No. 99-1258

In the Supreme Court of the United States

MCDONNELL DOUGLAS CORPORATION AND GENERAL DYNAMICS CORPORATION, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals properly reversed and remanded for a trial on the issue of the contractors' default, where the trial court awarded government contractors a judgment of $1.2 billion without considering whether they were in default of the contract.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-27a) is reported at 182 F.3d 1319. The opinion of the Court of Federal Claims (Pet. App. 28a-72a) is reported at 35 Fed. Cl. 358.

JURISDICTION

The judgment of the court of appeals was entered on July 1, 1999. A petition for rehearing was denied on October 29, 1999 (Pet. App. 73a-74a). The petition for a writ of certiorari was filed on January 27, 2000. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In January 1988, a team composed of petitioners McDonnell Douglas Corporation and General Dynamics Corporation entered into a contract with the Navy to design and build the A-12 Avenger, a new carrier-based attack aircraft employing low-observable (stealth) technology. See Pet. App. 1a-2a. The contract was a fixed-price incentive contract which provided that petitioners would design and build eight Full Scale Engineering Development aircraft for a ceiling price of $4,777,330,294. *Id.* at 2a. Delivery of the first aircraft was to take place in June 1990, with subsequent deliveries to be made at specified times from July 1990 to January 1991. *Ibid.*

From early on, petitioners encountered difficulty in designing and building an aircraft that would meet critical contract specifications within the negotiated schedule. Pet. App. 3a. In June 1990, petitioners failed to deliver the first aircraft as required under the contract, and they informed the government that the estimated cost of performing under the contract would substantially exceed the contract ceiling price. *Ibid.* Petitioners stated at that time that "the A-12 contractual schedule is not achievable and needs to be changed," and they asserted that the aircraft performance specifications had to be "modif[ied]." C.A. App. 15,616.[1]

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[1] Petitioners' statements were made in the midst of increasing evidence of their failure to overcome a wide range of problems in the design and fabrication of the aircraft. For example, the Navy estimated that the first plane entering fleet operations would weigh nearly 8,000 pounds—or over 20 percent—more than the empty weight specified in petitioners' best and final contract offer. See Pet. App. 32a; C.A. App. 27,080. In addition, petitioners had been unable successfully to fabricate (much less assemble) the

In August 1990, after unsuccessfully attempting to reach agreement with petitioners on an extended date for delivery of the first aircraft, the Navy unilaterally modified the contract to extend that delivery date to December 31, 1991. Pet. App. 3a. During the ensuing months, the Navy and the Department of Defense engaged in a comprehensive review of the issues arising from the cost, schedule, and performance failures associated with the program. See C.A. App. 13,388-13,391; Pet. App. 4a. In November 1990, petitioners submitted a formal proposal to restructure the contract. Pet. App. 4a. Petitioners emphasized that, in their view, development and production of the A-12 "under the terms of the existing contractual arrangement * * * is not possible, or equitable, or authorized by law." C.A. App. 16,334A. At the same time, petitioners commenced efforts to obtain assistance under Pub. L. No. 85-804, 50 U.S.C. 1431, which authorizes the Secretary of Defense to modify defense contracts when to do so "would facilitate the national defense." See C.A. App. 16,329, 18,217-18,226.

On December 17, 1991, the Navy issued a cure notice informing petitioners that their performance under the contract was unsatisfactory. Pet. App. 5a. The Navy explained that petitioners had failed to fabricate sufficient parts to meet the contract schedule. *Ibid.* In addition, the Navy stated that petitioners' "failure to meet specification requirements, such as aircraft weight, jeopardizes the carrier suitability of your design." C.A. App. 16,524. Because those conditions

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large composite parts necessary to produce the aircraft's inner wing, and were more than a year behind in completing the avionics software. See C.A. App. 3402-3404, 3519-3528, 3736-3738, 13,691, 25,906, 26,549-26,550.

were "endangering performance of [the] contract," the Navy informed petitioners that it might terminate the contract for default unless those conditions were cured by January 2, 1991. Pet. App. 5a.

