

ARMED SERVICES BOARD OF CONTRACT APPEALS

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

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OPINION BY ADMINISTRATIVE JUDGE THOMAS

In this opinion we determine the quantum due the Navy as the result of debt concessions by creditors of Northwest Marine Iron Works (NMIW) subsequent to confirmation of its Chapter 11 reorganization plan. The captioned contract is a fixed-price incentive contract for overhaul of the USS DULUTH. The contract was performed at a loss. The Navy's claim arose because it had reimbursed NMIW for its costs up to the ceiling price, and NMIW ultimately did not incur some of those costs because of the debt concessions. Southwest Marine, Inc. (SWM) is the successor in interest to NMIW. Jurisdiction arises under the Contract Disputes Act of 1978 (CDA), 41 U.S.C. §§ 7101-7109.

In ASBCA No. 47621, we sustained the appeal as to entitlement on the basis that the Chapter 11 proceedings barred the Navy's claim. The United States District Court for the Southern District of California reversed that decision and remanded the appeal for determination of quantum. The United States Court of Appeals for the Ninth Circuit affirmed the decision of the District Court. *Southwest Marine, Inc.*, ASBCA No. 47621, 96-2 BCA ¶ 28,601 (*SWM I*), *rev'd, Dalton v. Southwest Marine, Inc.*, No. 97-1488-IEG (LSP), Third Amended Order (S.D. Cal. Oct. 7, 1998) (hereinafter District Court

opinion), *aff'd*, 217 F.3d 1128 (9th Cir. 2000) (hereinafter Circuit opinion), *cert. denied*, 532 U.S. 1007 (2001). Upon remand, the Board assigned docket number 54550 to the quantum proceedings. We have issued three opinions under that docket number resolving various motions: *Southwest Marine, Inc.*, ASBCA No. 54550, 08-1 BCA ¶ 33,786 (*SWM II*), 08-2 BCA ¶ 33,981 (*SWM III*), 09-1 BCA ¶ 34,116 (*SWM IV*).

Pursuant to Board Order, the government filed Respondent's Statement of Costs (SOC) dated 21 May 2004 with supporting documentation. Appellant in turn filed Appellant's Response to the Government's Statement of Costs (Response) dated 23 July 2004. The SOC and Response serve as the parties' complaint and answer respectively. The SOC showed an amount due of \$1,407,408 plus interest from 15 August 1989 (at 11, 35). This amount consisted of an Incentive Price Revision (IPR) clause adjustment because of the debt concessions of \$1,204,551 plus "Overpaid REA Interest" of \$212,860 less contract retention of \$10,003. In *SWM II*, the Board ruled that we did not have jurisdiction of the claim for overpaid REA interest of \$212,860 and struck that amount (08-1 BCA ¶ 33,786 at 167,222). On 4 May 2009, the government reduced the amount claimed because of the debt concessions from \$1,204,551 to \$1,184,193, resulting in an amount due of \$1,174,190 after allowing for contract retention (SOC at revised pages 11, 32).

The Board held a three-day hearing in May 2009.¹ The record was closed at the end of the hearing (tr. 3/257). Subsequent to the hearing the government filed Respondent's Post-Hearing Brief ("gov't br."), appellant filed Appellant's Reply to the Government's Post Hearing Brief ("app. reply br."), and the government filed Respondent's Post-Hearing Reply Brief ("gov't reply br.").

¹ The record consists of the transcript of the hearing, the Rule 4 file in ASBCA No. 47621 excluding tabs 6 and 7, appellant's supplement to the Rule 4 file dated 10 April 2009, designated tab 28, a prehearing order of the Board dated 5 May 2009 memorializing certain admissions, designated exhibit B-1, and the following tabs from appendix A to the SOC: 1-8 including 1A, 10-17, 18 (pages 5843-5863), 19-21, 26-50, 53, 54 (pages 7054, 7438-39, 7450-51, 7485-91, 7493-95, 7497-98, 7508-09, 7538-39, 7875, 8068-90, 8155-56, 8167, 8253-55, 8257, 8388), 55-62, 64, 69-79 (tr. 1/10-12, 141, 147, 163, 166, 2/133, 3/110-11, 253-55). Tab 79 is the report of the government's expert, Mr. James R. Brown, CPA, entitled "Report on Determining Contract Cost Reduction for Debt Concessions Southwest Marine, Inc., Formerly Northwest Marine Iron Works, Inc. Contract No. N00024-85-C-8506 (Duluth) May 3, 2004," referred to hereafter as Brown expert report. SOC appendix A is abbreviated herein as appx. A.

The government continues to claim an amount of \$1,174,190 plus interest (gov't br. at 2). We agree with the government's methodology for calculating the amount of recovery. We reduce the amount due with respect to one of the creditors (Crosby & Overton, Inc.), resulting in an award of \$1,104,479 plus interest.

FINDINGS OF FACT

A. Contract Provisions and Background

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

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

(Appx. A, tab 1 at 6465-66) There were numerous modifications to the contract, including modifications providing for target profit (appx. A, tab 2).

2. The contract included Clause I-2-28, Federal Acquisition Regulation (FAR) 52.216-16, INCENTIVE PRICE REVISION-FIRM TARGET (APR 1984) (the IPR clause); FAR 52.232-16, PROGRESS PAYMENTS (APR 1984) ALTERNATE I (APR 1984); and FAR 52.232-17, INTEREST (APR 1984) (the Interest clause). NMIW performed the contract during its fiscal years ending 31 May 1986 and 31 May 1987 (FY 86 and FY 87). NMIW redelivered the DULUTH to the Navy in June 1986. (Appx. A, tab 1 at 6503-04, 6510-13, tab 53 at 6372; tr. 2/13)

3. The IPR clause provided:

(a) General. The supplies or services identified in the Schedule as Items 0001, 0005 and 0009 [are] subject to price revision in accordance with this clause; provided that in no event shall the total final price of these Items exceed the ceiling price of one hundred thirty (130%) percent of the target cost for these Items....

(b) Definition. "Costs," as used in this clause, means allowable costs in accordance with Part 31 of the [FAR] in effect on the date of this contract.

(c) Data submission. (1) Within ninety (90) days after the end of the month in which the Contractor has delivered the last unit of supplies and completed the services specified by item number in paragraph (a) above, the Contractor shall submit on Standard Form 1411 or in any other form on which the parties agree --

(i) A detailed statement of all costs incurred up to the end of that month in performing all work under the items;

....

(d) Price revision. Upon the Contracting Officer's receipt of the data required by paragraph (c) above, the Contracting Officer and the Contractor shall promptly establish the total final price of the items specified in (a) above by applying to final negotiated cost an adjustment for profit or loss, as follows:

(1) On the basis of the information required by paragraph (c) above, together with any other pertinent information, the parties shall negotiate the total final cost incurred or to be incurred for supplies delivered (or services performed) and accepted by the Government and which are subject to price revision under this clause.

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

....

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

....

(f) Adjusting billing prices. (1) Pending [establishment of the total final price], the Contractor shall submit invoices or vouchers in accordance with billing prices as provided in this paragraph. The billing prices shall be based on the target prices shown in this contract.

(2) If at any time it appears from information provided by the Contractor under subparagraph (g)(2) below that the then-current billing prices will be substantially greater than the estimated final prices, the parties shall negotiate a reduction in the billing prices. Similarly, the parties may negotiate an increase in billing prices by any or all of the difference between the target prices and the ceiling price, upon the Contractor's submission of factual data showing that final cost under this contract will be substantially greater than the target cost.

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

....

(g) Quarterly limitation on payments statement. This paragraph (g) shall apply until final price revision under this contract has been completed.

(1) Within 45 days after the end of each quarter of the Contractor's fiscal year in which a delivery is first made (or services are first performed) and accepted by the Government under this contract, and for each quarter thereafter, the Contractor shall submit...a statement, cumulative from the beginning of the contract, showing -

(i) The total contract price of all supplies delivered (or services performed) and accepted by the Government and for which final prices have been established;

(ii) The total costs...reasonably incurred for, and properly allocable solely to, the supplies delivered (or services performed) and accepted by the Government and for which final prices have not been established;

(iii) The portion of the total target profit...that is in direct proportion to the supplies delivered (or services performed) and accepted by the Government and for which final prices have not been established [-] increased or decreased in accordance with subparagraph (d)(2) above, when the amount stated under subdivision (ii), immediately above, differs from the aggregate target costs of the supplies or services; and

(iv) The total amount of all invoices or vouchers for supplies delivered (or services performed) and accepted by the Government (including amounts applied or to be applied to liquidate progress payments).

