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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

SSA
KINNARD

APR 28 1977

IN REPLY
REFER TO:

B-184830

The Honorable Melvin Price
Chairman, Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

This letter is in response to your request, dated October 21, 1976, asking us to investigate and report upon allegations involving Modification P00031 to Navy Contract N00024-70-C-0252. The contract and modification pertain to the nuclear guided missile CGN-41 cruiser (originally designated a frigate (DLGN)) under construction by Newport News Shipbuilding and Dry Dock Company.

On December 3, 1976, representatives from this Office met with Mr. Frank Slatinshek, then Chief Counsel of your Committee, and Mr. Adam Klein, staff attorney. At that meeting, we agreed, in view of the litigation on this matter (United States v. Newport News Shipbuilding and Dry Dock Company and Tenneco, Inc., Civil Action No. 75-88-NW), to limit GAO's investigation to the following items:

- (1) A brief history of the CGN-41 contract;
- (2) The Navy's estimated cost to the Government resulting from Modification P00031;
- (3) The potential of overpayment on account of escalation under the terms of the modification;
- (4) A statement as to whether normal review procedures were followed with respect to the negotiation and signing of Modification P00031;
- (5) A chronology of events surrounding the negotiation and signing of Modification P00031, beginning with the decision to appoint Mr. Gordon Rule as Navy's negotiator on the CGN-41 dispute, and ending with the rescission of his appointment as Contracting Officer; and

- (6) A history of the litigation involving the CGN-41, including a summary of the issues raised by the parties in briefs filed in the U.S. District Court prior to the court hearing held on January 13, 1977, as well as a summary of the court's opinion of March 8, 1977, granting a motion by Newport News to enforce the provisions of Modification P00031, and dismissing the Government's suit for specific performance.

In enclosures (1) through (6) to this letter we address the six matters delineated above.

We have discussed our findings in enclosures (1) through (5) with the Navy and with Mr. Rule, and have incorporated their comments as appropriate. Newport News Shipbuilding and Dry Dock Company declined to be interviewed by the GAO on this matter on the ground that the entire matter is in litigation with the U.S. Government.

We hope the material submitted will assist you in understanding this highly complex matter.

Sincerely yours,

R.F.KELLER

Deputy Comptroller General
of the United States

Enclosures - 6

HISTORY AND CURRENT STATUS OF THE CGN-41 PROCUREMENT

On June 25, 1970, a cost type contract was awarded to Newport News Shipbuilding and Drydock Company for the procurement of long-lead time items for the first nuclear powered guided missile cruiser of the CGN-38 class. On December 21, 1971, Contract Modification P00007 was executed for the construction of the first three ships in the class, the CGN-38, -39 and -40. This modification converted the contract into a fixed-price incentive contract with a firm target and an economic adjustment clause. The CGN-41 option was included in this modification. The provisions of the modification required the Navy to exercise the option for the CGN-41 by February 1, 1973.

The contractor proposed a target cost for the CGN-41 option of \$82.8 million and a target profit of \$10.8 million. During negotiations the contractor reduced his price significantly and agreed to a target cost of \$65.1 million, target profit of \$8.3 million and a ceiling price of \$86.4 million. The sharing ratio was 80 percent Government and 20 percent contractor. The delivery date was May 31, 1977.

On February 1, 1973, Modification P00018 was executed to extend the deadline date to exercise the option for CGN-41 to February 1, 1975, or 2 years later than the original date. The price structure was increased subject to downward revision only at the time the option was to be exercised by \$10.9 million-target cost, \$1.4 million-target profit, \$12.3 million-target price, and \$14.5 million-ceiling price. No cost or pricing data was audited by the Defense Contract Audit Agency at that time apparently on the basis that it would be obtained at the time the option was exercised and final pricing agreed upon. The share ratio was changed to a 95 percent Government and 5 percent contractor ratio if the final cost was within 15 percent of the target cost and a 90 percent Government and 10 percent contractor ratio if the final cost was not within 15 percent of the target cost. The delivery date was extended to June 1978 and a provision for the Government to provide long-lead time funds by December 1, 1973, was added. In addition, eight items were included in the contract as subject to resolution as soon as possible. These were to:

1. Establish a new pricing structure within the maximum price envelope;
2. Provide a total final negotiated cost separate from that for CGN-38, -39 and -40;
3. Establish separate escalation tables for the option;
4. Establish separate payment provisions for the option from the three-ship procurement;
5. Revise the project milestones for the option;
6. Establish a fixed fee, and other terms and conditions on account of the work which may be required by the Option Conditions;
7. Include a provision for computing equitable adjustments on account of changes in the Longshoremen and Harbor Workers Act, the Federal Insurance Compensation Act, State workmen's compensation, unemployment, disability compensation and public liability acts occurring since June 1970; and
8. Provide Government furnished equipment delivery schedules for the option.

