Tough Negotiation is not Coercion

BY JACK HORAN

On July 31, 1996, the U.S. Air Force Aeronautical Systems Center (ASC) selected Southern Defense Systems, Inc. (SDS), to supply aircraft support equipment for C-17 aircraft at Wright-Patterson Air Force Base in Ohio under the Small Business Administration (SBA) 8(a) Program. Under the structure created by Section 8(a) of the Small Business Act, SBA's implementing regulations, and *Federal Acquisition Regulation* (*FAR*) Subpart 19.8, ASC entered into an "indefinite-quantity" contract with SBA, which in turn subcontracted with SDS to supply the support equipment upon receipt of delivery orders issued by ASC.

The contract included FAR 52.219-17, "Section 8(a) Award," which provided ASC with "the responsibility for administering the contract with complete authority to take any action on behalf of the government under the terms and conditions of the contract." Thus, after contract award, SBA had no real role in either the administration of the contract with SDS, or the performance of the contract with ASC.

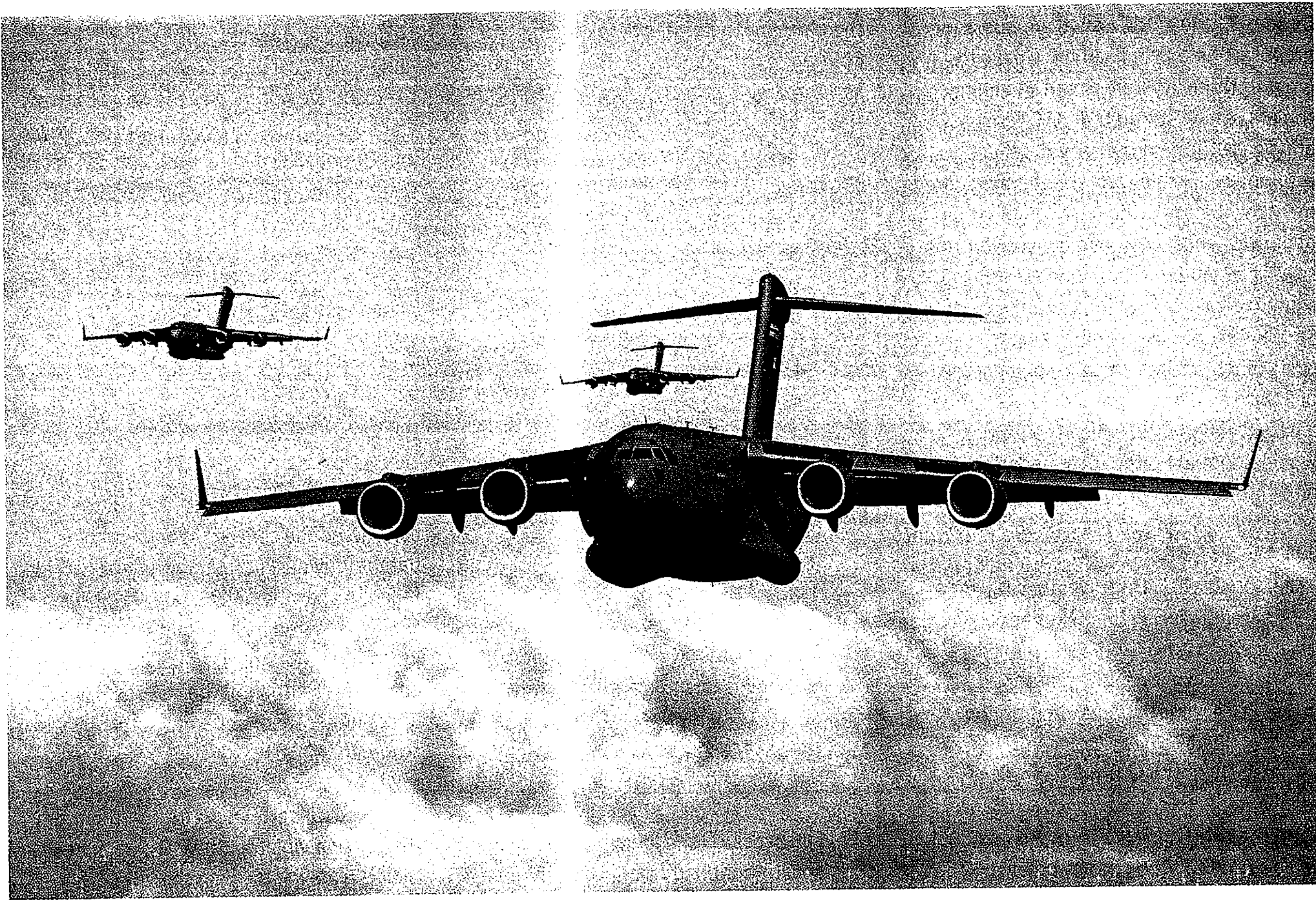
The contract contained standard *FAR* clauses, including FAR 52.216-22, "Indefinite Quantity," which provided that "the quantities provided in the schedule are estimates only," and ASC shall order at least the minimum quantity specified in the contract; and FAR 52.216-18, "Ordering," which provided that "all delivery orders or task orders are subject to the terms and conditions of this contract," and that the contract term would control over a conflicting term in a delivery order or task order. The contract also contained the following "special" clauses in Section H, "Special Contract Requirements":