(2) Notwithstanding any provision of this contract authorizing greater payments, if on any quarterly statement the amount under subdivision (1)(iv) above exceeds the sum due the Contractor, as computed in accordance with subdivisions (1)(i), (ii), and (iii) above, the Contractor shall immediately refund or credit to the Government the amount of this excess....

(3) If the Contractor fails to submit the quarterly statement within 45 days after the end of each quarter and it is later determined that the Government has overpaid the Contractor, the Contractor shall repay the excess to the Government immediately. Unless repaid within 30 days after the end of the statement submittal period, the amount of the excess shall bear interest, computed from the date the quarterly statement was due to the date of repayment, at the rate established in accordance with the Interest clause.

(Appx. A, tab 1 at 6510-12) Contract Line Item No. 0001 required the overhaul of the DULUTH (*id.* at 6466).

4. The cost principles in part 31 of the FAR, referenced in the IPR clause ¶ (b), include FAR 31.201-5, referred to herein as the Credits Provision Clause for consistency with the District Court and Circuit opinions, which stated as of the date of the contract:

The applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund.

5. The Interest clause provided in pertinent part:

(a) Notwithstanding any other clause of this contract, all amounts that become payable by the Contractor to the Government under this contract...shall bear simple interest from the date due until paid unless paid within 30 days of becoming due....

(b) Amounts shall be due at the earliest of the following dates:

(1) The date fixed under this contract.

(2) The date of the first written demand for payment consistent with this contract, including any demand resulting from a default termination.

(3) The date the Government transmits to the Contractor a proposed supplemental agreement to confirm completed negotiations establishing the amount of debt.

(4) If this contract provides for revision of prices, the date of written notice to the Contractor stating the amount of refund payable in connection with a pricing proposal or a negotiated pricing agreement not confirmed by contract modification.

6. NMIW filed a petition for Chapter 11 bankruptcy on 29 October 1986. NMIW also filed a list of its 20 largest unsecured creditors, including Crosby & Overton, Inc. (“Crosby”), Pacord, Inc. (“Pacord”), Port of Portland (“the Port”), and SAIF Corp. (“SAIF”, an acronym for State Accident Insurance Fund). (Appx. A, tabs 5, 16)

7. On or about 11 November 1986, NMIW filed a Schedule of Assets and Liabilities. This document included Schedule A-3, Creditors Having Unsecured Claims Without Priority (referred to hereinafter as the "Creditors Schedule"). (Appx. A, tab 15)

8. On 5 March 1987, NMIW filed its Debtor's Second Amended Plan of Reorganization (Second Amended Plan), which was confirmed by the Bankruptcy Court on 20 March 1987. The Second Amended Plan identified Class 13 creditors as those creditors with general unsecured claims of over \$1,000. It provided that NMIW in its capacity as a reorganized company would provide each Class 13 creditor a debenture in a principal amount equal to the allowed unsecured claim of each such creditor. The Second Amended Plan included terms for payment of the debentures over time. (Appx. A, tab 8 at 5767, 5780, tab 10) The government alleges, and appellant does not dispute, that all of the creditors addressed in its claim except for the Port were Class 13 creditors (gov't br. at 5, ¶ 6; app. reply br. at 3).

9. On 30 April 1987, in compliance with IPR clause ¶ (c), NMIW submitted a Statement of Allowable Costs Incurred on the contract. The total amount was \$25,093,862. On 11 May 1987, NMIW submitted a revised statement reducing the total amount to \$24,497,798. (Appx. A, tab 17 at 6332, tab 18; ex. B-1, Request No. 5)

10. During its FYs 86 and 87, NMIW also performed work on Contract No. N00024-85-C-8523 relating to the USS CUSHING. On 20 and 23 March 1989 respectively, the Defense Contract Audit Agency (DCAA) and William H. Zavin, II, NMIW's president, signed off on a letter setting forth the final rates for NMIW's indirect expense pools for those fiscal years. The letter stated that the rates were applicable to the CUSHING contract. (Appx. A, tab 53 at 6380-81; *see also* tab 54 at 7054)

11. On 20 March and 3 April 1989 respectively, Mr. Zavin and R. R. Morrison, the contracting officer, signed Modification No. A00202 (Mod 202) to the DULUTH contract. Mod 202 resolved five pending requests for equitable adjustment (REAs). It increased the ceiling price by \$2,727,082 to a total of \$23,295,755 including \$438,859 for interest on the REAs. (Appx. A, tab 2 at 6931-32; tr. 2/82-84) The government has admitted that "[t]he agreed ceiling price was not based on NMIW's actual incurred costs" (ex. B-1, Request No. 8).

12. On 5 April 1989, NMIW submitted an invoice requesting a progress payment in the amount of \$2,811,077. This amount represented the adjusted contract amount, which equaled the adjusted ceiling price (subject to a \$3 error), less \$10,000 retention and prior payments of \$20,474,675. The contracting officer approved payment of the invoice. (Appx. A, tab 3 at 6321-25; tr. 2/76; ex. B-1, Request No. 1)

13. Mod 202 did not establish the total final price for the contract, and the parties have not agreed upon a total final price. The IPR clause ¶ (g) provides for quarterly limitation on payments statements until such time as final price revision has been completed. Appellant has not disputed that NMIW did not submit such a statement in August 1989, and the record in these proceedings does not indicate that NMIW submitted any quarterly statement subsequent to 5 April 1989, when it submitted its invoice requesting a progress payment of \$2,811,077. (Gov't br. at 20; app. reply br. at 32 n.1)

14. By 17 January 1989, SWM and NMIW were discussing the possibility of SWM acquiring NMIW. According to SWM's letter of that date to NMIW, one of the conditions for such an acquisition would be reduction of NMIW's debt, including the amounts owed on the debentures. SWM suggested settling the estimated January 1989 balance of \$9.6 million on the debentures for \$1.0 million. (Appx. A, tab 19)

15. On 14 April 1989, NMIW forwarded to the Continuing Creditors' Committee documentation supporting settlement of the balances due on the debentures. NMIW's letter included a list of Class 13 creditors with an indication of the "AMOUNT ALLOWED." We refer to this list hereafter as the Amount Allowed List. (Appx. A, tab 31)

16. On 17 April 1989, SWM acquired NMIW through a stock purchase (Circuit opinion, 217 F.3d at 1133).

17. On 20 April 1989, NMIW filed its Chapter 11 Final Report in which it stated that the Continuing Creditors' Committee had "agreed on behalf of all holders of debentures to compromise and settle the balances due on the debentures upon payment of \$1,000 or 10 percent of the principal amount outstanding on each such debenture, whichever is greater" (appx. A, tab 33 at 5170). This agreement resulted in concessions by the creditors who had received debentures on the balances due on the debentures. The record also contains an undated NMIW Debenture Settlement list, with the names of NMIW's creditors and the settlement amount (appx. A, tab 43). On or about 24 April 1989, the Bankruptcy Court approved closing the Chapter 11 proceeding (appx. A, tab 35 at 5012).

18. On 21 April 1989, Mr. Morrison, the Navy contracting officer, wrote NMIW that media coverage was indicating that the Port had forgiven as much as \$5,000,000 in NMIW's debt to it. The letter stated that "[s]ince it is presumed that much of the excused debt relates to fees incident to Navy contracts for ship overhauls, the Navy has a distinct interest in this transaction." Mr. Morrison asked that NMIW respond as to the facts of the case. (Appx. A, tab 34)

19. On 26 April 1989, Mr. Zavin replied that “Northwest disagrees with your assertion that the Navy has an interest in our transactions with the Port or with any subcontractors or suppliers of this Company” (appx. A, tab 36).

20. The parties were unable to agree upon whether the Navy had a legitimate interest in NMIW’s settlement of the various creditors’ claims, generally referred to as debt concessions. We skip over the history of their communications back and forth on this subject except as needed for resolution of the issues presently before us.