By Modification P00021 executed on November 29, 1973, the parties extended the dates for authorization of long-lead time funds to March 1, 1974, and for delivery of the CGN-41 to October 1978. By Modification P00022 issued on February 27, 1974, the Government provided the long-lead time funds to Newport News.

On November 26, 1974, Newport News met with Navy representatives to discuss the validity of the CGN-41 option. At this meeting Newport News told the Navy that they believed the option was invalid. Newport News documented their beliefs in correspondence dated December 20, 1974.

The contractor's contentions centered around the following:

1. Invalidity of options caused by specification changes,
2. Commercial impracticability,
3. Mutual mistake of fact,

4. Unilateral mistake as precluding option exercise,
5. Unconscionability,
6. Illegality of option provisions under ASPR,
7. Illegality of extension and exercise of option,
8. Lack of consideration for option extension,
9. Failure or inadequacy of consideration,
10. Unenforceability of option provisions as not sufficiently definite, and
11. Excusability of non-performance.

On January 31, 1975, Modification P00024 was issued by the Navy to exercise its option to procure the CGN-41, and the same day, the General Counsels of Newport News and the Navy signed a "Memorandum of Understanding," (effective February 3, 1975) in which they agreed to negotiate, without prejudicing either side's position, on the validity of the option. On August 25, 1975, Newport News advised the Navy by letter that the "Memorandum of Understanding" was being cancelled and that work on the CGN-41 was suspended.

On August 29, 1975, at the request of the Navy, the Department of Justice filed an action against Newport News Shipbuilding and Dry Dock Company and Tenneco Incorporated (its parent company) in the United States District Court for the Eastern District of Virginia requesting a temporary restraining order, a preliminary injunction and a permanent injunction, all aimed at preventing the defendants from stopping work on the CGN-41 and from refusing to construct the ship in accordance with the contract. The court entered as an order an agreement of the parties under which the contractor agreed to continue work on the CGN-41 for 1 year (since then extended an additional year) while the Navy and the contractor were "to negotiate in good faith to modify those contract provisions requiring amendment or to take other appropriate action." Payment for work done by the contractor would be made at cost plus seven percent.

The Navy and Newport News conducted negotiations intermittently between February 1975 and July 1976 without reaching an agreement. On July 13, 1976, the Deputy Secretary of Defense stated to Navy officials that he wanted to see definite progress on the CGN-41 matter. It was agreed that Mr. Gordon Rule would be assigned as the negotiator. On August 19, 1976, Mr. Rule was appointed contracting officer. Between that date and October 7, 1976, the Navy (Mr. Rule) and Newport News negotiated and executed Modification P00031. The price structure previously agreed upon in Modification P00018 was adopted without downward revision, a new economic adjustment clause was adopted increasing the period of escalation payments up to the actual delivery of the ship, and the delivery date for the ship was extended to August 1980. In addition, escalation was to be paid based on actual increases for energy costs and labor fringe benefits.

As of December 5, 1976, \$34.3 million has been paid to Newport News based on incurred cost for the construction, and 22.6 percent of the construction should have been completed based on total estimated manhours needed to construct the ship. The Navy estimated prior to Modification P00031 that the ship would be delivered in May 1980, based upon Newport News' schedules, and performance to date.

ESTIMATED COST OF MODIFICATION P00031

The estimated cost of Modification P00031 is \$48.5 million and is composed of two parts. The first part is the increase in ceiling price of \$14.6 million in Modification P00018 which was adopted in Modification P00031 without downward revision. The second part is \$33.9 million estimated costs of the new economic adjustment clauses negotiated in Modification P00031 which are recoverable by the contractor outside of the ceiling price provision of the contract.

The ceiling price was used in arriving at the total cost based on current Navy expectations that the contractor will reach ceiling price.