In meetings with the government during the next two weeks, petitioners adhered to the position that they could not build the A-12 for the agreed-upon price, under the agreed-upon schedule, and to the agreed-upon specifications. See C.A. App. 16,533 (contracting officer's minutes of Dec. 18 meeting); *id.* at 16,548-16,549, 16,554-16,555 (minutes of Dec. 21 meeting); *id.* at 18,186 (minutes of Jan. 2 meeting); Pet. App. 5a-6a. On January 2, 1991, in their formal reply to the government's cure notice, petitioners stated that they would "not meet delivery schedules or certain specifications of the original contract, or the revised FSD delivery schedule." *Id.* at 6a. Petitioners asserted as well that compliance with the Navy's demand to cure the schedule, weight, and other conditions was "unachievable." C.A. App. 18,177. Petitioners proposed to have the government restructure the contract under Pub. L. No. 85-804 as a cost reimbursement fixed-loss contract, and they agreed to absorb a fixed loss of $1.5 billion. Pet. App. 6a.

On Saturday, January 5, 1991, Secretary of Defense Cheney determined that he would not authorize relief from the contract under Pub. L. No. 85-804. Pet. App. 6a. As he later explained, "no one could tell me how much the program [would] cost even just through the full-scale development phase or when [the aircraft] would be available. Data that had been presented at one point a few months ago turned out to be invalid and inaccurate." *Hearings on Authorization and Oversight of National Defense Authorization Act For FY 1992 and 1993 Before the House Comm. on Armed Services*,

102d Cong., 1st Sess. 60 (1991). The Secretary's decision was communicated to the Navy's contracting officer, Rear Admiral William R. Morris, by Under Secretary of Defense for Acquisition Donald J. Yockey. See Pet. App. 6a-7a. The Under Secretary was aware that the Navy was scheduled to commit $553 million under the contract on January 7, 1991. *Id.* at 6a. Under Secretary Yockey informed Admiral Morris that, in light of the Secretary's decision, no further funds should be obligated. *Id.* at 7a.

On January 7, 1991, Admiral Morris issued a letter terminating the A-12 contract for default. Pet. App. 7a. The termination letter explained that the action was based on the contractors' inability "to complete the design, development, fabrication, assembly and test of the A-12 aircraft within the contract schedule," as well as their "inability to deliver an aircraft that meets contract requirements," including the "weight guaranty contained within the contract specification." C.A. App. 18,297. The same day, Admiral Morris prepared a termination memorandum for the file, further explaining that the contractors had demonstrated "an inability or unwillingness * * * to meet the requirements of the contract." *Id.* at 18,303. The memorandum concluded that "the team's failure to make progress and to deliver an aircraft meeting required [cost, performance, and schedule specifications] has placed the entire program in jeopardy; and the contractors have offered no adequate excuse for these failures." *Id.* at 18,305. Shortly thereafter, the Navy issued a formal demand for the return of unliquidated progress payments totaling $1.35 billion. Pet. App. 7a.

2. In June 1991, petitioners filed the present action in the Claims Court (now the Court of Federal Claims (CFC)) challenging the government's default termina-

tion on a number of grounds. Pet. App. 7a. The complaint requested (*inter alia*) that the court "convert the government's termination for default into a termination for convenience." *Ibid.*[2] The CFC eventually focused on Count XVII of the complaint, which claimed that the government's termination of the contract for default was improper because the actions of the Department of Defense had deprived the contracting officer of the ability to make an "independent decision" regarding the termination. C.A. App. 68,460. The court held a trial on Count XVII in September 1993. The court made clear at the outset that the purpose of the trial was not to consider "whether there was sufficient evidence to justify a legitimate decision to terminate this contract for default," but solely to determine "whether improper factors [led] to the decision such that the decision itself was made for a[n] illegitimate reason." *Id.* at 74.

In December 1994, the CFC issued a brief order vacating the default termination. See Pet. App. 29a. In

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[2] "The right to terminate a contract when there has been no fault or breach by the non-governmental party, that is, for the 'convenience' of the government, appeared as a legal concept after the Civil War, to facilitate putting a speedy end to war production." *Maxima Corp.* v. *United States*, 847 F.2d 1549, 1552 (Fed. Cir. 1988). When the contract is properly terminated for convenience, the contractor's recovery is limited to "costs incurred, profit on work done and the costs of preparing the termination settlement proposal. Recovery of anticipated profit is precluded." *Ibid.* If the contractor would have sustained a financial loss in completing the contract, the contractor's recovery is further reduced by the rate of loss that the contractor was experiencing. 48 C.F.R. 49.203. Where a contract has been terminated because of an erroneous determination that the contractor was in default, the Federal Circuit has recognized that it has the power to treat the termination as one for the convenience of the government. See *Maxima Corp.*, 847 F.2d at 1553.