21. On 6 April and 20 July 1992 respectively, DCAA and SWM d/b/a NMIW, signed off on a letter setting forth the final rates for NMIW’s indirect expense pools for FYs 86 and 87 as applicable to the DULUTH contract. Except for an apparent transposition error, the rates were the same as those in the 20 March 1989 letter relating to the CUSHING. The 6 April 1992 letter reserved the Navy’s possible interest in the debt concessions, stating:

This letter sets forth the final rates established by audit determination, except for any reduction for the forgiveness of debt, in accordance with FAR 42.705-2(b) for your indirect expense pools. Your company previously agreed to these rates for Contract N00024-85-C-8523 (USS Cushing)....

....

...[T]his agreement will not change any monetary ceiling, contract obligation, applicable impact of debt forgiveness, or specific cost allowance or disallowance provided for in the contracts.

(Appx. A, tab 58 at 6417)

22. On 24 December 1992, the Navy sent NMIW a letter which, in essence, complained that NMIW had failed to update its incurred cost submission, as revised 11 May 1987, to reflect the debt concessions or, indeed, to provide any information about them (appx. A, tab 59). NMIW responded on 5 February 1993 that it disagreed with the Navy as to the merits, but that NMIW had “never” refused to furnish information about the debt concessions. NMIW stated that DCAA was “welcome to examine all of our cost books related to the DULUTH contract to ascertain precisely how all costs and credits applicable to that contract were accounted for.” (Appx. A, tab 60) The Navy argues on quantum that NMIW failed to live up to its commitment (*e.g.*, gov’t br. at 44). We find

that NMIW proceeded in good faith (*e.g.*, tr. 3/134), and that if the Navy (or DCAA) had any problems obtaining information it should have raised them at an earlier point.

23. On 11 March 1994, Mr. Morrison issued a final decision in which he determined that the Navy had overpaid NMIW \$2,161,287 (appx. A, tab 62).

24. These proceedings followed. The District Court, in reversing the Board's decision in *SWMI*, stated that "[e]ssentially, the Navy argues that unless it is allowed to seek recovery of funds, NMIW will recover a windfall because it will have obtained post-petition payments [in response to the 5 April 1989 invoice] from the Navy for subcontractor work on the Duluth project which the subcontractors subsequently excused" (District Court opinion at 8). Upholding the Navy's argument, the Court determined that "[t]he Navy is entitled to reimbursement under the Credit[s] Provision Clause, FAR 31.205-5, and the IPR Clause, FAR 52.216-16." The Court remanded the matter to the Board "for a determination on the merits of quantum." (*Id.* at 10, footnotes omitted) The Circuit Court affirmed, stating that "the contracting officer's final decision that the debenture concessions fell within the meaning of the Credits Provision Clause was correct, the ASBCA's application of bankruptcy law was error, and the district court conclusion that the Navy was entitled to reimbursement was correct" (Circuit opinion, 217 F.3d at 1140).

B. The Navy's Calculation of Quantum

25. The Navy revised its calculation of the amount owed pursuant to the Credits Provision Clause and the IPR clause prior to the hearing. It reduced the amount claimed because of the debt concessions from \$1,204,551 to \$1,184,193, resulting in a net amount after offsetting contract retention of \$1,174,190. (SOC revised page 11) The calculation consists of two parts: "Computation of Cost Impact on Duluth Contract caused by Debt Concessions," *i.e.*, the amount of the credit, and "Application of IPR Clause (I-2-28)," *i.e.*, the amount of the overpayment:

Revised Statement of Costs, page 11
Computation of Cost Impact on Duluth Contract caused by Debt Concessions

	<u>Direct</u>	<u>Indirect</u>	<u>Total</u>	
Debt Concessions:				
Crosby & Overton	\$ 92,344	\$ 7,243	\$ 99,587	Note 1
Pacord	113,679		113,679	
Port of Portland	539,097	55,464	594,561	
SAIF		607,456	607,456	
Other Creditors At Least \$10,000	348,124	40,550	388,674	Note 1
Creditors Under \$10,000	19,284	4,868	24,152	Note 1
Total Debt Concessions	<u>\$1,112,528</u>	<u>\$ 715,581</u>	<u>\$1,828,109</u>	Note 2

Application of IPR Clause (I-2-28):

a	Contract Ceiling Price FOR SUPPLIES AND SERVICES		\$ 22,856,839
b	“Total Final Negotiated Cost” Before Adjustment for Debt Concession	\$24,467,062	
c	Less: Debt concessions (from above schedule)	<u>1,828,109</u>	
d	Adjusted “Total Final Negotiated Cost” (b-c)	\$22,638,953	\$22,638,953
e	Target Cost	<u>17,582,184</u>	
f	Excess of Adjusted “Total Final Negotiated Cost” over Target Cost (d-e)	<u>\$ 5,056,769</u>	
g	Incentive Fee Adjustment (30% of f)	\$ 1,517,031	
h	Less: Target Profit	<u>550,724</u>	
i	Total decrease to Adjusted “Total Final Negotiated Cost” (g - h)	<u>\$ 966,307</u>	<u>966,307</u>
j	Adjusted “Total Final Negotiated Cost” (d - i)		<u>\$21,672,646</u> <u>21,672,646</u>
k	IPR Clause Adjustment (a - j)		\$ 1,184,193
l	Less: Contract Retention		<u>10,003</u>
	Amount Owed to the government because of debt concession (k - l)		<u>\$ 1,174,190</u>

Notes:

- 1 A subsequent review by DCAA of the calculated debt concessions reported and summarized on page 11 of the 21 May 2004 Statement of Cost resulted in decreasing (i) the \$112,404 amount for Crosby & Overton to \$99,587, (ii) the \$403,903 amount for “Other Creditors at Least \$10,000” to \$388,674, and (iii) the \$25,189 amount for “Creditors Under \$10,000” to \$24,152. As a result, the amount sought from Southwest Marine also decreases from \$1,194,548 (\$1,204,551 - \$10,003; as shown on p. 34 of SOC) to \$1,174,190.
- 2 Should future adjustments to the debt concession amount be required, simply multiply the reduction in the government’s share of debt concession by 70%, the government’s share of the cost overrun, and deducting that amount from the above amount owed of \$1,174,190. For example, if the debt concession amount is reduced by \$1,000, then the amount owed of \$1,174,190 would be reduced by \$700 for an adjusted amount owed of \$1,173,490.

C. Determination of the Amount of the Credit to the Navy Pursuant to the Credits Provision Clause

26. The Credits Provision Clause provides that “[t]he applicable portion of any...credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government...” (finding 4). For each creditor or class of creditors identified by the Navy, we first determine the amount of “any allowable cost” and then the amount of any “credit” relating to that cost.

27. In the context of this appeal, the allowable cost is the portion of a debenture (or promissory note, in the case of the Port) allocable to the DULUTH contract. As appellant’s expert explained, from an accounting perspective, “cost” and “debt” are different. Cost is an expense while debt is a promise to pay. (Tr. 3/150-52) Here, at the time it filed its petition in bankruptcy, NMIW had failed to pay various invoices. Invoices are demands for payment (tr. 3/155). As appellant’s expert further explained, since NMIW had not paid the invoices, it had not incurred the costs to which they related for purposes of government contract billing. NMIW basically paid the invoices when it issued the debentures. At that point, it incurred the costs. (Tr. 3/153, 189) We conclude that although, as just pointed out, cost and debt are different concepts, the debentures here represent the amount of the costs since the costs were incurred when the debentures were issued.

28. Also in the context of this appeal, the “credit” is the amount of the debt concession allocable to the DULUTH contract. NMIW issued debentures, as just described, in payment of the invoices. NMIW did not pay the debentures as issued and the creditors ultimately forgave most of the debts. Consequently, NMIW never actually paid those invoices and the Navy is entitled to a credit for the amount not paid.

29. Three documents are the starting point for determining the relevant amounts: (1) NMIW’s monthly computer runs entitled “Accounts Payable Invoice Distribution” (appx. A, tab 4), (2) NMIW’s Creditors Schedule filed in the Chapter 11 proceeding in 1986 (appx. A, tab 15; *see* finding 7), and (3) the Amount Allowed List which NMIW sent the Continuing Creditors’ Committee in connection with the proposed debt concessions in 1989 (appx. A, tab 31; *see* finding 15). The computer runs show how invoices were distributed to costs for all contracts (tr. 1/39). The Creditors Schedule identifies by creditor the invoices that were unpaid as of the Chapter 11 petition (tr. 1/46). The Amount Allowed List identifies the debenture amounts and the concession amounts for most of the creditors (tr. 1/47). In addition, there are documents which are more specific to each creditor or class of creditors as referenced below.

