919." (Motion Papers No. 1 at 1-2)

When FAR 49.202(a) is put side by side with FAR 49.305-1(a), it is clear that they simply cannot be interpreted the same way. FAR 49.202(a) provides:

> . . . Profit shall not be allowed the contractor for material or services that, as of the effective date of termination, have not been delivered by a subcontractor, regardless of the percentage of completion.

In other words, profit is only allowed on "delivered" material or services. *TRW, Inc.*, ASBCA No. 51003, 00-2 BCA ¶ 30,992 at 153,028 ("We grant TRW's motion for

summary judgment as to its entitlement to profit on data items that were delivered but not separately priced, if a reasonable value can be placed on the items"). In contrast, FAR 49.305-1(a) provides:

> The contractor's adjusted fee shall not include an allowance for fee for subcontract effort included in subcontractors' settlement proposals.

In other words, fee is not allowed on any subcontractor effort regardless of delivery. Moreover, FAR 52.249-6, which was included in the NAVSEA/Lockheed Martin prime contract and flowed down to the Lockheed/Raytheon first-tier transmitter subcontract further reinforced FAR 49.305-1(a) in providing at subparagraph (g)(4)(i) that termination for convenience settlements should exclude "subcontract effort included in subcontractors' termination proposals." (03-2 BCA at 160,390, ¶ 20, 160,394-95, ¶ 53) Again, completion or delivery makes no difference.

Thus, the result we reached in allowing higher-tier profit on the cost of delivered SDRLs under the antenna FFP contracts but disallowing higher-tier fee on the cost of delivered SDRLs under the transmitter CPFF contracts is entirely consistent with the plain dictates of the applicable FAR provisions in each case[1]. To apply the two provisions as though no difference existed would have been novel.

Application Of The Kollmorgen Case

In reaching our decision that Lockheed Martin is not entitled to recover higher-tier fee on the costs of SDRLs delivered under the CPFF subcontract, we relied on *Kollmorgen Corporation, Electro-Optical Division*, ASBCA No. 28480, 86-2 BCA ¶ 18,919. Like the transmitter side of the case before us, *Kollmorgen* involved termination for convenience of the prime contractor's CPFF contract. One of the issues before the Board for resolution was recovery of prime contractor fee on subcontractor

[1] Lockheed Martin again invites us to examine the regulatory history of DAR 8-303 and DAR 8-304, the predecessors to FAR 49.202(a) and FAR 49.305-1(a). Even though unnecessary, we have reviewed the documents under tabs 153 to 163 of the Rule 4 file. We are unable to conclude from them that the regulation writers intended to treat fixed-price contracts and cost-reimbursement contracts the same when it comes to allowing profit/fee on subcontract work delivered prior to termination. We note as early as 1967, the Armed Services Procurement Regulation (ASPR) Committee observed "there is an apparent inconsistency in the settlement of profits related to terminated subcontract work under a fixed price prime contract compared with settlement of fees in cost-reimbursement type contracts" (R4, tab 155). That the inconsistency persists even today, over thirty years later, is strong indication that it is intentional.

(Westinghouse) work. Lockheed Martin contends that we misapplied *Kollmorgen* because Westinghouse, "had not completed and delivered any part of the work" prior to termination, 86-2 BCA at 95,411, and thus, "the issue of recovery of higher-tier fee on the cost of subcontractor items **completed and delivered** prior to termination was not before the Board in *Kollmorgen*, and *Kollmorgen* is distinguishable on that basis." (Motion Papers No.1 at 3)

The language of DAR 8-406, ADJUSTMENT OF FEE, upon which the *Kollmorgen* Board relied was almost identical to the language in FAR 49.305-1(a). DAR 8-406 provided "The prime contractor's adjusted fee shall not include an allowance for fee for subcontract effort included in subcontractors' termination claims" 86-2 BCA at 95,411. The distinction Lockheed Martin attempts to draw is inconsequential since completion or delivery of subcontractor work has no effect on whether a higher-tier contract is entitled to fee under FAR 49.305-1(a), as under DAR 8-406. We relied on the following *Kollmorgen* holding for the proposition that the Board then, as we do today, saw no ambiguity in DAR 8-406 on that point:

> The termination clause and the regulations are very clear that the prime contractor, appellant, may not include a fee on subcontractor cost or effort included in the subcontractor's termination claim. The definitions apply equally to prime and subcontractors, and require that the subcontractor's termination claim include advances and partial payments. Kollmorgen may not collect a fee on the amount of the settlement with Westinghouse.

86-2 BCA at 95,411.