- "Delivery Orders," which provided that ASC had the "sole discretion" to issue orders, and SDS had to deliver the ordered supplies "at the price agreed upon in accordance with" Attachment Number 2 of Section J of the contact, which specified negotiated overhead and indirect rates for calendar year 1996, including specific rates for manufacturing overhead, general and administrative, profit, material overhead, and pass-through. Attachment Number 2 specified a pass-through rate of 20 percent.
- "Procedures for Submitting Proposal Using Negotiated Rates and Factors," which required ASC to issue a request for proposal for the supplies required, SDS to submit a price proposal, and the parties to negotiate the specific terms of the delivery order based on the proposal.
- "Pass-Through Definition," which provided that the "[p]ass-through rate is an indirect charge applied to the price of available items purchased from the original equipment manufacturer...which are merely purchased and delivered to the users of this contract." Pass-through items were shipped directly from the original equipment manufacturer to ASC, and did not require SDS to perform any production processes.
- "Priced and Unpriced Orders," which provided as follows:

  > The provisions of this contract shall apply without change to any order issued hereunder, unless the parties mutually agree to additional provisions or the modification of those set forth in this contract for application to specific orders provided that such modifications, if any, do not constitute a deviation to the limitations imposed by the *FAR*.

- "Negotiated Overhead and Indirect Rates on a Calendar Year Basis," which provided as follows:

  > The parties have agreed to negotiate on a calendar year basis overhead and indirect rates. The negotiated rates shall be applied to work authorized by delivery orders issued in that calendar year. The contractor shall submit a proposal for negotiations not later than September 30th of calendar years beginning in 1996 and ending in the year 2000. This negotiation will result in a modification to the basic contract incorporating the negotiated rates.



According to ASC's "Price Negotiation Memorandum," the parties included this last clause because SDS "could not forecast [its] business base and therefore could not propose overhead and indirect rates for the four-year ordering period."

ASC issued 20 delivery orders under the contract, including at least 15 delivery orders for pass-through items. All of the delivery orders for pass-through items except one, "Delivery Order Number 20," included a pass-through rate of 20 percent. The "Price Negotiation Memorandum" for two delivery orders stated that the 20-percent pass-through rate was negotiated "for the total period of performance of the basic contract." For eight other delivery orders, the "Price Negotiation Memorandum" stated that the 20-percent pass-through rate was "negotiated under the basic contract and will be used to price all delivery orders issued under this contract." Two of the delivery orders for pass-through items specified engine lift trailers manufactured by Stanley Aviation Corporation, and both included a 20-percent pass-through rate.

A new contracting officer for ASC had a new idea for issuing Delivery Order Number 20. The contracting officer called SDS' program manager and promised that the government would issue a "larger than usual" delivery order to SDS for Stanley engine lift trailers and engine transportation trailers if SDS agreed to enter into a teaming agreement with Stanley and accept a pass-through rate lower than 20 percent. The contracting officer apparently believed that the teaming agreement would permit SDS and ASC to obtain the equipment from Stanley at a lower price because of "economies of scale," and would change the lift and transportation trailers from pass-through items to production items. SDS initially resisted any reduction in the pass-through rate, but agreed to enter into a teaming agreement with Stanley with an expectation that ASC would issue a "larger" order.