30. Mr. David Koeltzow, a DCAA auditor, analyzed the available records to determine the amount of the debt concessions, and the allowable costs to which they

related. His review included both direct and indirect costs. Generally his methodology was to take the invoices identified on the Creditors Schedule, and trace them to the accounts payable computer runs to check whether they were for the DULUTH contract or an indirect account that would subsequently be allocable to the DULUTH contract. He then referred to the Amount Allowed List to determine the amount of the debt which was conceded. (Tr. 1/42, 45-47) Where there was a disparity among the different schedules, particularly between the Creditors Schedule and the Amount Allowed List, he tried to resolve the disparity by reviewing other available documentation (tr. 1/65). He assumed that a pro rata share of the debt concessions related to the DULUTH (tr. 2/125).

31. Generally, we base our findings below on DCAA's work. However, we have independently checked the source material to the extent we deemed warranted and, in particular, to address factual issues raised by appellant.

Crosby & Overton, Inc.

Amount of Allowable Cost

32. The Creditors Schedule, which includes invoice numbers, dates and amounts for each creditor, includes total unpaid invoices of \$461,767.68 for Crosby (appx. A, tab 15 at 6106-07).

33. DCAA traced the amounts in the Creditors Schedule to NMIW's accounts payable computer runs. DCAA determined that of the total amount of \$461,767.68, \$116,845 was charged direct to the DULUTH contract. (Tr. 1/103-04) Prior to hearing, the government reduced the amount of \$116,845 to \$102,604 (SOC revised page 11, \$92,344 = .9 x \$102,604; see tr. 1/105).

34. DCAA also determined that of the debt to Crosby, amounts of \$20,000 and \$40,400 were charged as indirect costs to all of NMIW's contracts for FYs 86 and 87 (tr. 1/104). For indirect charges, DCAA calculated a DULUTH "participation rate." The participation rate for FY 86 is 35.47% and the participation rate for FY 87 is 2.36%. Applying these participation rates to the amounts of \$20,000 and \$40,400 results in amounts of \$7,094 and \$953 allocable to the DULUTH contract for FYs 86 and 87 respectively. (Tr. 1/49-51)²

² Appellant argues that the rates included in the letter between DCAA and NMIW dated 20 March 1989 relating to the CUSHING should control (app. reply br. at 17-19). Those rates as applied to the DULUTH contract were subject to an exception for the impact of the debt concessions and do not, therefore, control (finding 21).

35. We find, based on DCAA's analysis, that \$110,651, the total of \$102,604 for direct charges and \$7,094 and \$953 for indirect charges, represents the amount of the allowable cost for the DULUTH which was part of the debt to Crosby.

Amount of Debt Concession

36. The government admits that "we lack direct evidence on...the exact percentage of its total debt conceded by Crosby & Overton" (gov't br. at 29). The government maintains that based on the pattern with other creditors, Crosby must have conceded 90% of the debt relating to the DULUTH, or \$99,587 (*id.*).

37. As a class 13 creditor, Crosby should have received a debenture in the total amount of its debt (finding 8).

38. The Amount Allowed List shows, for Crosby, amount allowed, principal balance and interest balance of zero, with an "A/P AT 1/17/89" of \$28,949. The Debenture Settlement list shows, for Crosby, a principal balance of zero and a blank amount for the amount of settlement. (Appx. A, tab 31 at 5188, tab 43 at 5821)

39. In 2002, a Crosby representative told DCAA that Crosby "did not recall what happened about the monies and property owed by NMIW." Further, Crosby's president "recalls only that an amicable settlement was obtained, but not the details." (Appx. A, tab 76 at 5018)

40. We conclude that these stray bits of information are insufficient to prove that Crosby conceded any of the debt relating to the DULUTH, or if it did, what the amount of the concession was. The government has not proved that any debt concession was in the amount of \$99,587.

Pacord

41. On 5 January 1987, Pacord submitted a proof of claim in the amount of \$893,982.89 to the Bankruptcy Court. Tracing invoices referenced in the proof of claim to NMIW's accounts payable computer runs, DCAA determined that \$126,310 of the amounts in the proof of claim represented a direct charge to the DULUTH contract. (Appx. A, tab 6; tr. 1/65-69)

42. Pacord received a debenture of \$893,983, the amount of its proof of claim, and settled that debenture for \$89,398, resulting in a concession of \$804,585 (.90 x \$893,983) (appx. A, tab 43 at 5824; *see also* tab 31 at 5790).

43. We find with respect to Pacord that a pro rata share of the total concession of \$804,585 related to the costs incurred for the DULUTH. We conclude that there was a debt concession of \$113,679 relating to an allowable cost of \$126,310 (.90 x \$126,310) for the DULUTH. (Tr. 1/62)

Port of Portland

Amount of Allowable Cost

44. NMIW and the Port were parties to several leases and agreements including one which entitled NMIW to use the Port's facilities (appx. A, tab 11 at 5968). The parties agree that the Port was not a Class 13 creditor (finding 8).

45. In 1991, the Port gave DCAA a schedule showing that pre-petition debt was \$4,112,466. The Port included a list of the invoices making up the \$4,112,466, which included invoices relating to the DULUTH. (Appx. A, tab 56 at 5236, 5240)

46. The Creditors Schedule showed debt to the Port of \$3,228,991.60. DCAA traced the invoices in the Creditors Schedule to the account payable records, and determined that when four negative entries were corrected to positive entries, it made up almost the total difference between the amount of \$3,228,991.60 in the Creditors Schedule and the amount of \$4,112,466 in the Port's list. We find, therefore, that \$4,112,466 should be used for total pre-petition debt to the Port. (Appx. A, tab 15 at 6171-76; tr. 1/88)

47. After tracing the invoices in the Creditors Schedule to the accounts payable records, DCAA determined and we find that there were direct charges to the DULUTH contract of \$594,112, and indirect charges to all contracts of \$131,627 and \$611,684 in FYs 86 and 87 respectively. Using participation rates of 35.47% and 2.36%, the indirect charges allocable to the DULUTH contract were \$46,688 and \$14,436. The total of these amounts, \$655,236, is the amount of the allowable cost for the DULUTH contract. (Tr. 1/91-92)

Amount of Debt Concession

48. In connection with the bankruptcy, the Port received a long term note in the amount of the pre-petition debt, \$4,112,466, instead of a debenture (tr. 1/85-86). This amount was to be paid off in nine annual installments (appx. A, tab 8 at 5789).

49. As of 28 March 1989, the Port had received payments of \$380,781 on the long term note, leaving a balance of \$3,731,685. As of that date, there was also post-petition

debt of \$1,759,628. The total amount of the debt as of that date was \$5,491,313. (Appx. A, tab 56 at 5236)

50. On 7 April 1989, the Port, NMIW, and SWM entered into a Debt Settlement Agreement. The agreement promised the Port a share of NMIW's future profits up to \$1,000,000 with \$100,000 per year for five years guaranteed by SWM. The profit-sharing provision related to the post-petition debt of \$1,759,628. The agreement provided that payments to the Port were to be in full satisfaction of all debt owed to the Port by NMIW as of 28 March 1989. (Appx. A, tab 28 at 4954, tab 30 at 5246-47, 5262-63, 5265, tab 56 at 5235)

51. DCAA concluded that \$3,731,685 of the pre-petition debt had been conceded. This amount is 90.74% of the long term note of \$4,112,466. Using this figure, DCAA calculated that the Port had conceded 90.74% of the debt of \$655,236 relating to the DULUTH, or \$594,561 (.9074 x \$655,236). (Tr. 1/93-94)

52. Appellant argues that none of the debt was conceded (app. reply br. 27-28). It points chiefly to the following evidence. In 2002, in the course of its work in connection with this appeal, DCAA sent an e-mail request to the Port for further information. The Port's Controller confirmed at that time:

I do have a listing of invoices, by job, at March 28, 1989, which were covered by the Debt Settlement Agreement, totalling \$1,759,628.39. The only payment received for these was the \$500,000 paid over five years by Southwest Marine [the guarantor], which again was applied to a total, not to individual invoices....

