ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --	)	
	)	
Raytheon Missile Systems Company	)	ASBCA No. 57594
	)	
Under Contract No. N00019-04-C-0569	)	

APPEARANCES FOR THE APPELLANT: Robert M. Moore, Esq.
Robert D. Windus, Esq.
Jason C. Constantine, Esq.
Moore & Lee, LLP
McLean, VA

APPEARANCES FOR THE GOVERNMENT: Ronald J. Borro, Esq.
Navy Chief Trial Attorney
James T. DeLanoy, Esq.
Senior Trial Attorney

OPINION BY ADMINISTRATIVE JUDGE CLARKE

Raytheon Missile Systems Company (Raytheon) appeals from the Navy contracting officer's decision denying its claim for $3,368,510 relating to an increase in the per gallon price of JP-10 fuel used in Tomahawk Cruise Missiles manufactured by Raytheon. We have jurisdiction pursuant to the Contract Disputes Act of 1978 (CDA), 41 U.S.C. §§ 7101-7109. We consider entitlement only. We sustain the appeal in part.

FINDINGS OF FACT

Request for Proposals/Raytheon's Proposal

1. On 22 December 2003 the Naval Air Systems Command (NAVAIR) issued a request for proposals (RFP) for Block IV Tactical Tomahawk Full Rate Production (FRP) Cruise Missiles (app. supp. R4, tab 3). The RFP provided, "JP-10 fuel and PBXN-7 will be furnished by the contractor. In addition, the JP-10 fuel shall be new fuel. The costs for these items should be included in the RMS[1] proposal." (*Id.* at 325) The RFP's Statement of Work (SOW) provided the following for "All-Up Rounds" (AUR):

[1] Raytheon Missile Systems.

4.1 AUR

The Contractor shall provide materials and services required to manufacture, integrate GFP, assemble, test and deliver new AUR missiles which meet the requirements of PMA280 1029. These AURs will be fueled using new JP-10.

(*Id.* at 353)

2. In February 2004, Raytheon submitted an updated proposal in response to the government's Block IV RFP (app. supp. R4, tab 5). In the Summary of Change portion of the updated proposal, Raytheon stated, "JP-10 has been added to the Bill of Material [BOM] and will be procured by Raytheon. Previously, that item had been assumed to be a GFE item." (*Id.* at 740) Raytheon's BOM listed JP-10 with a unit cost of $14.00 per gallon (*id.* at 742; tr. 1/85-86, 3/11, 48). Ms. Denise Winger was assigned to the supply chain organization at Raytheon and was responsible for purchasing JP-10 fuel for the Block IV Tomahawk contract (tr. 1/127). She purchased JP-10 from the Defense Energy Support Center (DESC) (tr. 1/128, 130). Ms. Winger reviewed DESC's pricing for JP-10. According to DESC's fuels price sheet, the price for JP-10 for FY 2002 was $15.15 and 2003 was $15.85 (tr. 1/131; app. supp. R4, tab 28 at 1413). The price for JP-10 for 2004 was $14.00 (tr. 1/138; app. supp. R4, tab 91 at 1757). Ms. Winger provided the $14.00 per gallon price for JP-10 used in the BOM/updated proposal (tr. 1/142). She testified that in her experience, there had been very little price fluctuation in the per gallon price of JP-10 (tr. 1/141). She testified that she believed that $14.00 per gallon was reasonable because it had been a very stable commodity with very little fluctuation in its unit price (tr. 1/143). She testified that when she provided the $14.00 to the proposal team, she had never heard that the price of JP-10 would include the price of a capital improvement program or the cost to purchase JP-10 inventory for DESC (tr. 1/142).

3. Mr. Walter Rogers was Raytheon's director of the Tomahawk program from December 2003 to June 2008 (tr. 1/55). He testified that DESC was the only source for JP-10 (tr. 1/87). He testified that Raytheon did not see much risk that the price of JP-10 would fluctuate much based on the price stability in the past (tr. 1/89). Raytheon did not consider asking for an economic price adjustment clause for JP-10 because of the low risk of price fluctuation (tr. 1/91). Mr. Michael Miller, an inventory management specialist for DESC, agreed that the price for JP-10 was relatively stable from 2001 through 2006 (app. supp. R4, tab 156 at 9-11, 41).

Contract No. N00019-04-C-0569

4. On 18 August 2004, NAVAIR awarded firm fixed-price Contract No. N00019-04-C-0569 (0569) to Raytheon for FRP of the Block IV Tomahawk Cruise Missile (R4, tab 4; tr. 1/87). The SOW of the FRP contract included the requirement that,

"[a]ll AURs will be fueled with new JP-10" (R4, tab 4, attach. 1 at 22; tr. 1/89). All Tomahawk missiles produced under the 0569 contract were fueled with JP-10 that was purchased by Raytheon from DESC (tr. 1/91; R4, tab 38). The contract included FAR 52.243-1, CHANGES–FIXED-PRICE (AUG 1987) (R4, tab 4).

JP-10

5. "JP-10 is a high-density, synthetic hydrocarbon liquid propellant used to launch all U.S. Navy and Air Force cruise missiles" (app. supp. R4, tab 101 at 1912). "JP10's use is specific to Defense Department missile programs, and there is no commercial application for processing JP10" (*id.* at 1913). Ms. Sharon Murphy, Director, Aerospace Energy Business Unit, DESC, (tr. 2/118), testified that there had never been more than one company manufacturing JP-10 – first Koch and then Dixie (tr. 2/175).

Defense Energy Support Center (DESC)[2]/Aerospace Energy Business Unit

6. From 2001 through October 2010, Ms. Murphy was the Director of the Aerospace Energy Business Unit, DESC (tr. 2/118). This unit manages JP-10 (tr. 2/119). DESC supports the Department of Defense, federal civilian customers, and authorized commercial customers (tr. 2/118-19, 171).

7. DoD Directive (DoDD) No. 4140.25, DoD Management Policy for Energy Commodities and Related Services, dated 12 April 2004, directs the Director of DLA to:

> Execute the integrated material management responsibility for propellants, pure gases, chemicals, cryogenic fluids; including procurement, transportation, ownership, accountability, budgeting, quality assurance and surveillance, and distribution of stocks to the point-of-sale.

(App. supp. R4, tab 40 at 1489) JP-10 is included in the commodities covered by DoDD 4140.25 (tr. 2/256).

8. The record includes DESC Policy Number DESC-P-11, Aerospace Energy, dated 14 April 2009,[3] that provides in part:

> 1.1. Pursuant to the authority delegated in DoDD 4140.25, DoD Management Policy for Energy Commodities and Related Services and DoD Manual 4100.39, Federal Logistics

[2] DESC and DLA-Energy are the same organization (tr. 1/129).

[3] The record does not contain an earlier version, however from Ms. Murphy's testimony we infer that the same policy existed from 2004 to 2009 (tr. 2/255-56).

Information System (FLIS), Volume 13, the Defense Energy Support Center (DESC) is the Department of Defense (DoD) Integrated Materiel Manager (IMM) for all Federal Stock Class (FSC) 9135 and certain 6830 and 9130 aerospace energy products. DoD customers who require aerospace energy products in the performance of government contracts shall obtain those products from the DESC, Aerospace Energy Commodity Business Unit (CBU) (DESC-M)....

....

1.4. All customers requiring aerospace energy products shall comply with the policies and procedures contained in this policy, to include utilization of the forms listed in Appendix 1....

....

3. **Responsibilities.**

3.1. The DESC Aerospace Energy CBU (DESC-M) shall:

3.1.1. Retain operational authority and responsibility for the entire supply chain for aerospace energy products managed by the CBU.

3.1.2. Perform all functions related to the end-to-end support to customers regardless of whether performed in-house or by DESC suppliers.

....

3.2. The DESC Program Support Branch (DESC-RRP) shall:

3.2.1. Be responsible for the financial management functions related to the supply and sales to customers of propellants, fuels, oxidizers and related items.

....

3.4. Aerospace Energy customers shall:

3.4.1. Comply with this regulation, as well as other guidance, interim or permanent, that applies to products and services managed by the Aerospace Energy CBU.

(App. supp. R4, tab 100 at 1876-78) Ms. Murphy, DESC, testified that the Aerospace Energy CBU performed all of the functions listed in DESC-P-11 (tr. 2/258). She testified that DoDD 4140.25 "assigns and delegates to DLA Energy DoD IMM authority for the commodities and supply chains we manage" including JP-10 (tr. 2/255-56). She testified, "[i]f Raytheon provided a funding document and we had the authority to support Raytheon, which we do, yes. All customers means Raytheon." (Tr. 2/257) She testified that Raytheon was an "authorized customer:"

Q. Well did it include Raytheon? Did your mission include the provision of fuel for use by Raytheon in fulfillment of its contract obligations to the Navy?