Pricing Structure

	<u>Modification P0007</u>	<u>Modification P00018</u> (millions)	<u>Modification P00031</u>	<u>Increase</u>
Target cost	\$65.1	\$ 76.0	\$ 76.0	\$10.9
Target profit	8.3	9.7	9.7	1.4
Target price	73.4	85.7	85.7	12.3
Ceiling price	86.4	101.0	101.0	14.6

Estimated Cost of Economic Adjustments

	<u>Prior to P00031</u>	<u>After P00031</u> (millions)	<u>Increase</u>
Escalation (labor, material, and overhead)	\$69.9	\$ 81.9	\$12.0
Energy Growth	---	5.1	5.1
Fringe benefits	---	16.8	16.8
	<u>\$69.9</u>	<u>\$103.8</u>	<u>\$33.9</u>

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The estimate for labor, material and overhead escalation is based on Navy computations. The estimates for Energy Growth and Fringe benefits are based on Newport News' figures.

None of the preceding dollar figures has been audited by the General Accounting Office.

POTENTIAL FOR OVERPAYMENT FOR ESCALATION
IN MODIFICATION P00031

A contractor may include additional cost in his price estimates as a contingency for unanticipated cost increases that are not covered by the economic adjustment clause. The new economic adjustment clauses in Modification P00031 cover more uncertainty than the previous clause. These were payments for escalation incurred to the actual delivery of the ship instead of to the contract delivery date, and payment based on actual cost increases for energy and labor fringe benefits. It is possible that Newport News had previously included contingency amounts for these uncertainties which were not deducted during the negotiation of Modification P00031. Since pertinent cost data was not audited by the Defense Contract Audit Agency subsequent to Modification P00007, there is a potential for overpayment.

The Defense Contract Audit Agency estimated without audit of the contractor's records that duplicate or overpayment which may be paid ranges from \$673,000 to \$3,741,000.

NORMAL PROCEDURES WERE NOT FOLLOWED ON
MODIFICATION P00031

The Chronology of Events contained in Attachment 5 describes the events relevant to the negotiation, review, and execution of proposed modification P00031 and involves the Office of the Deputy Secretary of Defense, the Naval Material Command and the subordinate Naval Sea Systems Command.

Normally contracts for ships are negotiated by contracting officers located in the Sea Systems Command, are subject to legal review, are subject to a determination of fund availability, and are reviewed prior to execution by the contract clearance group in the Material Command. Additionally, there is a statutory requirement for contractor certification of cost or pricing data for contract modifications exceeding \$100,000.

In this case, the Deputy Secretary of Defense suggested that the Navy appoint Mr. Rule, head of the contract clearance group in the Material Command, as negotiator of the dispute and emphasized what items should be addressed in that negotiation. Thereafter, Mr. Rule obtained a contracting officer's warrant and proceeded to reach an agreement with Newport News consistent with the guidelines provided by the Deputy Secretary. The Deputy Secretary was briefed daily by Mr. Rule's superior and was again briefed by Mr. Rule on August 23, 1976, on the verbal agreement Mr. Rule reached with Newport News on August 20, 1976. In his deposition, Mr. Rule stated that the Deputy Secretary responded "fine" to Mr. Rule's briefing.

Subsequently, on August 30, 1976, and October 7, 1976, (before Mr. Rule signed Modification P00031) the Chief of Naval Material advised Mr. Rule that prior to consummation of any binding agreement with Newport News, a panel established on August 30, 1976, would have to review and approve --from contract, business, and legal viewpoints--the proposed contract modification.

Without considering whether the normal review procedures were applicable to Modification P00031, it is undisputed that normal contractual and legal approval had not been obtained at the time Mr. Rule signed the modification, nor had a certificate of cost or pricing data been submitted by the contractor.

CONTRACT MODIFICATION P00031 TO CGN-41
NUCLEAR FRIGATE: CHRONOLOGY OF EVENTS

July 13, 1976 - A meeting was held in the Office of the Deputy Secretary of Defense to discuss Navy shipbuilding claims problems. Among those in attendance were:

- William P. Clements, Jr., Deputy Secretary of Defense,
- Eli T. Reich, Consultant to the Deputy Secretary of Defense,
- Jack L. Bowers, Assistant Secretary of the Navy (Installations and Logistics)
- Frederick H. Michaelis, Chief of the Naval Material Command,
- Vincent A. Lascara, Vice Chief of the Naval Material Command,
- E. Grey Lewis, General Counsel of the Navy,
- Gordon Rule, Director, Procurement Control and Clearance Division, Naval Material Command.

The Deputy Secretary of Defense asked the Navy officials why they had not reformed the contract, indicating that if they would not, he would. He then stated that he wanted to see four changes incorporated in the CGN-41 contract: (1) a new escalation clause; (2) a new "changes" clause; (3) a new ceiling price; and (4) a new delivery date.