...I can tell you that the \$97,995 [an amount relating to the USS OKINAWA which DCAA had inquired about] was an invoice, but was not covered under the Debt Settlement Agreement, and is not listed as one of the invoices which make up the total of \$1,759,628.39. For the DULUTH and KAWISHIWI, no invoices for these jobs were covered under the Debt Settlement Agreement, and I cannot verify the amounts you mention from information in my files. For the OKINAWA, 15 invoices totalling \$761,574 were covered by the Debt Settlement Agreement....

(Appx. A, tab 75 at 4949)

53. The schedule which the Port gave DCAA in 1991 referred to above includes a list of invoices supporting the amount of \$1,759,628.39 for post-petition debt. The list includes 26 invoices, including 15 invoices for the OKINAWA and none for the DULUTH and KAWISHIWI. (Appx. A, tab 56 at 5237)

54. Appellant contends that the statement “no invoices for those jobs [DULUTH and KAWISHIWI] were covered under the debt settlement agreement” means that no debt relating to the DULUTH contract was conceded (app. reply br. at 26-28). We find, to the contrary, that in context, the Controller more likely was referring to the post-petition debt of \$1,759,628.30, which he refers to in the beginning of his statement, and which was based upon the list of 26 invoices, not the pre-petition debt of \$4,112,466.

55. Appellant also points to a provision in the Debt Settlement Agreement that “[t]he Port shall be entitled to receive the amounts due on Navy settlements from the CUSHING, STORIS, and DULUTH projects as provided in the Second Amended Plan of Reorganization” (appx. A, tab 30 at 5246). It speculates that this provision “carved out payments from DULUTH and is consistent with (and probably explanatory of) the Port’s statement to [DCAA] quoted above, that no invoices for DULUTH were included in the debt settlement” (app. reply br. at 28).

56. The Second Amended Plan confirmed by the Bankruptcy Court in 1987, in addition to providing for nine payments on the long term note for \$4,112,466, also provided:

[A]ny tariffs or use fees to become due in respect of extra work, change orders, delays, or emergent work, or any of them (“growth items”) in Northwest Marine’s contracts for the repair of the U.S.S. Cushing, the U.S.S. Duluth and the U.S.C.G.C. Storis (the “Repair Contracts”) shall be paid to the Port of Portland by the Reorganized Company upon receipt thereof...

(Appx. A, tab 8 at 5789)

57. We find that the statement in the Debt Settlement Agreement to which appellant refers more likely relates to this provision and does not indicate that the pre-petition debt relating to the DULUTH, as calculated by DCAA, was not conceded along with the rest of the remaining pre-petition debt of \$3,731,685.

58. Finally, appellant points to a memorandum from a director of the Port recommending that the Port enter into the Debt Settlement Agreement. The memorandum states that:

Although Port staff would like to have further guarantees from Southwest that it will continue to operate in Portland for a number of years, the opportunity for Northwest to continue as a going concern is sufficient consideration for the Port to consent to the sale and enter into a Debt Settlement Agreement....

(Appx. A, tab 29 at 4957) We are unable to agree that this language helps establish “that any NMIW debts that were included in the settlement were exchanged for new and ‘sufficient consideration’” (app. reply br. at 28).

59. In summary, we find that there was a credit (debt concession) of \$594,561 relating to the allowable cost for the DULUTH contract of \$655,236.

SAIF Corp.

Amount of Allowable Cost

60. The Creditors Schedule showed debt to SAIF, the State workers’ compensation insurance fund, of \$1,047,759.54. DCAA, through review of NMIW’s accounts payable computer runs, determined \$363,349.53 of this amount was allocable to NMIW’s contracts as an indirect cost in FY 86. There were no direct costs associated with SAIF. (Ex. A, tab 15 at 6190; tr. 1/71, 73-74, 1/80-82; SOC, ex. K, row 13)

61. At the time of the Chapter 11 petition, NMIW and SAIF had not agreed upon the total amount due for policy years 1 August 1981 through 30 June 1986 (appx. A, tab 15 at 6204).

62. By letter dated 18 March 1987, SAIF confirmed that it had settled the entire outstanding balance of all policy years prior to 1 July 1986 for \$4,000,000 (appx. A, tab 54 at 7451).

63. On 7 May 1987, NMIW made an adjusting journal entry to the reserve for workers’ compensation claims for FY 86 in its books and records. The unadjusted balance at 31 May 1986 was a total of \$2,460,472. The adjusting entry was \$1,539,528, resulting in an adjusted balance at 31 May 1986 of \$4,000,000. (Appx. A, tab 54 at 7450; tr. 1/77)

64. On 11 May 1987, in conjunction with its revision to its statement of incurred costs (finding 9), NMIW sent DCAA a letter identifying that workers' compensation for FY 86 had an adjustment of \$1,539,528, the same amount as the adjusting journal entry (appx. A, tab 54 at 7438; tr. 1/79).

65. For purposes of the government's claimed quantum in this appeal, DCAA added the amount of the adjusting journal entry of \$1,539,528 to the amount of \$363,349.53 for a total of \$1,902,877.53 allocable to NMIW's contracts as an indirect cost in FY 86 (tr. 1/79-82).

66. Using the participation rate of 35.47% for FY 86, DCAA concluded and we find that the amount of the allowable cost for the DULUTH contract was \$674,951 (tr. 1/82).

Amount of Debt Concession

67. SAIF received a debenture of \$4,000,000 and, in 1989, conceded 90% of that amount, or \$3,600,000. On a pro rata basis, it conceded 90% of debt relating to the DULUTH, or \$607,456. (Appx. A, tab 27 at 5278, tabs 31, 43; tr. 1/71, 83)

68. Appellant argues that established rules for accounting for costs of insurance require that any credit be made to NMIW's costs for insurance in FY 89, when the debt concession occurred (app. br. at 22). Apparently where an insured (*e.g.*, NMIW) changes its estimate of the required insurance, the insured books the change in the period it recognizes it (tr. 3/173). Here, however, the insured did not revise its estimate of the amount of required insurance. Rather, in 1989, the insurer forgave part of the agreed upon premium. We conclude that under the Credit Provisions Clause, the amount of the debt concession as to the DULUTH related to FY 86, the year to which the cost was charged as part of the incurred cost submissions (finding 64), not FY 89.

Other Creditors

69. After allowing for the individual creditors above, there are two remaining groups of creditors, those with claims of \$10,000 or more and those with claims of less than \$10,000. Those creditors with claims of \$10,000 or more conceded 90% of the debenture amounts. Those creditors with claims of less than \$10,000 received a minimum payment of \$1,000. (Tr. 1/106-07)

70. DCAA calculated that \$403,484 of the debt owed to creditors with claims of \$10,000 or more was based on costs charged direct to the DULUTH contract. Using the 90% rate, this group of creditors conceded \$363,136 in direct costs. (Tr. 1/111, 113)

71. DCAA calculated that amounts of \$89,344 for FY 86 and \$576,502 for FY 87 of the debt owed to creditors with claims of \$10,000 or more were based on costs charged indirect. After application of the participation rates of 35.47% and 2.36%, allocable indirect costs were \$31,691 for FY 86 and \$13,605 for FY 87. Using the 90% rate, this group of creditors conceded amounts of \$28,522 and \$12,245 for those years. (Tr. 1/111, 113; SOC, ex. C)

72. These amounts total \$403,903 (\$363,136 + \$28,522 + \$12,245). In some cases the Amount Allowed List shows a lesser amount of debt than the Creditors Schedule. Prior to the hearing, the government recalculated the amount of the debt, using the lower amounts in the Amount Allowed List. This recalculation reduced the claimed concessions from \$403,903 to \$388,674. (SOC revised page 11; tr. 1/25, 114)

73. DCAA calculated that \$26,862 of the debt owed to creditors with claims of less than \$10,000 was based on costs charged direct to the DULUTH contract. The comparable amounts for indirect costs, after application of participation rates (to amounts of \$11,608 and \$98,703), were \$4,118 for FY 86 and \$2,329 for FY 87. (Tr. 1/112)

74. DCAA calculated that the creditors with claims of less than \$10,000 conceded an average of 75.62% of the total amounts owed to them by NMIW. Multiplying the amounts for direct and indirect costs by this percentage, DCAA concluded that the creditors in this group conceded \$20,314 for direct costs, \$3,114 for indirect costs in FY 86, and \$1,761 for indirect costs in FY 87, for a total of \$25,189. (Tr. 1/113)

75. Prior to the hearing, for the reason described above in connection with creditors with claims of \$10,000 or more, the government reduced the amount claimed for the smaller creditors from \$25,189 to \$24,152 (SOC revised page 11; tr. 1/115).