A. Yes, but because we had determined an authorized customer.

(Tr. 2/172) Ms. Peterson, DESC contracting officer for JP-10, agreed stating that DESC's "mission is to support DoD, so you either have to be DoD or you have to be supporting DoD under some kind of contract or grant in order for us to support you or the commercial space launch-out" (app. supp. R4, tab 154 at 15, 157).

9. On direct examination, Ms. Murphy testified that non-DoD/commercial customers are not required to purchase JP-10 from DESC and could procure it from other sources (tr. 2/127). She also testified that if Raytheon was dissatisfied with DESC's standard price it could hold its own competition for the supply of JP-10 (tr. 2/129, 146).[4] She testified that, "[t]hey [Raytheon] could have gone to their own supplier and awarded a contract other than to Dixie for the production of product" (tr. 2/146).

10. DESC is a Defense Working Capital Fund (DWCF) that means it must operate on a zero net operating (NOR) basis over a two year period (tr. 2/131-34, 2/197-98). This means that DESC is not supposed to recognize either a gain or a loss over that two year period (*id.*). DESC sets its standard fuel prices to accomplish NOR (tr. 2/198). All gains and losses from all commodities managed by DESC are considered

[4] This testimony conflicts with her testimony that Raytheon is a "DoD customer" and DESC Policy Number DESC-P-11 that mandates DoD customers "shall" purchase fuels such as JP-10 from DESC (finding 8).

in the arriving at NOR over a two year period (tr. 2/247). DESC has flexibility in adjusting its standard pricing to achieve NOR (tr. 2/245).

11. DESC describes its standard price as follows:

What the Standard Price of Fuel is

> The standard price of fuel is a tool that was created by DoD[']s fiscal managers to insulate the Military Services from the normal ups and downs of the fuel marketplace. It provides the Military Services and OSD with budget stability despite the commodity market swings, with gains or losses being absorbed by a revolving fund known as the Defense Working Capital Fund (DWCF). In years that the market price of fuel is higher than the standard price, the DWCF loses money. In years that the market price is lower than the standard price, it makes money. This gain or loss can be made up by adjusting the future standard prices or by providing our DoD customers with a refund....
>
> The standard price is established well in advance of the fiscal year it is used. It is built by assembling the following blocks:
>
> - A projection of the price of fuel 18 months in the future. (In the late fall the standard price is determined for fuel that will be sold to our customers during the Fiscal Year. As an example in the fall of 2005 the price is set that will be in effect from October 06 through September 07.)
>
> - The budgeted cost of transporting, storing, and managing the government fuel system, including war reserve stocks and some adjustment to those costs which reflects whether the revolving fund lost or gained money during the previous year.

What the Standard Price of Fuel is not

> The standard price of fuel is not a "marketplace price." You cannot compare the standard price of fuel with the price of fuel at the service station down the block. It is not intended that the standard price of fuel be comparable with similar fuels in the commercial market.

> The prices that you should examine for comparison with the "station down the block" are those which DESC actually paid for those fuels. They are invariably less than the price which is being offered in the commercial market place because of the centralized buying power of the federal government. We have provided a search field (below) to allow you to review the latest DESC acquisition cost of various commercial fuels.

(App. supp. R4, tab 128)

12. DESC and NAVAIR are completely separate organizations within DoD (tr. 2/141, 3/22). However, NAVAIR is DESC's customer (tr. 2/141).

Dixie Chemical Company

13. Prior to 2003 JP-10 was manufactured by Koch Chemical, but Koch stopped producing JP-10 in 2002 (tr. 2/172-73). DESC sought to replace Koch and conducted a competitive procurement designed to select a single manufacturer of JP-10 (tr. 2/175-76).

14. In anticipation of the competition for the new JP-10 vendor, the vendor certification process was discussed within DESC. Mr. Michael Miller, DESC, emailed Mr. James Wong, NAVAIR, the following:

> I have been discussing your request with my contracting officer and my quality folks and I would like to provide some additional information concerning our "new vendor" certification process for JP 10....
>
> Prior to contract award, we are unable to levy any type of requirement on prospective producers. We have provided interested parties with information on how to become certified to produce JP 10. One of these requirements is to send one two-gallon sample to the Air Force Research Lab (AFRL) in Ohio; a two-gallon sample representative of the product that will be offered from the contractors [sic] proposed production procedures will be submitted to this lab for full specification analysis.

(App. supp. R4, tab 33 at 1428) Mr. Wong forwarded Mr. Miller's email within NAVAIR adding:

> FYI. DLA finally sent me the JP-10 procurement requirements for the new vendors. I am having our fuel

> Chemists at AIR 4.4.5 to review these documents to make sure the Navy concurs with the new vendor certification process....

(App. supp. R4, tab 33 at 1427) Mr. Wong's email was forwarded to Raytheon (*id.*).

15. DESC awarded Contract No. SP0600-03-D-1509 (1509), a requirements contract for the supply of JP-10, to Dixie Chemical Co. on 2 February 2003 (R4, tab 23; tr. 2/176-77). Contract CLIN 0001AA provides $202,000 for "facility preparation" to pay Dixie to make changes to its plant so it could make JP-10 (R4, tab 23, § B; tr. 2/181). Facility preparation was required because the manufacture of JP-10 requires some "relatively unique" equipment such as a "high pressure hydrogenation" capability that "not every chemical company" has (app. supp. R4, tab 158 at 57). CLIN 0001AB requires a two-gallon preproduction sample and CLIN 0001AC requires a 6,000 gallon first article quantity (R4, tab 23, § B). The 1509 contract includes a Statement of Objectives (SOO) that in turn includes clause 10 Manufacturing Qualification Requirements. Clause 10(a) reads:

> a. If at time of contract award, the Contractor does not have full production capability to meet the Government requirements, the Contractor must meet the qualification requirements of both paragraphs (b) and (c) below. If the Contractor does have full production capability at time of contract award, the Contractor is only required to meet the qualification requirements of paragraph (c) below.

(R4, tab 23, SOO at 4-5) Clause 10(b) and (c) require that a contractor, such as Dixie, that does not have "full production capacity" at award, must pass both pre-production and first article testing (*id.*). The pre-production testing requires the contractor to produce four "homogeneous 1-gallon samples of JP-10...produced from a pilot plant which simulates the proposed process of the Contractor's production facilities." The contractor must test two of the 1-gallon samples and submit the test results and the other two 1-gallon samples to the Air Force Aerospace Fuels Laboratory at Wright-Patterson AFB, Ohio. If the pre-production sample passes "full specification analysis by the Government lab," the contractor is allowed to proceed with "plant retrofit/facility modification." (*Id.*) If the first article sample passes testing, the government will pay all "start up costs, to include plant retrofit/facility modification" (*id.*). CLIN 0002 provided for five years of "BULK" JP-10 at fixed prices ranging from $12.27 to $13.81 per gallon (R4, tab 23, attach. 1 at 4). CLIN 0003 provided for five years of "DRUM" JP-10 at fixed prices ranging from $13.45 to $15.13 per gallon (*id.* at 4-5.)

16. The SOO provided that Dixie could sell JP-10 to someone other than DESC provided, "Any sales of JP-10/PF-1 beyond those to DESC shall be coordinated in

advance with the DESC Contracting Officer, who shall negotiate a reduction in the unit price of CLINs 0002, 0003, and/or 0004 as consideration for the use of facility upgrades of which the Government reimbursed 100 percent to the contractor" (R4, tab 23, SOO at 1). Ms. Murphy testified that DESC could not use this authority to allow direct sales to Raytheon, "[b]ecause Raytheon was an authorized customer that we supported and built the facility to support" (tr. 2/187). She also explained that DESC had already taken Raytheon's JP-10 requirements into account when establishing their standard prices for JP-10 (*id.*). She agreed that DESC could not allow Raytheon to buy directly from Dixie because DESC's budgeting would be "out of whack:"

> Q And that's why you couldn't allow Raytheon to go purchase directly from Dixie because your budgeting to support DOD would have been out of whack right?
>
> A And the fact that the facility was for authorized customers that the government funded via the Dixie contract.

(Tr. 2/188) She further explained that Raytheon's requirements for JP-10 "were huge" and Dixie had a responsibility to support DESC's requirements (*id.*).

17. Since 2003 Dixie is the only manufacturer of JP-10 in the United States (tr. 2/174; app. supp. R4, tab 101 at 1913, tab 154 at 33-34). The use of JP-10 is limited to DoD missile programs, there is no commercial application for JP-10 (app. supp. R4, tab 101 at 1913).