April 1996, the court issued findings of fact and conclusions of law in support of its decision to convert the government's termination for default to a termination for convenience. *Id.* at 28a-72a.[3] The court acknowledged that petitioners had not met the June 1990 delivery date for the first plane, and had informed the Secretary of Defense that they "were having schedule and cost problems that would not allow them to perform under the terms of the contract." *Id.* at 33a. The court also found that Admiral Morris, the contracting officer, had "based the termination on the fault of the contractors because he did not believe that the Navy bore any responsibility for the contractors' perceived inability to achieve the contract specifications or deliver the aircraft on schedule," and because a termination of the contract for convenience "would result in a windfall to the contractors." *Id.* at 47a.

Relying principally on the decision of the United States Court of Claims (a predecessor to the Federal Circuit) in *Schlesinger* v. *United States*, 390 F.2d 702 (1968), the CFC nevertheless concluded that the default termination was improper because it was not the product of "reasoned discretion." Pet. App. 51a. The

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[3] During the period between the December 1994 order and the April 1996 opinion, the CFC repeatedly rejected the government's contention that the termination for default could not properly be converted to a termination for convenience without a trial to determine whether petitioners were, in fact, in default. The court refused to allow the government to file a two-volume proffer detailing the evidence of the contractors' default. C.A. App. 177, 263. The court eventually held a trial, in 1995, to consider only the evidence of default that was *concealed* from the Navy. But the court stopped those proceedings in the middle of the government's case, concluding that it had "heard no credible evidence that the Navy was unaware of critical information at the time of termination." *Id.* at 179.

court found that Secretary Cheney's decision not to grant relief under Pub. L. No. 85-804, which led to the termination of the A-12 program, was at odds with the Navy's inclination to continue the contract despite petitioners' failings. *Id.* at 52a-54a. On that basis, the court concluded that "[t]he A-12 contract was not terminated because of contractor default," but "because the Office of the Secretary of Defense withdrew support and funding from the A-12." *Id.* at 72a.

After converting the government's termination for default to a termination for convenience, the CFC held further proceedings on the question of damages and ultimately entered judgment for petitioners in the amount of $3,877,767,376. Pet. App. 2a. Because petitioners had already received progress payments of nearly $2.7 billion, the net judgment awarded by the trial court was approximately $1.2 billion, plus interest. *Id.* at 8a.

3. The court of appeals reversed and remanded for a trial on the question whether petitioners were in default of the contract. See Pet. App. 1a-27a. The court ruled that the CFC had "erred by vacating the termination for default without first determining whether a default existed." *Id.* at 18a. The court noted that on remand the government will bear the burden of proof with respect to the question whether termination for default was justified, and that "if the government is not able to make this showing, then the default termination was invalid and [petitioners] would be entitled to a suitable recovery." *Id.* at 19a.

The court of appeals concluded that *Schlesinger* was inapposite. It explained that "[t]he illegality in *Schlesinger* stemmed from the Navy's reliance on contractor default as a pretext to terminate its relationship with the contractor, independent of the state of actual

performance under the contract." Pet. App. 11a. In the instant case, by contrast, the court of appeals found that "the record demonstrates that the government properly terminated the A-12 program [and contract] for reasons related to contract performance." *Id.* at 14a. The court concluded that "because the termination for default was predicated on contract-related issues, it was within the discretion of the government." *Id.* at 2a.[4]

ARGUMENT

The court of appeals' interlocutory ruling is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is not warranted.