76. We conclude that the government has adopted a reasonable methodology with respect to these groups of creditors, including reducing the amount claimed to allow for discrepancies between the documents. We find that the amount of the debt concessions for the creditors with claims of \$10,000 or more is \$388,674 and the amount of the debt concessions for the creditors with claims of less than \$10,000 is \$24,152.

Summary of Findings on the Amount of the Credit to the Navy Pursuant to the Credits Provision Clause

77. Based on the foregoing, we find that the government has proved that the debt concessions were as follows:

Debt Concession	Total
Pacord	\$ 113,679
Port of Portland	594,561
SAIF	607,456
Creditors of \$10,000 or more	388,674
Creditors less than \$10,000	24,152
Total Debt Concessions	\$1,728,522

D. Determination of the Amount of the Overpayment Pursuant to the IPR Clause

78. Having determined the amount of the credit to the Navy, \$1,728,522, we turn to the calculation of the amount of the overpayment pursuant to the IPR clause as of the closing of the bankruptcy proceeding (on or about 24 April 1989). The calculation includes the following elements: (1) the ceiling price, (2) total cost prior to the credit, (3) adjusted total cost after the credit, (4) target cost, (5) target profit, and (6) contract retention, as follows.

79. Ceiling price. Mod 202 increased the ceiling price to \$23,295,755. This amount included \$438,859 for interest on the REAs, which is not part of the ceiling price for purposes of the IPR clause formula, and a rounding error of \$57. Accordingly, the ceiling price for purposes of the IPR clause is \$22,856,839. (Finding 11; tr. 1/37)

80. Total cost. NMIW's revised incurred cost statement showed total cost of \$24,497,798 (finding 9). DCAA audited the incurred cost statement and adjusted the total to \$24,467,062, exclusive of any credits for the debt concessions. Appellant has not challenged the adjustment in these proceedings. Accordingly, total cost prior to the credit is \$24,467,062. Reducing that amount by the credit we have found, \$1,728,522, results in adjusted total cost of \$22,738,540. (Appx. A, tab 53 at 6378; tr. 1/186-87) In its quantum calculation, the government refers to "Total Final Negotiated Cost" (finding 25). It is undisputed that the parties have not negotiated the total final cost (*see* tr. 1/185-86).

81. Target cost. The parties dispute what the target cost is. The government asserts the target cost is \$17,582,184 (finding 25). Appellant asserts that the government improperly reduced target cost by the difference between \$1,808,793 and \$1,760,173, *i.e.*,

\$48,620 (app. reply br. at 16). Resolution of this dispute depends upon the proper interpretation of Mod 202.

82. Mod 202 provided as follows:

1. The final negotiated Target Cost, Target Profit, Target Price, Ceiling Price and Section B manhours...are adjusted as follows:

Target Cost is increased by \$1,808,793.00
Target Profit is increased by \$ 169,544.00
Target Price is increased by \$1,978,337.00
Ceiling Price is increased by \$2,351,430.00

The section B manhour reservation is debited 40,450 manhours.

2. In accordance with the terms of the contract, the above Ceiling Price shall have interest added to it in the certain sum of \$438,859.00.

3. It is further agreed that liquidation of all remaining unused Section B manhours on the subject contract results in a decrease to the contract ceiling price of \$63,207.00.

(Appx. A, tab 2 at 6932) The block 12 accounting data provided for an increase of \$640,862.00 and \$2,149,427.00 and a decrease of \$63,207.00, for a net increase to the ceiling price of \$2,727,082 (*id.* at 6933; tr. 2/82-83).

83. Section B of the contract as awarded provided that target cost should include a manday reservation for emergent and supplemental work. It specified:

If at the end of the contract the reservation mandays have not been expended, those dollars outstanding...will be subtracted from the target cost.... Ceiling price will be reduced by the product of 1.30 times the target cost reduction.

(Appx. A, tab 1 at 6467)

84. A decrease of \$63,207 to the ceiling price for liquidation of the unused Section B manhours, as referred to in paragraph 3 of Mod 202, is the equivalent of a decrease of \$48,620 to the target cost (\$63,207 divided by 1.3 equals \$48,620).

85. The government's interpretation of Mod 202 is that the amount of target cost specified in paragraph 1 of Mod 202, \$1,808,793, must be decreased by the equivalent of the decrease of \$63,207 to the ceiling price specified in paragraph 3 for the Section B manhours, \$48,620. After performing this calculation, the resulting amount for target cost is \$1,760,173. This number in turn results in total target cost for the contract of \$17,582,184. (SOC, ex. E at 9964)

86. Appellant's 5 April 1989 invoice submitted subsequent to execution of Mod 202 indicated that the contract amount had been adjusted by \$2,727,082 as a result of that modification. As calculated above, the amount of \$2,727,082 includes a decrease of \$63,207, which corresponds to a decrease of \$48,620 to target cost. (Appx. A, tab 3 at 6324)

87. We conclude that the government's interpretation best gives meaning to all of the provisions of Mod 202, and is consistent with that expressed by appellant at the time in its 5 April 1989 invoice. Accordingly, we use the government's total target cost number of \$17,582,184 for purposes of calculating the overpayment pursuant to the IPR clause.

88. Target profit. There evidently is no dispute that target profit as of April 1989 was \$550,724 (finding 25).

89. Contract retention. When NMIW submitted its 5 April 1989 invoice, its calculations included a \$3 error in the amount of the ceiling price. The invoice provided for retention of \$10,000. The Board employs a retention amount of \$10,003 to compensate for this error. (Finding 12; tr. 2/76)

90. Using the above amounts, the amount of the overpayment pursuant to the formula in the IPR clause is as follows:

Application of IPR Clause (I-2-28):

a	Contract Ceiling Price		\$ 22,856,839
b	Total Cost Before Adjustment for Debt Concession	\$24,467,062	
c	Less: Debt concessions (as calculated by Board)	<u>1,728,522</u>	
d	Adjusted Total Cost (b-c)	\$22,738,540	\$22,738,540
e	Target Cost	<u>17,582,184</u>	
f	Excess of Adjusted Total Cost over Target Cost (d-e)	<u>\$ 5,156,356</u>	
g	Incentive Fee Adjustment (30% of f)	\$ 1,546,907	
h	Less: Target Profit	<u>550,724</u>	
i	Total decrease to Adjusted Total Cost (g - h)	<u>\$ 996,183</u>	996,183
j	Adjusted Total Cost (d - i)	<u>\$21,742,357</u>	<u>\$21,742,357</u>
k	IPR Clause Adjustment (a - j)		\$ 1,114,482
l	Less: Contract Retention		<u>10,003</u>
	Amount Owed to the government because of debt concession (k - l)		<u><u>\$ 1,104,479</u></u>

DECISION

In prior proceedings, the District Court, affirmed by the Circuit Court, held that the Navy was entitled to reimbursement for debt concessions under the Credits Provision Clause, FAR 31.201-5, and the IPR Clause, FAR 52.216-16 of the DULUTH contract (finding 24). The Credits Provision Clause provides that “[t]he applicable portion of any...credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government...” (finding 4). In the context of this appeal, the “allowable cost” is the portion of a debenture (or promissory note, in the case of the Port) allocable to the DULUTH contract, and the “credit” is the allocable amount of the debt concession (representing allowable costs which were never paid) (findings 27, 28). Once the amount of the credit is determined, the IPR clause provides a formula for calculating the amount of any overpayment (*see* finding 3, ¶ (d), finding 90).