18. Because DESC had paid for Dixie to develop the capability to manufacture JP-10, DESC would not allow Dixie to sell JP-10 produced on the government-funded facility to anyone other than DESC without DESC's consent (tr. 2/149-51; R4, tab 44 at 1; app. supp. R4, tab 73 at 1621, tab 155 at 56-57, tab 154 at 103). Ms. Murphy testified that Dixie could not sell JP-10 produced in its DESC funded facility to Raytheon or any other customers without DESC's permission (tr. 2/150). Ms. Murphy testified that the chance of DESC granting such permission is "none" because DESC needed to recoup the cost of paying for Dixie's plant modifications through the standard price (tr. 2/152). However, Ms. Murphy testified that Raytheon could purchase JP-10 from another source (tr. 2/127-29, 146), but she knew of no other production facility for JP-10 in the United States (tr. 2/142, 175).

19. A DESC publication entitled, "Fuel Line" dated April 2009 included the statement:

> The current JP-10/PF1 contractor, Dixie Chemical Company, has the only working JP-10/PF1 production facility in the United States and possibly the world. The cost of

> retrofitting Dixie's facility was evaluated as part of the previous procurement and upon award, was paid by Defense Energy Support Center's Aerospace Energy Commodity Business Unit at the beginning of the contract.

(App. supp. R4, tab 101 at 1913)

20. The record includes a 6 February 2008 "JUSTIFICATION FOR OTHER THAN FULL AND OPEN COMPETITION FOR PRODUCTION OF JET PROPELLANT 10 (JP-10) AND PRIMING FLUID 1 (PF-1) UNDER AUTHORITY OF 10 U.S.C. 2304 (c)(1) ONLY ONE RESPONSSIBLE SOURCE" authorizing a sole source extension of Dixie's JP-10 production contract (app. supp. R4, tab 77). The justification reads in part:

> a. Previous Procurement History: The current contract was competitively awarded to Dixie Chemicals on 20 February 2003. At the time of award, DESC Aerospace Energy paid Dixie Chemicals a one-time facility preparation fee of $202,000.00 in order to retrofit their facility for JP-10/PF-1 production. As such Dixie's facility in Houston, Texas, is now the only domestic production facility capable of producing JP-10/PF-1 in the United States....
>
> ....
>
> 5. Market Research/Efforts to Obtain Competition (10 U.S.C. 2304(f)(3)(D & E): The offeror is the sole domestic supplier of JP-10/PF-1 and has indicated an interest in continuing to provide the product under this contract. Dixie Chemical has an active production facility capable of meeting the Government's needs. There is no other known source that currently has the production capacity to meet our JP-10 needs for this extension period.

(*Id.* at 1634) A similar sole source justification with similar language was signed on 2 February 2009 (app. supp. R4, tab 96).

Defense Fuel Support Point (DFSP)

21. In a 2 February 2004 email from Ms. Murphy, DESC, to "Dennis" at Dixie, Ms. Murphy discusses the possibility of establishing a Controlled Storage Point (CSP) at Dixie for JP-10 (app. supp. R4, tab 37 at 1468, tab 38; tr. 2/119-220). The CSP consists of creating a storage capability at Dixie that would store JP-10 that was already accepted

and paid for by the government to allow for faster delivery of JP-10 to DESC's customers (*id.*; tr. 2/142, 174-75). Ms. Murphy testified that at the time DESC would not have brought their plans to build a CSP that might increase the price of JP-10 to their customers' attention (tr. 2/220). The CSP requirement document identified "[a] minimum of two storage tanks...with a useable capacity range from a combined total of 20,000 to 40,000 gallons" (app. supp. R4, tab 37 at 1470). DESC negotiated the possibility of establishing a CSP with Dixie in February 2006 (app. supp. R4, tab 55 at 1528). By early June 2006 the nomenclature had changed from CSP to DFSP, but the project had been "cancelled" (app. supp. R4, tab 65). By the end of June 2006 the DFSP project was back in play but it was decided to put "our requirements for a DFSP in the follow-on/new contract" (app. supp. R4, tab 66 at 1599). It appears from the email string that funding for the DFSP was a problem (*id.*, tab 154 at 139). Ms. Murphy testified that DESC did not mention the DFSP to its customers (tr. 2/220).

22. In June 2006, FY 2007 and 08 standard price increases were discussed in a series of internal DESC emails. On 6 June 2006, Ms. Canales, DESC, emailed Ms. Spillman, DESC, copy to Mr. Greeley (DESC), attaching a spreadsheet indicating that the price of JP-10 would increase from $13.09 to $25.00 per gallon for FY07 and 08 (app. supp. R4, tab 61 at 1566-69). On 6 June 2006 Mr. Jay Greeley emailed Ms. Spillman and Ms. Canales stating:

> There are a few thing [sic] we would like to take a look at prior to accepting these standard price increases.
>
> If I recall from the SP meeting, everyone seemed to agree that the prices we were setting were already the most that customers could handle. Many of the proposed changes that are in this email are +$20 greater.
>
> First:
>
> Do we really feel comfortable that the customer will continue to buy at these higher standard prices? In other words what is the elasticity of demand here?

(App. supp. R4, tab 61 at 1565-66) Ms. Canales emailed back on the same day, 6 June 2006, stating:

> As for whether we feel comfortable that the customer will continue to buy at the higher price, for hydrazines, N204 and JP10, we have the only source of supply and with the additional requested costs from DESC-M and the loss in sales; it is justifiable and warranted to increase the standard

> prices to recover our costs. The remaining products that we increased the standard prices all have additional costs that are on the obligation and expense plan that need to be recovered. There are very few large programs within missile fuels that we could increase the standard prices to allow us to recover $8.6M to be at zero AOR [sic] in FY08 after we expense everything including the $13.5M.
>
> ....
>
> For JP10, they are creating a new DFSP that is expected to have a cost $468,000.00.

(App. supp. R4, tab 61 at 1563-64)

23. On 21 January 2009, DESC awarded Contract No. SP0600-09-D-1518 (1518), an indefinite quantity contract, to Dixie (R4, tab 54). The contract listed a total quantity of JP-10 as 613,392 gallons from 20 May 2009 through 19 January 2014 at unit prices ranging from $14.99 to$16.87 (R4, tab 54 at 3, 4). The contract's STATEMENT OF OBJECTIVE/WORK AND/OR SPECIFICATIONS (JP-10/PF-1) (AEROSPACE ENERGY) (DESC SEP 2008), paragraph 5, BULK STORAGE REQUIREMENTS, required Dixie to provide a bulk storage DFSP with a minimum of two storage tanks capable of holding at least 130,000 gallons of government owned JP-10 (R4, tab 54 at 9). Paragraph 5, subparagraph c reads:

> c. The Government intends to build a reserve inventory of JP-10 of 100,000 gallons. This inventory build will begin as soon as possible after First Article Test Acceptance. The timeline for the inventory build will be based on the plant's production capacity. As such, the total required storage capacity of 130,000 gallons is not needed at time of contract award and may be provided incrementally to accommodate the inventory build.

(*Id.*) CLIN 0001AB in the amount of $1,199,940, includes costs for the First Article sample of 6,000 gallons of JP-10 and the DFSP (*id.* at 4; app. supp. R4, tab 158 at 68). Ms. Murphy testified that DESC paid Dixie to build the DFSP and that it was completed in FY 09 (tr. 2/231-32). In January 2009 DESC's price to its customers for JP-10 was $25.00 per gallon (app. supp. R4, tab 10 at 809). Ms. Murphy testified that proceeds from the $25.00 per gallon price were used to purchase 100,000 gallons of JP-10 to stock the DFSP and that DESC owned the JP-10 stored in the DFSP (tr. 2/237-38).

DESC Standard Prices for FY 2002 through FY 2011

24. Missile fuel prices were published annually in DESC memorandums. The FY 2002 price for JP-10 ("PC 28") was $15.15 per gallon (app. supp. R4, tab 28 at 1413; tr. 1/131). The FY 2003 price for JP-10 was $15.85 per gallon (app. supp. R4, tab 29 at 1416). The FY 2004 price for JP-10 was $14.00 per gallon (app. supp. R4, tab 30 at 1420; tr. 1/138). The FY 2005 price for JP-10 was $15.50 per gallon (app. supp. R4, tab 31 at 1422; tr. 1/146). The FY 2006 price for JP-10 was $13.09 per gallon (app. supp. R4, tab 7 at 800; tr. 1/148). The FY 2007 price for JP-10 was $25.00 per gallon (R4, tab 6 at 2). The FY 2008 price for JP-10 was $25.00 per gallon (app. supp. R4, tab 9 at 805). The FY 2009 price for JP-10 was $25.00 per gallon (app. supp. R4, tab 10 at 809). The FY 2010 price for JP-10 was $25.00 per gallon (app. supp. R4, tab 11 at 813). The FY 2011 price for JP-10 was $15.75 per gallon (app. supp. R4, tab 13 at 820).