During the meeting it was agreed Gordon Rule would become negotiator for the CGN-41. He was to report directly to the Chief of the Naval Material Command. The Vice Chief of the Naval Material Command was to meet with the Deputy Secretary of Defense each day at 9:15 a.m. to report progress of the negotiation.

July 14, 1976 - According to Mr. Rule and the Executive Vice President of Newport News, Gordon Rule telephoned the Executive Vice President of Newport News on this date to explain he had been assigned principal negotiator on the CGN-41 and requested a meeting.

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July 15, 1976 - According to the Executive Vice President of Newport News, he was contacted by a consultant to the Deputy Secretary of Defense who explained Mr. Rule's authority.

According to Mr. Rule and the Executive Vice President for Newport News their first meeting was held on this date at Newport News.

July 16, 1976 - The Assistant Secretary of the Navy (Installations and Logistics) wrote to the Chief of the Naval Material Command informing the Chief that he would be responsible for the direct discussions between Mr. Rule and Newport News.

July 28, 1976 - According to the Executive Vice President of Newport News, the Vice Chief of Naval Material and the consultant to the Deputy Secretary of Defense held discussions with him at Newport News. Among other matters the CGN-41 was discussed. Areas discussed were: when the CGN-41 problems would be solved, ceiling price, and escalation provisions.

August 10, 1976 - According to the Executive Vice President of Newport News, Gordon Rule telephoned him and requested a meeting in Washington on August 12, 1976.

August 12, 1976 - According to Gordon Rule and the Executive Vice President of Newport News, during their meeting in Washington the Executive Vice President left a briefing paper of a general outline for negotiations.

August 12 and 13, 1976 - According to Mr. Rule, the Vice Chief of Naval Material asked Mr. Rule about the August 12 meeting so as to inform the Deputy Secretary of Defense. Mr. Rule explained that Newport News had delivered a proposal and he did not approve of it.

August 17, 1976 - According to the Executive Vice President of Newport News, Mr. Rule telephoned him and requested a negotiating session to be held on August 20.

August 19, 1976 - The Deputy Chief of Naval Material (Procurement and Production) issued to Gordon Rule an appointment as Contracting Officer with "unlimited authority with respect to negotiations with Newport News."

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August 20, 1976 - Negotiations were held between Mr. Rule and Newport News.

August 23, 1976 - The Vice Chief of Naval Material and Gordon Rule met with the Deputy Secretary of Defense to brief him on the August 20th negotiations. According to Mr. Rule, the Deputy Secretary of Defense's comment on the negotiations was "fine."

According to Mr. Rule, after he and the Vice Chief of Naval Material left the Deputy Secretary of Defense's office, he received a note from the Chief of Naval Material to meet him in the Office of the Assistant Secretary of the Navy (Installations and Logistics).

Among those attending this meeting were:

- Jack L. Bowers, Assistant Secretary of the Navy (Installations and Logistics),
- Frederick H. Michaelis, Chief of Naval Material Command,
- Vincent A. Lascara, Vice Chief of Naval Material Command,
- Gordon Rule, Director, Procurement Control and Clearance Division, Naval Material Command,
- Robert C. Gooding, Commander, Naval Sea Systems Command,
- Leroy E. Hopkins, Deputy Commander for Contracts, Naval Sea Systems Command.

At this meeting, the Chief of Naval Material Command ordered Gordon Rule to describe the results of the August 20 negotiations.

August 25, 1976 - According to the Executive Vice President of Newport News, he telephoned the Office of Deputy Secretary of Defense, and read a prepared press release. The consultant to the Office of the Deputy Secretary of Defense said he and the Deputy Secretary approved of the press release, an excerpt of which stated: "The parties have agreed to sign a definitive contractual document embodying the negotiated agreement for the construction of the CGN-41."

Later that day, the Assistant Secretary of the Navy (Installations and Logistics) telephoned the President of Newport News, informed him that he was perturbed by the Newport News press release, and stated that the Navy would issue its own press release stating that agreement had been reached in principle but that the matter was to be reviewed by higher authority.

On this same date the Navy issued a press release explaining an "agreement in principle" was being drafted for review and approval.

August 30, 1976 - According to the Executive Vice President of Newport News, he and his associates met with Gordon Rule in Washington on this date and delivered the first draft of Modification P00031.