Lockheed Martin next argues that the Board in *Kollmorgen* turned to DAR 801.1 to determine what was meant by the phrase "subcontractor cost or effort included in the subcontractors' termination claims" stated in DAR 8-406. Since DAR 801.1 was the predecessor to FAR 49.002(d), Lockheed Martin contends that FAR 49.305-1(a) should also be interpreted in the context of FAR 49.002(d). (Motion Papers No. 1 at 3-4)

DAR 801.1 to which the Board in *Kollmorgen* referred provides as follows:

> 801.1 Amount of Claim or Settlement.
>
> When the action to be taken under this Section depends upon the amount of a termination claim or settlement, then, in determining such amount, (i) credits for retention or other disposal of termination inventory allocated to the claim and for advance of partial payments shall not be deducted from

> the gross claim or settlement; but (ii) amounts payable for completed articles or work at the contract price, or for the settlement or discharge of termination claims of subcontractors, shall be deducted.

(86-2 BCA at 95,411) The corresponding FAR 49.002(d), **Applicability**, provides:

> When action to be taken or authority to be exercised under this part depends upon the "amount" of the settlement proposal, the amount shall be determined by deducting from the gross settlement proposed the amounts payable for completed articles or work at the contract price and amounts for the settlement of subcontractor settlement proposals. Credits for retention or other disposal of termination inventory and amounts for advance or partial payments shall not be deducted.

Lockheed Martin argues:

> The practical impact of this definition is clear. When determining how much of a subcontractor's settlement proposal cannot be included in a higher-tier contractor's cost base for the application of fee in a termination for convenience, *i.e.*, how much of the subcontractor's incurred cost must be placed "below the fee line," FAR 49.002(d) provides, in relevant part, that "amounts payable for completed articles" should ***not*** be included in the amount placed below the fee line [footnote omitted]. The effect of this is to allow, in the cost-type context, contractors to recover fee on amounts associated with articles or work "completed" by subcontractors prior to termination, thus bringing the result in terminated cost-type contracts into line with the result in the *TRW* case for fixed-price contracts. Here, this would mean that Lockheed Martin and Raytheon as CPFF contractors should be allowed to recover fee on the value of the Subcontract Data Requirements List ("SDRL") deliveries completed by their respective subcontractors prior to termination. The Board's conclusion to the contrary is incorrect [footnote omitted].

(Motion Papers No. 1 at 4-5)

The government counters that FAR 49.002(d) is invoked only "When action to be taken or authority to be exercised under this part [*i.e.*, Part 49 – TERMINATION OF CONTRACTS] depends upon the 'amount' of the settlement proposal." Thus, FAR 49.002(d) provides guidance as to how the amount of the settlement proposal is to be determined when action needs to be taken or authority needs to be exercised. For example, FAR 49.107, **Audit of prime contract settlement proposals and subcontract settlements** requires the Termination Contracting Officer (TCO) to refer each prime contractor settlement proposal of $100,000 or more to the appropriate audit agency for review and recommendations. Thus, the TCO needs to follow the guidance of FAR 49.002(d) of what to include and exclude to determine whether the prime contractor's settlement proposal is above or below the $100,000 threshold for referral to the appropriate audit agency. According to the government, "it is not necessary to consult that guidance [FAR 49.002(d)] in order to follow the dictate [in FAR 49.305-1(a)] that a contractor's 'adjusted fee shall not include an allowance for [fee for] . . . subcontract effort included in subcontractors settlement proposals'." (Motion Papers No. 2 at 5) The government's interpretation is straightforward and consistent with the regulatory scheme of FAR Part 49 because it gives meaning to the phrase "When action to be taken or authority to be exercised under this part depends upon the 'amount' of the settlement proposal." We conclude FAR 49.002(d) exists for the benefit of the government and confers no contract right on Lockheed Martin. *Cessna Aircraft Co. v. Dalton,* 126 F.3d 1442, 1454-55 (Fed. Cir. 1997), *cert. denied*, 525 U.S. 818 (1998). Lockheed Martin has not explained how FAR 49.002(d) relates to FAR 49.305-1(a).

Lockheed Martin argues that "[t]he mere listing of the cost of particular subcontract effort somewhere on a termination form, however, cannot mean that that effort is 'included' in the subcontractor's settlement proposal for the purpose of FAR 49.305-1(a)" (Motion Papers No. 3 at 4). It suggests that we could, on our own, get around FAR 49.305-1(a) by simply including the unpriced but delivered Phase II subcontractor work as a part of "Finished Product" on line 10 of Unisys' Standard Form (SF) 1436. It argues that Lockheed Martin and Raytheon recovery of fee "should not turn on where Unisys may erroneously have placed these costs on a form over a decade ago." (Motion Papers No. 3 at 5)

There is no support for the proposition that Unisys erroneously placed the delivered Phase II transmitter SDRL costs on its Termination Settlement Proposal (TSP) (SF Form 1436). As the government points out, the costs assigned to the "Finished Product" category in Unisys' TSP were for completed Phase I work[2]. These costs were deducted in arriving at the "net proposed settlement" amount. That amount would then be audited and negotiated to arrive at a final settlement amount. (Motion Papers No. 4 at 2-3; R4, tab 136 and tab 137 at 4) Thus, the Phase II transmitter SDRL costs

[2] The government has paid for all of the costs involved on Phase I (03-2 BCA at 160,041).