On May 4, 1999, the contracting officer issued a draft request for proposals for lift trailers and transportation trailers to SDS, which did not include quantities. The contracting officer informed SDS that ASC had not decided how it would procure the items, but the manner in which SDS planned "to achieve a teaming approach" with Stanley "to result in economies of scale...will significantly form the government's decision."

At a three-day meeting from May 17 through May 19, 1999, SDS prepared an initial draft of a teaming agreement with Stanley, which Stanley and ASC revised. On May 20, 1999, SDS and Stanley executed the teaming agreement, which provided that SDS would act as the "lead contractor" responsible for program management and communication with ASC, and Stanley would act as "manufacturing contractor for the portion of the work assigned to it." Although the government initiated and revised the teaming agreement, it was not a party to it.

On June 1, 1999, ASC issued a request for proposals for a firm-fixed-price delivery order of three lift trailers and 13 engine trailers, which stated that ASC "now anticipate[d] the proposal will reflect economies of scale" and the teaming agreement "will afford...the best combination of performance, cost, and delivery for this specific equipment." On June 30, 1999, SDS submitted a proposal for a total price of $7,088,688, consisting of $6,594,507 for the costs of the trailers and a 7.5 percent fee of $494,181. The proposal did not include a pass-through rate, which the parties would negotiate later. After negotiations on September 15 through 17, 1999, SDS accepted a total fixed-price of $6,717,361, which included $6,314,361 for Stanley and $403,000 for SDS. On November 16, 1999, ASC issued Delivery Order Number 20 with a price of $6,717,361.

In its "Price Negotiation Memorandum," ASC described Delivery Order Number 20 as "an exclusive 'one time' opportunity to deviate, with contractor concurrence, from the contractual rate for pass-through rates as stated in the basic contract." The memorandum described two "interwoven and basically inseparable" unique elements as justification for the deviation: 1) "the pass-through rate appears excessive when related to dollars vs. effort" based on a comparison of "the item costs to contractual pass-through rate"; and 2) "the [teaming agreement] relationship and proven capability of [Stanley] with regard to the engine lift trailers" would reduce SDS' workload and risk as the lead contractor. ASC concluded that "[a]lthough the basic contract calls for a pass-through rate of 20 percent, which includes profit, the teaming agreement...allowed for a negotiated pass-through rate of 6.3 percent, which includes profit."

SDS apparently was not satisfied with the lower pass-through rate. On July 17, 2002, it submitted a certified claim to ASC, asserting that the contract required a 20-percent pass-through rate and Delivery Order Number 20 "mistakenly" included a pass-through rate of 6.38227 percent. Not surprisingly, the contracting officer issued a final decision denying the claim, and SDS appealed the denial to the Armed Services Board of Contract Appeals (ASBCA). The case is noted as *Southern Defense Systems, Inc.*, ASBCA Nos. 5045, 54528 (February 12, 2012).

SDS presented the ASBCA with five arguments that proved it was entitled to a 20-percent pass-through rate:

- The 20-percent pass-through rate was a term of the indefinite quantity contract and could not be changed in a delivery order;
- The contract, taken as a whole, is at best ambiguous as to whether the pass-through rate can be changed through a delivery order;
- The change of the pass-through rate in Delivery Order Number 20 violates the *FAR*, and is unenforceable;
- The lower rate resulted from a mistake; and
- SDS accepted the lower rate because of government bad faith, coercion, duress, and misrepresentation.

ACS' position was simple: The parties negotiated a change to the pass-through rate and SDS accepted the changed rate for Delivery Order Number 20.

The ASBCA applied routine contract interpretation principles, starting with reading the contract terms, in its consideration of SDS' first argument. The board noted that the "Pass-Through Definition" clause categorized the pass-through rate as an indirect rate, and the "Negotiated Overhead and Indirect Rates on a Calendar Year Basis" clause explicitly provided that the parties would renegotiate indirect rates on an annual basis. Applying a well-established rule that a contract should be interpreted "to effectuate its spirit and purpose giving reasonable meaning to all parts of the contract," the board found "that the underlying agreement allowed for a changeable pass-through rate and do[es] not limit the parties' ability to amend the rate in a particular contracting instrument."