25. Ms. Murphy, DESC, testified that NAVAIR did not participate in or have any involvement in setting DESC's standard prices (tr. 2/140). She testified that the FY 2007 price increase to $25.00 was partially based on a loss in the previous year (tr. 2/138, 218). She testified that surplus money resulting from the sale of $25.00 JP-10 had the effect of offsetting loses from other commodity sales (tr. 2/246). She testified "[w]e roll up and we look at the bottom NOR to balance to a zero NOR. But it's not by commodity. It's not all of DLA. It's Aerospace Energy products." (Tr. 2/248-49)

Raytheon's Reaction to the FY 2007 Price Increase

26. Ms. Winger, the person responsible for purchasing JP-10 for Raytheon (tr. 1/127), first learned of the FY 2007 price increase to $25.00 per gallon in July 2006 when she saw the DESC standard price sheet (tr. 1/175). She testified that she was "utterly shocked" because she had never seen such an "exorbitant price increase" in JP-10 in the past (*id.*). She immediately notified her program personnel of the FY 2007 price increase to $25.00 (tr. 1/92, 176; R4, tab 7). She also sought to determine if Raytheon could mitigate the impact of the price increase (tr. 1/177).

27. Mr. Rogers, Director Tomahawk Program, testified that he learned that the FY 2007 price increase was not due to market conditions but that the government wanted to fund a "tank farm" for JP-10 (tr. 1/93, 95-96). He testified that Raytheon had assumed the risk that the price of JP-10 might fluctuate based on market conditions, but not based the government's desire to build a tank farm and finance it through a price increase in JP-10 (tr. 1/101). Raytheon experienced a similar price increase in titanium caused by market conditions and Raytheon did not file a claim because it had assumed that risk (tr. 1/94).

28. By email dated 19 September 2006, Ms. Winger, Raytheon, wrote Ms. Jessie Hamilton, DESC, the following:

> Is it possible for DESC to grant permission for Dixie Chemical to sell direct to Raytheon? We used to due [sic] business with Koch when they manufactured JP-10.
>
> Also, can you provide rationale as to what is driving the huge influx in price from $13.09 to $25.00? This is going to have a drastic impact on my Program's Budget for the upcoming year.

(App. supp. R4, tab 67 at 1602)

29. On the same day, 19 September 2006, Mr. Michael Miller, DESC, responded to Ms. Winger stating in relevant part:

> Thought I would jump in and hopefully answer your questions/concerns....
>
> At this time, DESC Aerospace Energy plans on supporting your requirements within the timeframe for which they were projected to us and cannot authorize Raytheon to local purchase JP-10 from our vender (Dixie Chemicals Inc.). If we were unable to support your forecasted requirements, DESC would contact you and work towards an alternate product support solution.
>
> DESC operates using the Defense Working Capital Fund (DWCF) which is a revolving fund that serves all DLA customers. We budget our requirements and requests funds be made available based on customer forecasted requirements like yours. As with all of our customers working within this system, we rely heavily on these forecasts in order to accurately set our annual standard prices and maintain pricing stability at competitive rates. Several things cause our standard prices to vary from year to year: 1) Un-forecasted product requirements and or related services may drive expenses, 2) increases in direct purchase costs or ancillary production and transportation costs, 3) Wide variances in sales will also impact you standard prices in the out years (cost recovery is absorbed in the out year process). These are

> the major factors that cause variations in standard prices, but variations are not limited to these events.
>
> These past two years, DESC has been working on improving our support posture for JP-10 deliveries due to an increased demand on product deliveries with shorter turn-around times than we have experienced in the past. A corporate decision was made to offset aggressive turn-around delivery times by setting up a controlled DESC inventory (Defense Fuels Support Point – DFSP) at our contractor's facility. We have calculated our FY07 standard price to include the costs associated with setting up a DFSP, which will benefit all programs by ensuring inventory availability for immediate release when the situation requires.
>
> We apologize for any impact this price change may have on your program, but would ask that all of our customers continue to join us in sharpening our pencils and work towards keeping our prices competitive by anticipating future program requirements.

(App. supp. R4, tab 67 at 1601-02; tr. 1/181-82) This email was the first time that Ms. Winger heard of DESC's plan to build a DFSP (tr. 1/190-91). Ms. Winger testified that she was not allowed to purchase JP-10 directly from Dixie and that she was required to purchase it from DESC (tr. 1/149). Ms. Murphy testified that DESC would not allow Raytheon to buy directly from Dixie because DESC had paid Dixie $202,000 plus $73,000 for a total of $275,000 to modify Dixie's facility to be able to produce JP-10 (tr. 2/182-83). DESC's contract with Dixie had an "exclusivity provision in it that did not allow Dixie to sell to other customers other than DLA Energy or DESC at that time, without our authorization and approval" (tr. 2/150-51).

30. Ms. Winger asked DESC if Raytheon could make a bulk purchase of 100,000 gallons of JP-10 before the price went up in FY 2007 (tr. 1/178-79; app. supp. R4, tab 8 at 801). She was told that Raytheon would not be able to make bulk purchases before the price went up (tr. 1/182-83). Ms. Winger testified that she had "never" been told that JP-10 was not available to fill her orders until she asked to purchase the 100,000 gallons (tr. 1/191). In an 18 September 2006 email Ms. Hamilton, DESC, explained that the bulk purchase was not possible because it would take 60 to 90 days prior notification for such a large order and there was no DESC storage facility large enough to handle that amount of JP-10 (app. supp. R4, tab 67 at 1603). Likewise, Raytheon did not have a storage facility large enough to store 100,000 gallons of JP-10 but it was investigating "all possibilities for storage" at other locations (tr. 1/178). Once Raytheon learned that the bulk purchase

was not a possibility, it stopped looking for appropriate storage (tr. 1/182). Ms. Murphy's testimony corroborates Ms. Winger's testimony (tr. 2/147-48).

31. NAVAIR also inquired of DESC if Raytheon could purchase JP-10 directly from Dixie. In an 18 January 2007 email to DESC, Mr. Ambroziak, NAVAIR, asked if it would be possible for Raytheon to purchase JP-10 directly from Dixie (R4, tab 44 at 2). Ms. Hamilton responded:

> As we stated on the phone verbally, DESC Aerospace Energy are the Integrated Material Managers (IMMs), for DOD and Missile Fuel (JP-10), and services to all authorized DOD customers; to include commercial customers under the Commercial Space Launch Act (CSLA). No one is permitted/authorized to purchase (JP-10) directly from Dixie Chemical under the current contract....

(R4, tab 44 at 1)

Raytheon's Purchase of JP-10

32. On 17 November 2005, Ms. Winger signed Purchase Order (PO) No. 0010115282 ordering 116,200 gallons of JP-10 from DESC[5] at $13.09 per gallon (tr. 1/150; R4, tab 38). Ms. Winger explained that the price could change based on DESC's yearly pricing and that various "versions" or changes to the PO would reflect changes in prices and actual orders of fuel (tr. 1/151, 154-55). The first actual order was for 4,000 gallons of JP-10 at $13.09 per gallon (for deliveries in FY06) (R4, tab 5). Version 2 of the PO indicates that effective 1 October 2006 (FY 07) the price changed from $13.09 to $25.00 (tr. 1/166; app. supp. R4, tab 121 at 1995). While the purchase order history is somewhat confusing, it indicates that the price changes from $13.09 to $25.00 as of 1 October 2006 (*id.*), and from $25.00 to $15.75 in "version 15" of the PO in 2011 (app. supp. R4, tab 121 at 1993). Ms. Winger testified that there was only one qualified source of JP-10 and that was Dixie (tr. 1/198), and that the price remained $25.00 through FY 2010 (tr. 1/198-200; app. supp. R4, tab 9 at 805, tab 10 at 809, tab 11 at 813).

33. Mr. Thomas Blume has been contract manager for the Tomahawk program since October 2008 (tr. 2/49). He signed the claim submitted by Raytheon (tr. 2/63; R4, tab 12). Rule 4(b), tabs 14, 122 contain invoices for JP-10 that indicate Raytheon paid $25.00 per gallon for the fuel (tr. 2/75, 80). Mr. Blume testified that the "financial damage" caused by the price increase was $3.3 million (tr. 2/83).

---

[5] Raytheon ordered directly from DESC, NAVAIR was not identified on the purchase order (R4, tab 38).

Raytheon's REA, Certified Claim and Contracting Officer's Final Decision

34. On 20 December 2007, Raytheon submitted its REA requesting $1,719,664 based on the increase in the price of JP-10 to $25.00 (R4, tab 10). On 18 December 2008, the government denied Raytheon's REA (R4, tab 11). On 5 October 2009, Raytheon submitted a CDA certified claim requesting $3,909,544 based on the increase in the price of JP-10 to $25.00. Raytheon alleges that the price increase combined with refusal to allow bulk or direct purchases constituted a constructive change, breach of the duty to cooperate and not hinder performance and unconscionability. (R4, tab 12) By final decision dated 4 February 2011, the government denied Raytheon's certified claim (R4, tab 21). Raytheon appealed to the ASBCA on 14 April 2011 and the appeal was docketed as ASBCA No. 57594 on 15 April 2011.