1. a. Petitioners do not contend that the decision of the court of appeals is in conflict with any decision of this Court or of any other court of appeals. Instead, their core contention is that the court of appeals did not properly apply the rationale of *Schlesinger* v. *United States*, 390 F.2d 702 (Ct. Cl. 1968), which is the authority upon which the trial court placed primary reliance. See Pet. 11; Pet. App. 51a-59a. Petitioners' claim of an intra-circuit conflict does not satisfy the Court's usual criteria for the exercise of certiorari juris-

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[4] The court of appeals noted the government's separate arguments concerning the trial court's assessment of damages. Pet. App. 19a-20a. It concluded, however, that in light of its disposition of the liability issue, questions pertaining to damages were "not ripe for [its] decision" and should be considered in the first instance by the CFC on remand. *Id.* at 20a. The court also rejected the contention raised in petitioners' cross-appeal that the A-12 contract was not subject to termination for default because it was funded incrementally. *Id.* at 21a-26a. Those issues are not raised in the petition.

diction. See *Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957).

b. The interlocutory nature of the court of appeals' ruling also weighs against review by this Court at the present time. The court of appeals "remand[ed] the case to the trial court for a determination of whether the government's default termination was justified, an issue upon which [the court of appeals] express[ed] or intimate[d] no view." Pet. App. 2a. Review by this Court would consequently be premature. See, *e.g.*, *Brotherhood of Locomotive Firemen* v. *Bangor & Aroostook R.R.*, 389 U.S. 327, 328 (1967) ("because the Court of Appeals remanded the case, it is not yet ripe for review by this Court"); *Virginia Military Inst.* v. *United States*, 508 U.S. 946 (1993) (the Court "generally await[s] final judgment in the lower courts before exercising [its] certiorari jurisdiction") (Scalia, J., respecting the denial of certiorari).

2. a. The decision of the court of appeals is correct and consistent with that court's precedent. In *Schlesinger*, the Navy terminated a contract for 50,000 caps on grounds of default when the contractor sought a limited extension of a delivery date. See 390 F.2d at 703-706. The court of appeals agreed that Schlesinger was technically in default at the time of the termination because he had failed to deliver 15,000 of the caps by a date specified in the contract. *Id.* at 706-707. Based on the evidence introduced at trial, however, the court determined that the Navy had terminated the contract because the chairman of a congressional subcommittee had sent the Navy a letter implying that the contract should be canceled for reasons unrelated to the failure to supply the caps on time. See *id.* at 705, 708 & n.6.

The Court of Claims held that under those circumstances, the termination for default should be treated as

a termination for convenience. See 390 F.2d at 707-710. The court found that the Navy had not exercised its discretion to terminate the contract, but had "simply surrendered its power of choice" in light of congressional pressure. *Id.* at 708. The court explained that the contractor's "status of technical default served only as a useful pretext for the taking of action felt to be necessary on other grounds unrelated to the plaintiff's performance." *Id.* at 709.

The holding in *Schlesinger* has no application here. As the court of appeals observed, "*Schlesinger* and its progeny merely stand for the proposition that a termination for default that is unrelated to contract performance is arbitrary and capricious, and thus an abuse of the contracting officer's discretion. This proposition itself is but part of the well established law governing abuse of discretion by a contracting official." Pet. App. 13a.[5] Petitioners do not and could not

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[5] As the court of appeals correctly noted (Pet. App. 11a-12a), the two other cases on which petitioners principally rely are in the same mold as *Schlesinger* and reflect the same principle. In *Darwin Construction Co.* v. *United States*, 811 F.2d 593 (Fed. Cir. 1987), the court held that the government's termination for default was arbitrary and capricious because the "action was taken solely to rid the Navy of having to deal with" the contractor. *Id.* at 596. The court stated that "[t]he facts of the case before us are almost identical to the salient facts in *Schlesinger*, where it was found that the contractor's status of technical default served only 'as a useful pretext for taking the action found necessary on other grounds unrelated to the plaintiff's performance.'" *Ibid.* (quoting *Schlesinger*, 390 F.2d at 709). Similarly in *John A. Johnson Contracting Corp.* v. *United States*, 132 F. Supp. 698 (Ct. Cl. 1955), the court held that the government's termination for default should be treated as a termination for convenience, on the ground that the contracting officer's "action in terminating the [contract] for delay did not represent his judgment as to the merits of the case, but

plausibly contend that the A-12 contract was terminated for reasons unrelated to performance. Rather, "[t]he record shows that the government's default termination was not pretextual or unrelated to Contractors' alleged inability to fulfill their obligations under the contract." *Ibid.* Indeed, petitioners' acknowledged inability to perform triggered the Secretary's review and was the impetus for the actions taken by the Office of the Secretary of Defense and the contracting officer. See *id.* at 3a-7a. Nor were petitioners' failures to satisfy the contract terms merely "technical" (*Schlesinger*, 390 F.2d at 709): petitioners affirmatively declared that they could not meet the contract's basic cost, schedule, or performance specifications. See Pet. App. 3a-6a.