The government proved that the amount of the debt concessions relating to the DULUTH contract was \$1,728,522. Application of the IPR clause formula, using this amount for the amount of the credit, results in an overpayment amount of \$1,104,479. (findings 77, 90) We also conclude that the government is entitled to interest on the amount of the overpayment, for the reasons set forth below in connection with appellant’s Point Six.

Appellant argues six points in opposition to the government’s claim, as follows:

Point One: The Government Has Failed To Prove The Fundamental Fact Required By Order Of The Board: That Any “Particular Cost Was ‘Subsequently Excused.’”

Point Two: The Government’s Accounting Expert Testified To A “Correct” Claim Calculation Method That Results In A Government Recovery Of Zero.

Point Three: The Government Has Failed To Prove An Essential Element Of Its Claim: The Contract Target Cost.

Point Four: Indirect Costs And SAIF: The Government Has Failed To Substantiate Its Claim For Avoidance Of The Parties’ Indirect Cost Rate Agreement And Has Failed To Prove Any Credits To SAIF Costs For The Contract Year, 1986.

Point Five: Direct Costs: The Government’s Proof DISPROVES Its Claims Concerning Crosby & Overton And

Port Of Portland And Fails To Establish Any Nexus Between
Debt Concessions And DULUTH Costs.

Point Six: The Government Is Not Entitled To Any
Prejudgment Interest; There Has Been No Overpayment And
No Refund Is Due Until The Final Price Is Established.

(App. reply br. at i-iii, subheadings omitted) We take up each of these points in turn, after addressing the government's motion to strike a table in appellant's brief.

The Government's Motion to Strike

Appellant included in its brief "TABLE 1, Tab 15 Totals Compared to Tab 31 Totals" (app. reply br. at 12). This table lists 54 creditors ("vendors") included in the government's claim and, for each creditor, lists the total for the creditor from the Creditors Schedule (appx. A, tab 15) and the principal balance for the creditor from the Amount Allowed List (appx. A, tab 31). For example, for Crosby, the first creditor listed, the table indicates a total from the Creditors Schedule of 461,767 and a principal balance from the Amount Allowed List of zero. Appellant argues that Table 1 demonstrates that "the discrepancy rate for the vendors in the Government's claim between Tabs 15 and 31 exceeds 80%," and "actively negates any nexus between DULUTH contract costs and subsequent debt compromises" (app. reply br. at 11).

In its reply brief, the government argues that "SWM's new Table 1 is not even admissible evidence and is further flawed by gross omissions and numerous errors" (gov't reply br. at 6). The government further argues that "SWM's new Table 1 in its Brief is inadmissible as evidence..." (*id.* at 14).

The Board interpreted the government's argument as a motion to strike Table 1, and requested further briefing from the parties (order dtd. 25 Jan. 2011). Appellant argued that Table 1 was not evidence but argument; "it is an arrangement of evidence referred to and purportedly relied on by the Government's expert witness [Mr. Brown]." It also stated that Table 1 "assembles and juxtaposes the evidence purportedly relied on by the Government's expert, Mr. Brown, in support of Appellant's argument that Mr. Brown's testimony was inconsistent with the evidence on which he purported to rely." (App. ltr. dtd. 7 Feb. 2011 at 1)

The government replies that it "submits that Appellant's explanation of Table 1 shows that Table 1 is an attempt to introduce into the record information that has not been authenticated and subjected to cross-examination.... Appellant's [sic] asserts that Table 1 is argument. But in reality it is an after the fact attempt to insert new material into the record after it has been closed." The government cites *United Technologies Corp.*,

ASBCA No. 25501, 86-3 BCA ¶ 19,171 at 96,924, in which the Board struck attachments to a brief which summarized voluminous material. (Gov't ltr. dtd. 15 March 2011)

Table 1 does not summarize voluminous material. We accept appellant's explanation that Table 1 is argument designed to undercut Mr. Brown's testimony and deny the motion to strike.

Appellant's Point One: The Government Has Failed To Prove The Fundamental Fact Required By Order Of The Board: That Any "Particular Cost was 'Subsequently Excused.'"

In *SWM III*, after quoting from the District Court opinion (finding 24, *supra*), we stated "the Navy presumably will have to prove as part of its quantum case that a particular cost was 'subsequently excused.'" 08-2 BCA ¶ 33,981 at 168,078. Appellant agrees with this statement: "The Board has simply affirmed that, in order to qualify as a credit, any debt excused in April 1989 must be proven to be 'related to' a DULUTH contract cost incurred in 1986" (app. reply br. at 9).

Appellant makes two arguments under this heading. First, the government's expert witness, Mr. Brown, admitted that "creditor concessions cannot be traced to any specific invoice" (app. reply br. at 9, quoting Brown expert report at 3). Rather, the government took the amount of the creditor debt concessions and allocated them pro rata to the invoices associated with the DULUTH contract. Second, the pro rata allocations were based on an assumption that is contrary to fact, *viz.*, that it is possible to link the invoices listed in the Creditors Schedule (appx. A, tab 15) with the debt listed in the Amount Allowed List (appx. A, tab 31). Appellant asserts: "In fact, as demonstrated at Table 1...the discrepancy rate for the vendors in the Government's claim between Tabs 15 and 31 exceeds 80%" (app. reply br. at 11).

The government responds to the first argument that the Court of Appeals for the Ninth Circuit has already held "that these post-petition debt instruments [the debentures] relate back to the original pre-petition invoices for purposes of the FAR Credits Provision" (gov't reply br. at 4). It quotes the Court's statement that "[t]he debenture holder's [sic] agreement to forego collection of the debentures...was related to the claimed cost--there would have been no debentures had NMIW actually paid its subcontractors for the Duluth work" (*id.* at 4, quoting from the Circuit opinion, 217 F.3d at 1140). The government continues that what was left for it to do, was to quantify the portion of the debentures that related back to pre-petition DULUTH debt. The government did this through its "pro rata" methodology, which assumes that a pro rata share of the debt concessions related to the DULUTH invoices. Furthermore, the government adjusted its claimed amount "to consider the most conservative figures available" (*id.* at 5; *see* SOC revised page 11, reducing the amount claimed because of the

debt concessions). The government contends that this methodology was reasonable, and that appellant's expert did not challenge it (gov't reply br. at 5-6).

With respect to the second argument, the government points out what it contends are numerous errors in appellant's Table 1 (gov't reply br. at 7-9, 13-15, 17). More fundamentally, the government explains that the Creditors Schedule and the Amount Allowed List were starting points for its analysis. DCAA's approach when there was a disparity in the amounts shown for a particular creditor was to review other documentation to reconcile the difference. If the disparity could not be resolved, DCAA used the lower number, to the advantage of appellant. (Gov't reply br. at 9-13, 16)

In our view, the government has adequately established that particular costs were subsequently excused. We agree with the government that the difficulty in tracing the debt concessions to specific pre-petition invoices is inherent in the facts of the case. NMIW did not pay all of the invoices relating to the DULUTH and other contracts, resulting in debts. In 1986 NMIW instituted chapter 11 proceedings and ultimately provided the creditors with debentures in the face amount of the debts. In 1989, post-petition, NMIW invoiced the Navy, and was paid, more than \$2,000,000 in progress payments on the DULUTH contract (finding 12). Shortly thereafter the creditors conceded most of the debenture debt which had arisen from the unpaid invoices for work on the DULUTH and other contracts. The parties in the bankruptcy proceeding did not allocate the debt concessions to specific pre-petition invoices. In these circumstances, we agree with the government that all that was required on quantum was for it to come up with a reasonable method of determining what portion of the debt concessions related to the pre-petition invoices on the DULUTH contract as opposed to other contracts, and that the pro rata method is such a method.

With respect to appellant's second argument, we are satisfied that, in general, the government adequately reconciled the discrepancies in the various documents, and, where it could not do so, used the lower number. We were not satisfied with the government's evidence on Crosby and, accordingly, rejected the amount claimed for it (finding 40).

Appellant's Point Two: The Government's Accounting Expert Testified To A "Correct" Claim Calculation Method That Results In A Government Recovery Of Zero.

Mr. Brown's expert report states that "because NMIW had been reimbursed for the costs recorded in its accounting records before the debt concession[s] were obtained, NMIW has been overpaid by the same amount, excluding a retention of \$10,003" (at 8; tr. 3/24). Mr. Brown agreed on cross-examination that what the trier of fact should do is first determine the amount of costs that NMIW had been reimbursed, second determine

the cost of performing the work on the DULUTH less the debt concession credit, and then subtract the second figure from the first (tr. 3/25).