DECISION

Contentions of the Parties

The Navy contends that the Board lacks jurisdiction. It argues Raytheon should have filed its claim with DESC because the fuel was purchased from DESC and DESC increased the price not NAVAIR (gov't br. at 17). Raytheon counters that the Board's jurisdiction is based on the final decision denying its claim under its contract with NAVAIR (app. reply br. at 5-7).

Raytheon's argument is founded upon the contention that "NAVAIR is responsible for the actions of DESC" (app. br. at 37), or stated another way, DESC's actions in raising the price of JP-10 are imputed to NAVAIR. Raytheon's primary argument relies on cases that impute one agency's actions to another based upon the relationship between the agencies. Raytheon argues that DoD established a "significant bond" between DESC and NAVAIR by making DESC the Integrated Materials Manager (IMM) for fuels, including JP-10 (app. br. at 37-40). Having imputed DESC's decision to increase the price of JP-10 to NAVAIR, Raytheon contends that by requiring it to fund the construction of a DFSP, fund the purchase of 100,000 gallons of JP-10 to stock the DFSP and subsidize losses DESC experienced in commodities other than JP-10, the Navy constructively changed the contract (app. br. at 40-43) and breached its implied duty not to hinder or interfere with Raytheon's performance (app. br. at 49-51).

The Navy counters stating that the cases cited by Raytheon do not apply to the facts of this case and that, "there is no evidence in the record of a 'significant bond' or for that matter any bond between DESC and NAVAIR" (gov't reply br. at 35). The Navy contends that Raytheon failed to satisfy the requirements of the Changes clause and is not entitled to a price adjustment (gov't br. at 22). The Navy argues that since there was no constructive change there could be no breach for not granting an adjustment under the

Changes clause (gov't reply br. at 37). The Navy argues that NAVAIR had no involvement with Raytheon's choice to purchase JP-10 from DESC and therefore could not have interfered with its performance (gov't reply br. at 38-39).

The Navy contends that since NAVAIR's contract with Raytheon was a fixed price contract without an economic price adjustment clause covering JP-10, Raytheon assumed the risk of a price increase (gov't br. at 18-22). Raytheon counters that the price increase was not caused by market factors which was the only risk it assumed (app. reply br. at 7-13).

Finally Raytheon contends that it suffered financial damage because it had to buy JP-10 at $25.00 per gallon when its price was based on $14.00 per gallon (app. br. at 54-55). The Navy counters that Raytheon failed to mitigate any damage and was paid for the risk it assumed (gov't reply br. at 40). The Navy also contends that Raytheon failed to prove damage (gov't br. at 23-24). Raytheon counters that the Navy demands proof of quantum when, in an entitlement only proceeding, it need only prove the fact of damage, not the precise amount (app. reply br. at 20-25).

Jurisdiction

With respect to jurisdiction, we agree with Raytheon. The 0569 contract was between Raytheon and NAVAIR (finding 4). Raytheon submitted a written, certified claim to NAVAIR asserting a right to a sum certain resulting from the increase in the price of JP-10 (finding 34). A NAVAIR contracting officer issued a final decision denying the claim and Raytheon submitted a timely appeal to the Board (*id.*). Accordingly we have jurisdiction. *Green Dream Group*, ASBCA No. 57413 *et al.*, 12-2 BCA ¶ 35,145.

The analysis we are about to embark upon involves three distinct questions. First, is DESC's decision to increase the price of JP-10 imputed to NAVAIR? Second, if the price increase is imputed to NAVAIR, was it a breach of NAVAIR's implied duty not to hinder or interfere with Raytheon's performance? Third, if there was a breach, was Raytheon damaged thereby?

Is DESC's Decision to Increase the Price of JP-10 Imputed to NAVAIR?

Raytheon contends that DESC's decision to increase the price of JP-10 may be imputed to NAVAIR because of the significant bond between them (app. br. at 37-40). We agree that there is a sufficiently "close relationship" (app. br. at 37), between DESC and NAVAIR to impute DESC's decision to increase the price of JP-10 to NAVAIR. We start our analysis by noting that the Federal Circuit recognizes DESC is the "purchasing agent" for fuel for the Department of Defense, "[t]he plaintiffs entered into multiple contracts with the Defense Energy Support Center, a purchasing agent for the Department

of Defense, to supply fuel."[6] *ConocoPhillips v. United States,* 501 F.3d 1374, 1376 (Fed. Cir. 2007). We also take into consideration the fact that DESC is the Integrated Material Manager (IMM) for, among other things, aerospace energy products including JP-10 (findings 7, 8). As such "DoD customers who require aerospace energy products in the performance of government contracts shall obtain those products from the DESC, Aerospace Energy Commodity Business Unit (CBU) (DESC-M)" (finding 8). NAVAIR is a DoD customer and therefore must purchase JP-10 from DESC. Raytheon is an authorized customer of DESC and likewise was required to purchase JP-10 from DESC (finding 16). Based on the fact that DESC is both the IMM and purchasing agent of JP-10 for NAVAIR we conclude that there is a "significant bond" between NAVAIR and DESC. This conclusion is further supported by the cases discussed next.

Raytheon relies upon *Weaver Construction Co.,* DOT BCA No. 2034, 91-2 BCA ¶ 23,800 and the cases cited therein to support its argument (app. br. at 37-39). Weaver Construction contracted with the Federal Highway Administration (FHA) to build a bridge across the Muddy River in the Gifford Pinchot National Forest, Washington, an area supervised and regulated by the Forest Service. During contract performance the Forest Service issued fire closure orders that prevented Weaver from performing work. The DOT BCA imputed the forest service's actions to the FHA and concluded that the FHA could be responsible for interference with the contract:

> That the acts were committed by personnel of the Forest Service rather than by Federal Highway Administration personnel is irrelevant. Where there is a "significant bond" between two agencies and their projects, the Government will be held liable for a breach, even though it is committed by the non-contracting agency. *See, J. A. Jones Construction Co. v. United States*, 182 Ct. Cl. at 626 [390 F.2d at 892]. *Accord, L. W. Foster Sportswear Co. v. United States*, [405 F.2d 1285, 1291-92], 186 Ct. Cl. 499, 510 (1969). In this case, there is "a significant bond" between the Federal Highway Administration and the Forest Service. The contract work was performed in a national forest that was supervised and regulated by the Forest Service. Coordination between the Federal Highway

---

[6] *ConocoPhillips* involved jet fuel. We are mindful of the distinction between "bulk" petroleum and aerospace energy (JP-10). The contracting officer, Ms. Peterson, testified that DoD Directive No. 5101.8 appointed DESC the "Executive Agent" for bulk petroleum and that aerospace energy (JP-10) was not bulk petroleum (app. reply br. at 4 ¶ 12). However, the Federal Circuit does not refer to the DoD Directive in support of its conclusion that DESC is the purchasing agent for fuel for DoD and we consider DESC to be DoD's purchasing agent for JP-10.

> Administration and the Forest Service concerning the contract was undoubtedly essential.

Weaver Construction, 91-2 BCA ¶ 23,800 at 119,184.[7]

In *J.A. Jones Construction Co. v. United States*, 390 F.2d 886, 892-93 (Ct. Cl. 1968), the court, reviewing a decision of the ASBCA, noted that the Air Force and Army Corps of Engineers (COE) were part of the DoD and that the COE was the "construction agency" for the Air Force. Based on this relationship, the court reversed the ASBCA and held that the Air Force, though not the contracting party, had a duty to disclose to Jones certain construction plans that would increase Jones' labor costs.[8] In *J.A. Jones Construction* the court distinguished *Bateson-Stolte, Inc. v. United States*, 172 F. Supp. 454 (Ct. Cl. 1959). Bateson-Stolte, under contract with the COE, built a power house that was part of the Clark-Hill multi-purpose dam and reservoir project on the Savannah River. The COE was both the contracting and using agency for the power house. At the time of award to Bateson-Stolte, the Atomic Energy Commission (AEC) was planning a billion dollar construction project in an area also on the Savannah River. The AEC contracted with E. I. Du Pont for construction, not the COE. The AEC's project caused the prevailing wages to increase, an increase that Bateson-Stolte did not anticipate but had to pay. In denying the government's motion for judgment on the pleadings the court said:

> It is at least questionable that defendant should be held liable, unless the agency dealing with plaintiff had knowledge of what the Atomic Energy Commission was going to do. If it had been the Atomic Energy Commission that had dealt with plaintiff, it would have been its duty to disclose to plaintiff that it was going to use this very large labor force on this other project, so plaintiff could have taken this into consideration in estimating its labor costs. If it had not done so, it would have been responsible for the increase over what plaintiff had estimated in preparing its bid. But, in a business so vast as that engaged in by the United States Government, with its multitudinous departments, bureaus, and independent agencies, with various and sundry projects scattered all over the world, it is impossible for one department to know what another department is going to do. In such case, it seems

---

[7] In *Weaver* the DOT BCA denies a government motion for summary judgment and as such it was not a decision on the merits.