(subcontractor effort) were a part of, and included in, Unisys' settlement proposal, subject to the no-fee limitation of FAR 49.305-1(a).

Determination Of Delivered Antenna SDRL Costs For Purpose Of Determining Higher-Tier Profit

As the second basis of its motion, Lockheed Martin contends that we erred in finding that cost information collected in accordance with DODINST 7000.2 could not be used by it to estimate the value of the SDRLs actually delivered by the subcontractors prior to termination. Lockheed Martin contends that the purpose of DODINST 7000.2 "simply is not to establish guidelines for the calculation of recovery in the litigation of a termination for convenience settlement." (Motion Papers No. 1 at 6-7; Motion Papers No. 3 at 3)

In a termination for convenience situation, the terminated contractor has the burden of showing that it is entitled to payment. In cost-reimbursement contracts, it would be necessary for the contractor "to prove the actual cost incurred in manufacture in order to secure the 'plus' profit." In fixed-price contracts, however, we have allowed adjustment upon terminating a contract to be made on the basis of estimate. We did so for fixed-price contracts where the books of the terminated contract "were not set up to show the cost of the various items manufactured." *Algonac Mfg. Co.*, ASBCA No. 10534, 66-2 BCA ¶ 5731 at 26,722 (citation omitted), *aff'd, Algonac Mfg. Co. v. United States*, 428 F.2d 1241 (Ct. Cl. 1970).

In this case, Work Breakdown Structure (WBS) and the Cost/Schedule Control System (C/SCS) requirements were imposed on all contractors[3]. With respect to WBS, Attachment 7 lists the applicable documents that form a part of the NAVSEA/Lockheed Martin letter contract. Among the documents listed is MIL-STD-881[A] "Work Breakdown Structure For Defense Items." (R4, tab 213 at C-012344; ex. 2004) MIL-STD-881A defines "Work breakdown structure (WBS)" as follows:

> A work breakdown structure is a product-oriented family tree composed of hardware, services and data which result from project engineering efforts during the development and production of a defense material item, and which completely defines the project/program. A WBS displays and defines the product(s) to be developed or produced and relates the elements of work to be accomplished to each other and to the end product.

[3] We have found that the WBS requirement was "flowed down" to the first and second-tier subcontractors on both the antenna and the transmitter (03-2 BCA at 160,393-96, ¶¶ 42, 49, 55, 63).

(Ex. 2004 at 2, ¶ 3.4)

MIL-STD-881A also defines a WBS element as "a discrete portion of a work breakdown structure. A WBS element may be either an identifiable item of hardware, set of data, or a service." (Ex. 2004 at 3, ¶ 3.9) The purpose for establishing a WBS in a contract is to provide the ability to "track and manage performance under the contract as it goes along" (tr. 1592). It is a convenient way of gathering costs and moving them ultimately to the contract level (tr. 1190). As Lockheed Martin's own witness testified, the WBS in the second source qualification contracts established "the cost accounting rollup method that would wind up being reported in the cost performance reports [CPRs]" (tr. 1191).

With respect to C/SCS, Attachment A8 of the letter contract pertains to C/SCS. As a part of this system, the Contractor is required to:

> 1.0 GENERAL
>
> The Contractor shall implement and maintain an integrated Cost/Schedule Control System (C/SCS) through the period of performance of this contract. . . .
>
> . . . .
>
> 4.1 Program Planning
>
> The contract Work Breakdown Structure (WBS) (Attachment E) [is] to be used as the base for planning the contract work, *establishing cost accounts*, developing detailed Gantt charts, and *reporting cost* and related schedule achievement information to the Government. The Contractor shall *extend its portion of the contract WBS down to the cost account level*. The WBS elements will not be changed without the Government's concurrence.
>
> . . . .
>
> 4.2 Cost Planning and Control
>
> The Contractor's cost planning and control system will conform to the requirements of DODINST 7000.2.
>
> . . . .

> 4.5 Cost/Schedule Control System Reporting
>
> All cost and schedule information reported to the Government shall be derived from the Contractor's Cost/Schedule Control System and shall be reported in a format and frequency specified by the appropriate CDRL and in conformance with DODINST 7000.10 requirements.