The board acknowledged that the parties "generally treated the 20-percent rate as fixed and did not modify the basic contract." The board found, however, that the "Priced and Unpriced Orders" clause "is sufficiently broad to allow the parties mutually to amend the pass-through rate by means of either the underlying contract or a deliver order." In short, the board reached the predictable conclusion that the contract permitted the parties to mutually modify the contract.

The board easily rejected SDS's claim of ambiguous contract language. The board noted that SDS failed to allege whether it considered the contract language to be patent (obvious) or latent (hidden). SDS also failed to show how the contact clauses it claimed created an ambiguity were facially inconsistent, or how it relied on a reasonable interpretation of the clauses. Thus, under either theory of ambiguity, SDS's argument failed.

SDS fared no better with its argument that the revision violated the *FAR*. SDS alleged that ACS' deviation from the 20-percent pass-through rate resulted in violations of the following parts of the *FAR*:

- FAR Part 7, which requires acquisition planning, because the change in the pass-through rate deviated from the acquisition plan;
- FAR 52.219-17, because ACS's action was inconsistent with the "terms and conditions of the contract"; and
- FAR subpart 1.4, because the revision to the pass-through rate ignored the *FAR* procedures for authorizing deviations.

Rejecting all three allegations, the board relied on long-established cases that have held that ACS and SDS could "modify not only the prescribed contract procedures, but substantive provisions of their [8(a)] contract" after award.

The board also rejected SDS's argument that the revised pass-through rate was a mistake, as there was no evidence to

support the theory. The board found that "[b]oth parties were knowledgeable and deliberate in substituting the 6.4-percent pass-through rate...and there is no proof that a 'mistake' occurred."

Applying the law previously discussed in this column, the board rejected SDS's claim of bad faith, finding that SDS had not provided "'clear and convincing proof' sufficient to overcome the presumption that the contracting officer acted properly and in good faith." The board also found that SDS failed to prove *any* of the three elements required to establish coercion and duress:

- The party alleging duress involuntarily accepted another party's terms,
- The circumstances permitted no other alternative, and
- Such circumstances were the result of another party's coercive actions.

"Pressure, even the threat of considerable financial loss, is not the equivalent of duress," the board stated. The board also found that the government had no obligation to issue Delivery Order Number 20, and SDS "could have declined, but made a reasoned business determination to accept" the delivery order. Duress and coercion was not a part of the decision.

Finally, the board rejected SDS's claim that ACS misrepresented the size of Delivery Order Number 20, the special and unique conditions surrounding the delivery order and the teaming agreement, and the reduction of procurement risk resulting from the teaming agreement. Again, the board found a lack of evidence that ACS misled SDS. The board noted that SDS was aware of the size of the order prior to accepting Delivery Order Number 20; thus, SDS failed to make the required showing that "the government made an erroneous representation of a material fact that the contractor honestly and reasonably relied on to the contractor's detriment."

The *SDS* case reinforces basic principles of contract management, including a principle previously discussed in this column—a contractor claiming bad faith against the government has an uphill battle. The law favors the government with a presumption that government officials act in good faith. Courts and boards rarely find that a contractor has sufficient evidence to overcome the presumption.

The *SDS* case also demonstrates the difficulty in prevailing on similar theories, often misunderstood by contractors, that the government *forced* the contractor to do something through coercion and duress or *tricked* the contractor into doing something through misrepresentations. Tough negotiations do not amount to coercion. The government, like any other party, can generally negotiate to protect its interests at the expense of the contractor. Thus, a contractor that accepts a contract, order, or modification because of pressure by the government that the contractor does not like or think is fair should not plan on changing it by asserting a claim. The contractor will be held to the bargain it struck unless it can prove the difficult elements of coercion and duress. Even the threat of "considerable financial loss" is unlikely to be enough for a court or board to change the contract.

Similarly, the standard noted in *SDS* makes a claim based on government misrepresentation unlikely to succeed. A contractor must show that the government not only misrepresented a fact but also that the fact was material to the contract and the contractor honestly relied on the misrepresentation. In general, a contractor should not rely on any representations that are not stated in writing in the contract with the expectation that a court or board will revise a contract if the representations prove to be incorrect. In addition, a contractor should insist that "material facts" be included in writing as part of the contract. **CM**

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