[8] Although the court did not employ the theory of imputing the Air Force's knowledge to the COE, it relied on the relationship between the parties to find the duty. This is the same kind of relationship that allows for imputing knowledge from one agency to another.

> unreasonable to charge one agency with knowledge of what another one is going to do. It would seem that defendant should be held liable only if the agency that dealt with plaintiff had knowledge of the impending employment of this huge labor force.

Bateson-Stolte, 172 F. Supp. at 457.[9] In *J.A. Jones* the court, referring to *Bateson-Stolte*, stated:

> They were wholly independent agencies. The Corps was not the contracting, construction, or service agent for the Commission, which was building its plant for itself. It would, furthermore, have been unrealistic to impose a duty on the AEC to warn Bateson-Stolte that the AEC contractors might conceivably drain the labor supply counted on for the Clark Hill Project.... In sum, there was no significant bond between the two agencies, or their projects, and no reason for the AEC to look out for Engineers' contractors.

J.A. Jones, 390 F.2d at 892. Such is not the case with DESC and NAVAIR.

In *L.W. Foster Sportswear Co. v. United States*, 405 F.2d 1285 (Ct. Cl. 1969), the Court of Claims considered the effect of a change in contracting offices. Between 1949 and 1956 L.W. Foster manufactured approximately 200,000 goatskin flying jackets under contract with the Navy. The specifications were defective, however, the Navy allowed deviations to facilitate manufacture. In 1956 the contracting organization was changed to the Army's Military Clothing and Textile Supply Agency (MCTSA). There was "no finding and little evidence that the MCTSA actually knew of the defects in the specifications or the prior practice with regard to deviations from the flying jacket contract requirements, or that it had consulted with the Navy prior to the award concerning the problems involved in this sort of procurement." *L.W. Foster*, 405 F.2d at 1291. The MCTSA would not allow deviations as was the case with its Navy predecessor. The court held, "[i]n this case the relationship between the Navy and MCTSA, with respect to this procurement, was such that the contractor could reasonably anticipate that they would consult, that the latter would learn from the former of the deviations which had been permitted, and that the new agency would follow the same policies." *L.W. Foster,* 405 F.2d at 1291. In other words, the court imputed the Navy's knowledge to the MCTSA based on the "relationship" between them. The "relationship" was that the MCTSA was purchasing the flight jackets for the Navy.

[9] As with *Weaver*, this was not a judgment on the merits.

In this appeal, the Navy counters first citing *L'Enfant Plaza Properties, Inc. v. United States*, 645 F.2d 886 (Ct. Cl. 1981), that involved a construction project in Washington, D.C. L'Enfant Plaza leased land from the District of Columbia Redevelopment Land Agency (RLA), an agency of the federal government. The lease provided that L'Enfant Plaza was to build a large combined hotel and office building. L'Enfant Plaza also entered into an Area Project Coordination Agreement with RLA and the General Services Administration (GSA) and other redevelopers for the purpose of coordinating construction schedules. Before L'Enfant Plaza commenced construction, a GSA contractor built a large building (the HUD building) on adjoining property. That contractor laid foundations that encroached on L'Enfant Plaza's leased land that interfered with its construction project. There was no evidence that RLA knew of the encroachment of the foundation by the GSA contractor. The court, relying on the quote we included above from *Bateson-Stolte*, concluded:

> Here, we see no ground for charging RLA with constructive knowledge of the activities of GSA's contractor. RLA and GSA are independent entities and have no connection, outside of the fact that both agencies were involved with the urban development of the L'Enfant Plaza complex....
>
> In particular, the Area Project Coordination Agreement and the lease provisions relating to it are not sufficient to create the kind of close relationship between GSA and RLA under which it would be appropriate to impute to the latter any knowledge which the former might have had of McShain's improper placement of the HUD Building footings....

L'Enfant Plaza, 645 F.2d at 890. The case was ultimately decided on the risk allocation inherent in the lease. Based on this precedent the Navy states, "Thus, it would be 'unreasonable to charge' NAVAIR with knowledge at contract award of what DESC years subsequently was 'going to do' in setting DESC JP-10 standard price for any fiscal year" (gov't reply br. at 34). We disagree with the Navy's conclusion concerning imputation of knowledge and we disagree that the knowledge must be imputed at contract award. However, we point out DESC first discussed the CSP (later the DFSP) in February 2004 (finding 21), six months before award of the 0569 contract (finding 4).

The Navy distinguishes *Weaver Construction* by pointing out that it was a denial of a motion for summary judgment and that "no entitlement for the contractor was ever found" (gov't reply br. at 34). Although true, *Weaver Construction* is an example where one Board, the DOT BCA, found that a "significant bond" existed when one agency (FHA) contracted to build a bridge on land of another agency (Forest Service). The Navy distinguishes *J.A. Jones Construction* by arguing that DESC "did not award or administer

a contract on behalf of NAVAIR" (*id.*). We disagree. While DESC did not have privity of contract with NAVAIR, DESC was the purchasing agent for JP-10 for NAVAIR and therefore was acting "on behalf of NAVAIR." The fact that NAVAIR required Raytheon to place the actual order with DESC does not change DESC's relationship with NAVAIR. The Navy also raises the knowledge issue, "[n]either NAVAIR nor DESC had any knowledge at time of award about the future setting of DESC standard prices for FY 2007 through FY 2010 that Raytheon did not have" (*id.*). We disagree that knowledge at time of award is important. However, as we stated above, DESC discussed the establishment of a CSP (later DFSP) six months before the award of contract 0569; Raytheon had no knowledge of that fact. While we agree that in 2004 DESC would not know what the FY 2007 through FY 2010 prices would be, it was considering building a CSP and it knew or should have known that the establishment of a CSP could affect the price of JP-10.

The Navy argues, "[i]n contrast with JA Jones Construction NAVAIR did not tell DESC for what to contract or with whom.... Neither NAVAIR nor the subject contract requires Raytheon to place a P.O. with DESC for JP-10 or to continue to order and to receive deliveries pursuant to that P.O." (Gov't reply br. at 34-35) This argument reflects the Navy's position seen in its briefs that Raytheon was free to conduct its own competition to find another supplier of JP-10 (findings 9, 18; gov't br. at 8, ¶ 31, at 12 ¶ 41, at 18) or that Raytheon could provide another type of fuel other than JP-10 suggesting that Raytheon could simply go back to the old fuel, RJ-4 (gov't br. at 8, ¶ 31, at 18; gov't reply br. at 1, ¶ 87). In fact, the contract required JP-10 (findings 1, 4), Dixie was the only source of JP-10 and Dixie was only allowed to sell it to DESC (findings 3, 5, 13, 16-20). DESC would not allow Dixie to sell directly to Raytheon because it needed the revenue (finding 18). The Navy and DESC were meticulous in qualifying Dixie as a source of JP-10 and the contract imposed continuous testing/quality assurance requirements on Dixie (findings 14, 15).[10] It is inconceivable that the Navy or DESC would allow Raytheon to simply select another supplier or worse yet substitute another fuel to use in one of this nation's primary tactical weapons, the Tomahawk cruise missile. The Navy's argument is simply beyond belief. The primary testimony supporting the Navy's argument is that of Ms. Sharon Murphy, Director of the Aerospace Energy Business Unit, DESC (finding 6). Ms. Murphy's testimony was conflicting. On cross-examination when asked about the requirement in DESC Policy Number DESC P-11, Aerospace Energy, that "DoD customers who require aerospace energy products in the performance of government contracts shall obtain those products from the DESC, Aerospace Energy Commodity Business Unit (CBU) (DESC-M)" and "[a]ll

[10] The Navy elicited testimony that DESC did not "pre-qualify" bidders on the JP-10 contract (gov't reply br. at 7, ¶ 27) but provided no explanation of "pre-qualification." Given the fact that the bidders did not have the equipment necessary to produce JP-10, we interpret it to mean that bidders were not obligated to expend funds to prove they can manufacture JP-10 before award.

customers requiring aerospace energy products shall comply with the policies and procedures contained in this policy," she testified that "[a]ll customers means Raytheon" (finding 8). This testimony was corroborated by Ms. Peterson, DESC contracting officer for JP-10 (*id.*). However, on direct examination, Ms. Murphy testified that Raytheon "could have gone to their own supplier and awarded a contract other than to Dixie for the production of product" (finding 9). We also note that Ms. Murphy testified that since Raytheon was an "authorized customer," Dixie would not be allowed to sell directly to Raytheon (findings 16, 18). Although she testified that Raytheon could find another source for JP-10, she also testified that she knew of no other source other than Dixie in the United States (finding 18). We find Ms. Murphy's testimony that Raytheon could contract with another supplier of JP-10 not credible.