b. In this Court, petitioners do not contend that the government's termination of the A-12 contract for default was a "pretext" (*Schlesinger*, 390 F.2d at 709); nor do they assert that their admitted inability to satisfy the critical cost, schedule, and performance provisions of the agreement reflected shortcomings that are "technical" (*ibid.*) in nature. Petitioners urge instead that they were deprived of "a reasoned determination on the merits as to whether a default termination was justified, including consideration prior to termination of any reasons or excuses for problems in performance." Pet. 6. Petitioners thus contend that if a contracting officer fails adequately to consider a contractor's proffered excuses for non-performance, the government's termination for default may be converted to a termination for convenience, even if the failures of performance go to the heart of the contract, and even if

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was a device to satisfy what lawyers told him were, or probably were, the legal requirements of the situation." *Id.* at 705.

the contractor in fact has no valid excuse for those failures. Petitioners do not identify any provision of law that would authorize a court to grant such relief on that basis, nor do they cite any judicial decision that has adopted their legal theory.

In any event, petitioners' claim is factually unsupported. On the day the contract was terminated, the contracting officer issued a letter, and prepared a memorandum to the file, setting forth the reasons for the termination. C.A. App. 18,297, 18,303; see Pet. App. 7a. Contrary to petitioners' suggestions (see, *e.g.*, Pet. 14), Admiral Morris considered and rejected petitioners' proffered excuses for their performance failures. As Admiral Morris testified, he spent "60 to 70 percent of December [1990], through the 7th of January [1991], working [on] A-12 issues," and took part in "dozens" of meetings and conversations, C.A. App. 3791, which set out the contractors' excuses in detail. His termination memorandum concluded that "the contractors have offered no adequate excuse for [their] failures." *Id.* at 18,305.[6] Indeed, the CFC itself recognized that

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[6] Contrary to petitioners' suggestions (see Pet. 11-12, 14), Admiral Morris's termination memorandum addressed all but one of the factors identified in the pertinent provision of the Federal Acquisition Regulation (FAR), 48 C.F.R. 49.402-3(f). See C.A. App. 18,302-18,306. The only factor that the memorandum did not mention—"[t]he urgency of the need for" the A-12 (see Pet. App. 49a)—was obvious to all, and had in fact been considered. See C.A. App. 1047, 1070, 1155, 1264, 1274, 1315. See also *DCX, Inc.* v. *Perry*, 79 F.3d 132, 135 (Fed. Cir.) (noting that the FAR "does not confer rights on a defaulting contractor" and that consideration of the FAR factors is not a "prerequisite[] to a valid termination"), cert. denied, 519 U.S. 992 (1996).

> Admiral Morris based the termination on the fault of the contractors because he did not believe that the Navy bore any responsibility for the contractors' perceived inability to achieve the contract specifications or deliver the aircraft on schedule. Absent some fault on the part of the Navy, he believed that he could not terminate for convenience because he believed that action would result in a windfall to the contractors.

Pet. App. 47a.

c. A court is not, of course, required to accept the contracting officer's default termination. Indeed, the contracting officer's decision receives no presumption of correctness in an action challenging a termination of a government contract for default. See *Wilner* v. *United States*, 24 F.3d 1397, 1401-1402 (Fed. Cir. 1994) (en banc). The question in this case is simply whether that inquiry may be pretermitted altogether, leaving petitioners in the position they would have occupied had no default occurred. As the court of appeals in this case correctly held, "the trial court erred by vacating the termination for default without first determining whether a default existed." Pet. App. 18a. That holding does not warrant this Court's review, especially in the present interlocutory posture of this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MARCH 2000