(Emphasis added) (R4, tab 213 at C-012351-53)

In short, MIL-STD-881A and DODINST 7000.2 outline "how [a contractor] go[es] about developing a WBS, and then how [it] work[s] to allocate cost within that WBS" (tr. 1599). DODINST 7000.2 required the use of C/SCS[4]. Among the accounting requirements was that a contractor must "Summarize direct costs from cost accounts into the WBS without allocation of a single cost account to two or more WBS elements" (ex. 2003 at 6; tr. 1602). This requirement prohibits capturing one WBS cost – such as data item cost – in other WBS items. Similarly, it prohibits capturing costs relating to other WBS elements in the data WBS element. This prohibition against commingling of costs is consistent with the underlying purpose of requiring WBS, *i.e.*, to keep track of costs by individual, discrete WBS elements (tr. 1603). *See, e.g., AT&T Technologies, Inc.*, DOT BCA No. 2007, 89-3 BCA ¶ 22,104 at 111,154 (WBS requirement compels the contractor to divide the work into segments by type of effort for "accounting purposes").

While Lockheed Martin acknowledges that, under DODINST 7000.2, it is necessary for a given cost to be allocated to only one WBS element, and that capturing each cost only once and in the appropriate WBS element helps ensure that the contractor and the government have an accurate picture from which to measure progress, it questions why no costs other than those recorded in the "Data" category may be allocated to the delivered SDRLs (Motion Papers No. 3 at 9-10).

All of the contracts involved in this appeal required data (SDRLs) as a separate contract line item (CLIN). All of the data CLINs refer directly or indirectly to DD Form 1423. This form instructs contractors to price data items "only from those costs which will be incurred as a direct result of the requirement to supply the data, over and above those costs which would otherwise be incurred in performance of the contract if no data were required" (R4, tab 191 at 2, Item 26a). The purpose of requiring a contractor to fill out the DD Form 1423 for each SDRL or C[Contractor]DRL prior to incorporating SDRLs or CDRLs into the contract is to enable the government to determine whether it

[4] We have found at the time the 5175 Contract was awarded, Lockheed Martin, Raytheon, Unisys and Westinghouse were all using the DODINST 7000.2 accounting system (03-2 BCA at 160,415, n.10).

would be worthwhile "to buy [a particular SDRL or CDRL] at this price" (tr. 1574). The "over and above" concept is designed to eliminate the possibility of paying for the same effort twice. Thus, if a contractor is required to engage in certain effort in performing its contract already, such as the effort required to perform all of the WBS elements other than the data WBS element, it is required by DD Form 1423 to price that data WBS element solely on the basis of what it would cost to submit the data WBS element in an acceptable format. (Ex. 2001 at 9-29)

The method Lockheed Martin used to estimate recovery of the cost of SDRLs delivered reassigned the cost incurred by other WBS elements to the data (SDRL) WBS element. This approach eviscerates the WBS concept on which the prime and subcontracts were structured from the beginning. It also totally revamps the way all of the contracts – through C/SCS and DODINST 7000.2 – required cost of each WBS element to be separately collected and reported with the result that costs that had already been paid as a part of other WBS elements[5] would end up being paid again as SDRL costs.

Had the 5175 Contract been allowed to run its course, Westinghouse would have been paid no more than $338,897 from Unisys for all of the antenna SDRLs delivered, and Unisys would have been paid no more than $185,275 from Lockheed Martin for all of the antenna SDRLs delivered (03-2 BCA at 160,392-94, ¶¶ 39, 46). By scrapping the way the contracts required data WBS element (SDRL) costs to be accumulated, Lockheed Martin came up with a $9,428,742 base, and sought higher-tier antenna profit, loadings and fee totaling $2,799,881 (ex. 1024, tab G at 3). Lockheed Martin has not explained why resort to estimating in the manner it did was necessary, and there is no proof that the way data costs were collected and reported would not result in a fair profit on the antenna SDRLs delivered prior to termination to which we said Lockheed Martin would be entitled. Notwithstanding the FFP nature of all of the lower tier contracts on the antenna side, in view of the strict requirement of the C/SCS mandating establishment and reporting of cost accounts down to the WBS element (data or SDRL) level, we conclude resort to estimating the cost of the antenna SDRLs delivered is unnecessary, and would lead to an excessive base on which to apply profit under FAR 49.202(a).

For the foregoing reasons, Lockheed Martin's motion for reconsideration is denied.

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[5] The CPRs for the antenna reported costs for the following WBS elements: (1) Program Management; (2) Engineering Support; (3) Technical Support Build/Test; (4) Manufacturing; (5) Material Management; (6) Westinghouse Subcontract; (7) Trainee Expense; and (8) Data. (R4, tab 301 at AP-004083, *see* 03-2 BCA at 160,406, ¶134)

Dated: 10 March 2004

PETER D. TING
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
Vice Chairman
Armed Services Board
of Contract Appeals

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA Nos. 53032, 54064, Appeals of Lockheed Martin Corporation, Naval Electronics & Surveillance Systems - Surface Systems, rendered in conformance with the Board's Charter.

Dated:

DAVID V. HOUPE
Acting Recorder, Armed Services
Board of Contract Appeals