The Navy distinguishes *L.W. Foster* by arguing that "no knowledge of a past practice with a predecessor agency is even in the record" (gov't reply br. at 35). This may be true but it misses the point. *L.W. Foster* stands for the proposition that the "significant bond" exists where one agency (Army MCTSA) buys something for another agency (Navy). *L.W. Foster*, 405 F.2d at 1291-92.

The Navy states, "[m]oreover, there is no evidence in the record of a 'significant bond' or for that matter any bond between DESC and NAVAIR. There is only evidence in the record of no bond." (Gov't reply br. at 35) We disagree. In this case DESC and NAVAIR were both part of the DoD and DESC was the purchasing agent for JP-10 for NAVAIR. Previously NAVAIR purchased JP-10 directly from DESC and furnished JP-10 to Raytheon as GFP. NAVAIR contract 0569 changed that and required Raytheon to provide the JP-10 (findings 1, 4). DESC was the only source of JP-10 available to Raytheon (findings 3, 5, 13, 16-20). The fact that NAVAIR required Raytheon to purchase the JP-10 does not affect the "significant bond" between NAVAIR and DESC. We hold that DESC's decision to raise the price of JP-10 to finance the building of the DFSP, stock the DFSP with JP-10, and cover losses for other commodities managed by the Aerospace Energy Business Unit of DESC (findings 23, 25), is imputed to NAVAIR.

Did NAVAIR Breach its Implied Duty Not to Hinder or Interfere with Performance?

The Federal Circuit established the guidelines we must follow in assessing the issue of government breach of the implied duty of good faith and fair dealing[11] in *Precision Pine & Timber, Inc. v. United States*, 596 F.3d 817 (Fed. Cir. 2010). Before we discuss the standard established in *Precision Pine*, we very briefly discuss the cases upon which *Precision Pine* is based, *Centex Corp. v. United States*, 395 F.3d 1283 (Fed. Cir. 2005) and *First Nationwide Bank v. United States.*, 431 F.3d 1342 (Fed. Cir. 2005). *Centex* and *First Nationwide* are members of the group of cases related to *United States*

[11] The implied covenant of good faith and fair dealing includes noninterference. *Centex*, 395 F.3d at 1304.

v. Winstar Corp., 518 U.S. 839 (1996), that involve an issue of sovereign immunity. The concept of "specifically targeted" action in *Precision Pine* was utilized in the *Winstar* cases to avoid sovereign immunity:

> We do not interpret those passages from *Winstar* to suggest that the unmistakability doctrine automatically applies whenever an exercise of the government's power to tax is involved. The quoted references to the taxing power assumed that the particular legislation in question was an "exercise of a sovereign power," and thus was not the kind of targeted legislation that the *Winstar* Court treated as not constituting such an exercise.

Centex, 395 F.3d at 1309-10; *see First Nationwide*, 431 F.3d at 1351. In *Precision Pine* the concept of "specifically targeted action" finds its way into government contract cases that have nothing to do with sovereign immunity. Such is the case in this appeal.

The court in *Precision Pine* frames the standard derived from *Winstar* in the colloquial concepts of "bait-and-switch" and "double crossing:"

> There are no similar indicia of a governmental bait-and-switch or double crossing at work here. We conclude that there was no breach of the government's implied duty of good faith and fair dealing because the Forest Service's actions during these formal consultations were (1) not "specifically targeted," and (2) did not reappropriate any "benefit" guaranteed by the contracts, since the contracts contained no guarantee that the Precision Pine's performance would proceed uninterrupted. *Cf. id.* at 1306.
>
> The Forest Service's actions are not akin to the "specifically targeted" government action in *First Nationwide, Centex*, or *Hercules*. In those cases, the subsequent government action was for the specific purpose of eliminating an express, bargained-for benefit in the contracts and "sole[ly] impact[ed]" these contracts. *Hercules*, 516 U.S. at 420; *First Nationwide*, 431 F.3d at 1350-51; *Centex*, 395 F.3d at 1305-07. Here, there is no evidence that the Forest Service's slight delay in initiating formal consultations, or its initially unsuccessful attempts to formulate a satisfactory Biological Opinion, were undertaken for the purpose of delaying or hampering Precision Pine's contracts. Nor is there any evidence of bad faith or a failure to cooperate with Precision

> Pine. *Cf. Centex*, 395 F.3d at 1304-06; *Malone*, 849 F.2d at 1445-46.

Precision Pine, 596 F.3d at 829. Accordingly, we must determine if NAVAIR's increase in the price of JP-10 (1) was "specifically targeted" at Raytheon and (2) "reappropriated" a benefit guaranteed by the contract to Raytheon – or employing *Precision Pine's* parlance, did NAVAIR "double cross" Raytheon? We believe it did.

Specifically Targeted Action

We imputed DESC's Aerospace Energy Business Unit's price increase to NAVAIR, the government agency in privity of contract with Raytheon. Therefore, as a matter of law, NAVAIR is responsible for the price increase in JP-10. DESC was the only source of JP-10 available to Raytheon (findings 3, 5, 13, 16-20). The price increase affected only DESC's customers purchasing JP-10. Therefore, NAVAIR's action "specifically targeted" that small group of JP-10 customers, including Raytheon. The first element of breach of the implied duty is satisfied.

Did NAVAIR's Action Reappropriate a Benefit Guaranteed by the Contract?

It is true that the contract did not guarantee that the price of JP-10 would not increase, nor did it include a price escalation clause. In that sense the contract allocated the risk of a price increase in JP-10 to Raytheon. However, we must determine if the risk thus allocated to Raytheon fairly included the risk that NAVAIR would increase the price to finance the DFSP, fill it with JP-10 and cover the losses from other commodities and thus deprive it of the fruits of its bargain.

Inherent Risk in Firm-Fixed-Price Contracts

We agree with the Navy that the general rule in fixed-price contracting is that, in the absence of a contract provision reallocating risk, a contractor assumes the risk of the increase in material and labor costs. In *Southern Dredging, Co.*, ENG BCA No. 5843, 92-2 BCA ¶ 24,886, the Engineer BCA found that Southern Dredging had assumed the risk of a rise in the price of fuel due to Iraq's invasion of Kuwait, "[u]nder a well-established principle of contract law, a contractor assumes the risk of unexpected increase in the cost of the materials and supplies necessary for performance absent an express contract provision shifting the risk to the Government." *Southern Dredging*, 92-2 BCA at 124,116. In *New Era Contract Sales, Inc.*, ASBCA No. 56661 *et al.*, 11-1 BCA ¶ 34,738, the item was fuel pumps manufactured by Isuzu Motors. The price increased because Isuzu stopped giving a discount to New Era. The ASBCA held that New Era assumed the risk of such a price increase under its firm fixed-price contract. From the cases mentioned above and similar cases we conclude that the risk allocated to contractors by fixed-price-contracts of

unexpected increases in the costs of material and labor is very broad indeed. However, it is not unlimited.

Maya Transit Co., ASBCA No. 20186, 75-2 BCA ¶ 11,552, for example, involved a "limited form"[12] requirements contract[13] for school bus service on U.S. Naval Base, Subic Bay. The case involves school bus route #12. Route #12 was cancelled "due solely to budgetary limitations." *Maya Transit*, 75-2 BCA ¶ 11,552 at 55,124. In arriving at its decision, the ASBCA first made several inferences:

> At the time the contract was entered into the Government had certain capabilities to fulfill its various needs. This bus service was in excess of its capabilities at the time and consequently was purchased from the contractor. Likewise the Government had a budget which apparently contained adequate funds for this procurement. The allocation of its capabilities to various needs according to their various priorities is a matter of internal management. Budgeting funds for the various requirements according to their priorities is likewise an internal matter. We say no more than that having undertaken to purchase from a contractor those bus service needs in excess of its own capabilities the Government may not, by reordering its budget priorities, or redistributing its capabilities, eliminate a portion of its excess needs from the contract. We infer on this record that the "budgetary limitations" resulted from a decision to apply available funds elsewhere. We infer that the Government was able to provide this bus service itself by either developing additional bus capability or forsaking some other bus requirement. There is no evidence that the Government's other bus needs were diminished so as to release that much of its capability to provide this service.

Maya Transit, 75-2 BCA ¶ 11,552 at 55,125. The Board then quoted from *Womack v. United States*, 389 F.2d 793 (Ct. Cl. 1968):

> In summary, the defendant overreaches when it says that the variance in quantity clause, within its percentage limits, put the risk of an index card overrun, whatever its

---

[12] The government promises to buy less than all of its needs. *Maya Transit*, 75-2 BCA ¶ 11,552 at 55,121, 55,125.

[13] We recognize that Raytheon did not have a requirements contract, but both Raytheon's contract and the delivery orders in Maya's contract were firm-fixed-price.