According to appellant, “[a]pplication of Mr. Brown’s calculation methodology to the true facts of this case results in a Government recovery of zero, for a simple reason: NMIW was not reimbursed for any costs whatever.... NMIW invoiced and was paid the agreed ceiling price for DULUTH which ‘was not based on NMIW’s actual incurred costs.’” (App. reply br. at 14-15, quoting the government’s admission which is quoted above in finding 11) Appellant adds in a footnote that even if the price paid were considered to be reimbursement of costs, Mr. Brown’s methodology would result in far less recovery for the government than it claims. Appellant arrives at this result by subtracting from the ceiling price (\$22,856,839) amounts for retention (\$10,003) and for adjusted final cost (\$22,638,953), resulting in an amount of \$207,883 (app. reply br. at 15 n.3, *see* finding 25 for the source of these numbers).

We are not persuaded by this argument. Based on NMIW’s incurred cost statement, NMIW’s costs on this contract at the time the parties agreed to a new ceiling price in Mod 202 exceeded the agreed-upon amount (findings 9, 11, 12). In paying NMIW the ceiling price (less \$10,003 retention), the Navy in substance was reimbursing NMIW for its costs up to that amount. We have already rejected the footnote argument in a prior opinion, *SWM IV*, 09-1 BCA ¶ 34,116 at 168,692 (in that opinion we used numbers from the SOC prior to revision, which resulted in a balance of \$237,023 as opposed to \$207,883). Fundamentally, appellant’s footnote argument ignores the requirements of the IPR clause (*id.*).

Appellant’s Point Three: The Government Has Failed To Prove An Essential Element Of Its Claim: The Contract Target Cost.

Here, appellant argues that in calculating target cost of \$17,582,184 (finding 25, line e), the government has made an improper “post-facto” adjustment to the amount of the increased target cost in bilateral Mod 202. Appellant concludes that “[t]he Government’s calculation of total target cost...does not accurately reflect the parties’ agreed target cost, is not reliable, and cannot be used to calculate quantum. The Government has failed in an essential element of its proof.” (App. reply br. at 16)

We have made detailed findings on Mod 202 above (findings 11, 81-87). We concluded there that the government’s interpretation of Mod 202 best gives meaning to all of its provisions, and is consistent with that expressed by appellant at the time. Appellant’s interpretation in its reply brief focuses on paragraph 1 of the modification and fails to give meaning to paragraphs 2 and 3. Accordingly, we reject that interpretation. The government has proved that the correct number to use for target cost is \$17,582,184.

Appellant's Point Four: Indirect Costs And SAIF: The Government Has Failed To Substantiate Its Claim For Avoidance Of The Parties' Indirect Cost Rate Agreement And Has Failed to Prove Any Credits To SAIF Costs For The Contract Year, 1986.

Point Four consists of two arguments relating to indirect costs. First, appellant argues that the government improperly "seeks to reduce the DULUTH indirect costs from the rates agreed by the parties in March 1989" (app. reply br. at 18). Contrary to appellant's argument, by date of 20 March 1989, NMIW and DCAA agreed in writing to indirect cost rates for FYs 86 and 87, but that agreement stated that the rates were applicable to the CUSHING contract (finding 10). NMIW and DCAA subsequently agreed to the same rates for the DULUTH contract, but that agreement, signed by SWM d/b/a NMIW, included a reservation that "this agreement will not change any...applicable impact of debt forgiveness..." (finding 21). Accordingly, the government is not limited to the rates agreed upon in March 1989 in calculating the amount of the debt concessions.

Second, appellant argues with respect to SAIF, the costs for which are charged indirect, that "if any credits to insurance costs are to be made based on the 1989 settlements, they are to be made in that year - not to any of many prior years covered in the 1987 buy-out" (app. reply br. at 23). We analyzed that contention at finding 68. We conclude, as we did there, that the amount of the debt concession relating to SAIF is properly booked in FY 86, the year to which the cost was charged as part of the incurred cost submissions.

Appellant's Point Five: Direct Costs: The Government's Proof DISPROVES Its Claims Concerning Crosby & Overton And Port Of Portland And Fails To Establish Any Nexus Between Debt Concessions And DULUTH Costs.

Here, after repeating its argument in point one that the government has failed to prove any nexus between cost invoices issued in 1986 and debts compromised in 1989, appellant focuses on alleged deficiencies in the government's proof as to Crosby and the Port. Our findings resolve the issues relating to Crosby and the Port. We agreed with appellant as to Crosby, but concluded that the government had proved its case as to the Port. (Findings 40, 59)

Appellant's Point Six: The Government Is Not Entitled To Any Prejudgment Interest; There Has Been No Overpayment And No Refund Is Due Until The Final Price Is Established.

The government seeks an award of interest from 15 August 1989 pursuant to the IPR and Interest clauses. Paragraph (g) of the IPR clause applies "until final price revision under this contract has been completed" (finding 3). It requires the contractor to

submit quarterly statements within 45 days after the end of each quarter of its fiscal year in which a delivery is first made (or services are first performed) and each quarter thereafter. Where the final price has not been established (as here), the quarterly statement is supposed to show cumulative total costs, total target profit, employing the formula in the IPR clause, and the total amount of all invoices. If the amount paid on invoices exceeds the sum due the contractor, “the Contractor shall immediately refund or credit to the Government the amount of this excess.” (*Id.*) If these provisions are not complied with, the IPR clause provides for the payment of interest:

(3) If the Contractor fails to submit the quarterly statement within 45 days after the end of each quarter and it is later determined that the Government has overpaid the Contractor, the Contractor shall repay the excess to the Government immediately. Unless repaid within 30 days after the end of the statement submittal period, the amount of the excess shall bear interest, computed from the date the quarterly statement was due to the date of repayment, at the rate established in accordance with the Interest clause.

(Finding 3) The Interest clause states in part that “Amounts shall be due at the earliest of the following dates: (1) The date fixed under this contract...” (finding 5).

Here, the government states, NMIW should have filed a quarterly statement for the period ending 30 June 1989. NMIW did not file a quarterly statement at that or any time subsequent to submission of its invoice on 5 April 1989. Therefore, the government is entitled to interest on the amount of the overpayment “from 15 August 1989, which is 45 days after 30 June 1989” (gov’t br. at 119).³

Appellant responds that the government’s argument is “incomprehensible.” It points out that August 1989 was three years after completion of performance and over two years after NMIW submitted its “final” contract costs in April 1987. (App. reply br. at 32 n.8; *see* finding 9) The IPR clause states explicitly, however, that the requirement to submit quarterly statements applies until final price revision has been completed. Presumably there would be no practical problem if there were no change in the relevant figures. Here, however, a major event, the creditor debt concessions, occurred in April 1989. Accordingly, appellant was required to file a quarterly statement, and refund or credit the government with the amount of the excess.

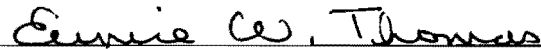
³ Evidently NMIW’s fiscal year, which ended May 31, was changed to match SWM’s, with a quarter ending on 30 June 1989. We calculate 45 days after 30 June 1989 as 14 August 1989, not 15 August 1989.

Appellant also argues that interest should not run at the earliest until such time as the total final price is established (app. reply br. at 33). This interpretation is directly contrary to paragraph (g)(3) of the IPR clause. Furthermore, the Interest clause is applicable, because the contract (the IPR clause) fixes the date from which interest is calculated (45 days after the date the quarterly statement was due). Accordingly, we conclude that the government is correct. Interest runs in accordance with the IPR and Interest clauses from 14 August 1989.

CONCLUSION

The government is entitled to recover \$1,104,479 plus interest pursuant to the Interest clause from 14 August 1989. The appeal is denied to that extent. It is sustained to the extent the government seeks greater amounts.

Dated: 16 June 2011



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

I concur

I concur



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



RICHARD SHACKLEFORD
Administrative Judge
Armed Services Board
of Contract Appeals

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA No. 54550, Appeal of Southwest Marine, Inc., rendered in conformance with the Board's Charter.

Dated:

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