> cause and foreseeability, on the plaintiffs. Specifically, the clause apportions only a particular type of risk to the parties, the risk of an excess or shortage resulting from factors not reasonably apparent to them at the time that they entered into their contract. The clause does not require one party to bear the first 25 percent of the burden of the other party's negligence.

Womack, 389 F.2d at 801. Relying on *Womack* the Board concluded:

> The same logic is applicable when the increase or decrease is caused by whatever other factors not reasonably within the ambit of the risk assumed by the appellant when it agreed to the variation clause. We think it clear that the appellant did not assume the risk that the Government would refuse to order its needs in excess of its capabilities. That its school bus needs might increase or decrease was a risk assumed. That its other bus needs might decrease or increase making available for school bus service more or less of its capability was a risk assumed. There might be other risks assumed as well; however, we are confident that it was not contemplated by the appellant that the Government's internal "budgetary limitations" were within the risk the appellant was expected to assume.

Maya Transit, 75-2 BCA ¶ 11,552 at 55,126. In *Womack* the court applied a standard based on whether the other party's negligence increased the cost while in *Maya Transit* the standard applied was "reasonably within the ambit of the risk assumed." These concepts serve to limit the risk inherent in fixed-price contracts. We now consider if there are similar limits on the risk associated with the price of JP-10 allocated to Raytheon by the 0569 contract.

Raytheon's View of the Risk it Assumed

When assembling its bid, Raytheon included $14.00 per gallon for JP-10 based on the history of price stability for JP-10 (finding 2). Mr. Rogers, Director Tomahawk Program, testified that Raytheon did not see much risk that the price of JP-10 would fluctuate much based on the price stability in the past (finding 3). He testified that Raytheon had assumed the risk that the price of JP-10 might fluctuate based on market conditions, but not based on the government's desire to build a tank farm and finance it through a price increase in JP-10 (finding 27). Mr. Rogers recounted a situation where the price of titanium increased unexpectedly and Raytheon did not submit a claim

because it was the risk it had assumed (*id.*). This testimony was referenced in Raytheon's post-hearing brief (app. br. at 18, ¶ 67).

The Risk Allocated to Raytheon by the Contract

DESC publishes an explanation of what its standard price is and is not (finding 11); Raytheon is charged with that knowledge. DESC specifically states that its standard price is "not a market price" (finding 11). Therefore, contrary to Mr. Rogers' testimony, Raytheon knew or should have known that DESC's prices were set based on more than just market conditions.

DESC's published explanation of how its fuel prices are determined is:

> It is built by assembling the following blocks:
>
> - A projection of the price of fuel 18 months in the future. (In the late fall the standard price is determined for fuel that will be sold to our customers during the Fiscal Year. As an example in the fall of 2005 the price is set that will be in effect from October 06 through September 07.)
>
> - The budgeted cost of transporting, storing, and managing the government fuel system, including war reserve stocks and some adjustment to those costs which reflects whether the revolving fund lost or gained money during the previous year.

(Finding 11) We conclude that although the contract allocated to Raytheon the risk of changes in the price of JP-10, that risk was limited to increases caused by the components of the price as defined in the published explanation of DESC's standard price. The "benefit" involved in this case was Raytheon's right to limit its risk of a price increase to those components identified in DESC's standard price.[14] We now need to determine if NAVAIR's increase in price "reappropriated" that benefit.

In order to complete this analysis we consider the composition of the $25.00 per gallon price Raytheon complains of. Raytheon does not challenge that portion of the $25.00 that pays for the cost of the JP-10 normally charged by DESC, i.e., $13.09 per gallon in FY 06 (finding 24). Raytheon identifies three costs paid for by the $25.00 price

[14] Indeed, if we were to adopt the government's theory of the case we would have to credit DESC with discovering a contract mechanism that is capable of solving all of the government's funding problems.

increase it believes it should not be held responsible for. They are: (1) funding the construction of a DFSP; (2) funding the purchase of 100,000 gallons of JP-10 to stock the DFSP; and, (3) subsidizing losses DESC's Aerospace Energy Business Unit experienced in commodities other than JP-10 (app. br. at 40-43). We consider each of these individually.

The Cost of Losses from Commodities Other Than JP-10

This is the easiest of the three costs Raytheon complains of to resolve so we consider it first. As stated above, DESC publicly explains what its standard price is and is not (finding 11). We have held that Raytheon's risk is defined by that description. One of the items making up the price is "whether the revolving fund lost or gained money during the previous year" (finding 11). This would include losses for commodities managed by Aerospace Energy Business Unit, DESC, other than JP-10 (findings 10, 11, 25). We find that the third element of damage claimed by Raytheon, paying for losses of commodities other than JP-10, was a clearly stated component in the definition of the standard price. Therefore, the contract allocated to Raytheon the risk that the price of JP-10 would increase as a result of losses from all commodities DESC's Aerospace Energy Business Unit managed. NAVAIR's "targeted action" of increasing the price for these losses therefore did not "reappropriate" a benefit from Raytheon. The Navy did not breach its implied duty as to this component of the $25.00 price increase.

Financing the Construction of the JP-10 DFSP

It is undisputed that DESC increased the price of JP-10 to $25.00 per gallon in FY 2007 for, among other things, the purpose of financing the construction of the DFSP (findings 21-23). As explained above, we consider the risk allocated to Raytheon to be defined and circumscribed by the published description of how the standard price is calculated (finding 11). The DFSP consists of large storage tanks (findings 21, 23). One sentence in the standard price description deals with storage, "[t]he budgeted cost of transporting, storing, and managing the government fuel system." Raytheon's experience with JP-10 was that its price was generally stable (findings 2, 3, 24). This according to Raytheon was why they were willing to include a fixed price of $14.00 in its overall price (finding 2). Availability of JP-10 was not a problem. Ms. Winger testified that there was "never" a problem with availability of JP-10 until she asked to purchase the 100,000 gallons (finding 30). Based on the language of the standard price description, the stability of the price of JP-10, and the general availability of JP-10 to fill Raytheon's orders, we do not interpret "storing" to be broad enough to impose upon Raytheon the risk of financing a new storage facility for JP-10. Accordingly, we find that NAVAIR's "targeted action" increasing the price of JP-10 to finance the DFSP "reappropriated" Raytheon's right to limit its risk to DESC's "standard price" description. Therefore, NAVAIR breached the implied duty of cooperation and noninterference.

Funding the Purchase of 100,000 Gallons of JP-10 to Stock the DFSP

DESC's contract 1518 with Dixie, among other things, stated that the government "intends to build a reserve inventory of JP-10 of 100,000 gallons" (finding 23). DESC used part of the proceeds from the $25.00 per gallon price of JP-10 to purchase the "reserve inventory" stored in the DFSP (*id.*). This reserve inventory was owned by DESC (*id.*). We do not believe that DESC's standard price description includes the risk that Raytheon buy JP-10 for someone else. We find that NAVAIR's "targeted action" increasing the price of JP-10 to stock the DFSP "reappropriated" Raytheon's right to limit its risk to DESC's "standard price" description. Therefore, NAVAIR breached its implied duty of cooperation and noninterference.

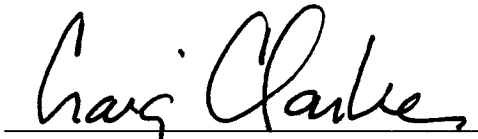
Was Raytheon Damaged by the Price Increase?

Raytheon included $14.00 per gallon for JP-10 in its firm fixed-price for the 0569 contract (finding 2). On orders for JP-10 during FY 2007 to 2010, Raytheon paid $25.00 per gallon for JP-10 it ordered (finding 32). Mr. Blume, Tomahawk contract manager, testified that the "financial damage" caused by the increase in the price of JP-10 to $25.00 was $3.3 million (finding 33). We have held that in making this price increase NAVAIR breached its implied duty of cooperation and noninterference. Since Raytheon was required to pay more than the $14.00 per gallon for JP-10 in its firm fixed-price for increases associated with this breach by NAVAIR, it was financially damaged by the breach. The amount of that financial damage is yet to be decided in the quantum portion of this appeal.

CONCLUSION

To the extent the price of $25.00 per gallon of JP-10 includes the cost of constructing the DFSP, the appeal is sustained. To the extent the price of $25.00 per gallon of JP-10 includes the cost of the reserve inventory stored in the DFSP, the appeal is sustained. In all other regards the appeal is denied. The case is remanded to the parties to determine quantum.

Dated: 18 March 2013



CRAIG S. CLARKE
Administrative Judge
Armed Services Board
of Contract Appeals

(Signatures continued)

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 No. 57594, Appeal of Raytheon Missile Systems Company, rendered in conformance with the Board's Charter.

Dated:

JEFFREY D. GARDIN
Recorder, Armed Services
Board of Contract Appeals