On this same date, Gordon Rule was sent a letter from the Chief of Naval Material explaining that, prior to a binding agreement on the CCN-41, the elements of the agreement must be submitted to the Chief of Naval Material for review and approval. The review was to be conducted by the Vice Chief of Naval Material, the Deputy Chief of Naval Material (Procurement and Production), the Naval Sea Systems Command Deputy Commander for Contracts; and the General Counsel of the Navy. Mr. Rule was to provide the proposed contract modification, the business clearance justifications, and other supporting papers for review prior to signature by the Contracting Officer.

Gordon Rule forwarded a draft memorandum summarizing his negotiations with Newport News to the Chief of Naval Material.

August 31, 1976 - The General Counsel of the Navy noted the Gordon Rule draft memorandum summarizing his negotiations to the Chief of the Naval Material Command. He explained to Mr. Rule his responsibility to review the summary of negotiations. Additionally, the General Counsel requested more information to support Gordon Rule's summary.

September 1, 1976 - Gordon Rule sent a summary of his negotiations to the Chief of the Naval Material Command.

September 3, 1976 - In response to the August 31, 1976, memo from the General Counsel of the Navy, Gordon Rule sent additional information to the General Counsel in support of his

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summary of negotiations. He also gave him a copy of the first draft of proposed Modification P00031.

September 14; 1976 - According to Gordon Rule and the Executive Vice President of Newport News, members of the Navy negotiating team, members of the Newport News negotiating team, and DCAA auditors from the Newport News Office met in Washington to discuss provisions in the first draft of proposed Modification P00031. At this meeting the DCAA was asked to review certain provisions of the proposed modification.

September 20; 1976 - The Naval Sea Systems Command Deputy Commander for Contracts and a member of the "review team" submitted his analysis of the first draft of proposed Modification P00031 to the Vice Chief of the Naval Material Command. This analysis was not made available to Gordon Rule.

September 24; 1976 - The Defense Contract Audit Agency submitted its analysis of certain provisions of the first draft of the proposed modification to a Navy negotiating team member.

September 27; 1976 - According to the Executive Vice President of Newport News, a member of his negotiating team delivered a second draft of proposed Modification P00031 to Gordon Rule. The Executive Vice President also delivered a copy of it to the Defense Contract Audit Agency in Newport News. Gordon Rule then requested the Defense Contract Audit Agency to review the second draft.

September 28; 1976 - The Defense Contract Audit Agency submitted its analysis of the second draft of Modification P00031 changes to Gordon Rule.

On that same date, the Deputy Secretary of Defense wrote the Attorney General and assured him that the "agreement in principle" would undergo full (including legal) Naval review.

October 4; 1976 - The Naval Sea Systems Command submitted its estimate of the additional cost of proposed Modification P00031, which estimate Mr. Rule declined to accept.

October 5; 1976 - Gordon Rule submitted a cost estimate of the proposed modification P00031 to the Chief of the Naval Material Command.

On that same date, the General Counsel of the Navy sent to the Department of Justice its analysis of information supplied by Gordon Rule. This analysis was not made available to Gordon Rule.

October 7, 1976 - According to Gordon Rule and the Executive Vice President of Newport News, the Executive Vice President handcarried a third draft of proposed Modification P00031 to Gordon Rule. The Executive Vice President's covering letter contains the following statement: "I have executed the enclosed modification on behalf of the company and request you immediately return a fully executed copy."

According to Mr. Rule, he took a copy of this cover letter to the Chief and Vice Chief of the Naval Material Command in the afternoon. He returned to his office and received a letter from the Chief of the Naval Material Command explaining that neither he nor his review group had a copy of the proposed modification that accurately reflected the results of Mr. Rule's efforts. Final review had not been completed and the proposed modification could not be consummated until the review was complete.

According to Mr. Rule, he could foresee that action would be taken to preclude him from concluding the assignment that had been given him with the concurrence of the Deputy Secretary of Defense and, after considering the desires of the Deputy Secretary of Defense, the history of the CGN-41, and his perceived lack of cooperation from the Navy, he signed the third draft of Modification P00031 at 6:00 p.m.

October 8, 1976 - According to Mr. Rule, the Vice Chief of the Naval Material Command called him into his office and, at 8:22 a.m., Mr. Rule was given a letter dated October 7, 1976, from the Vice Chief which explained that Mr. Rule did not have authority to sign the proposed modification. Mr. Rule explained that he had already signed the modification. The Vice Chief then requested Mr. Rule to give him all signed copies of the modification so that he might keep them in his safe. Mr. Rule refused, but said that he would give the copies to the Deputy Secretary of Defense if he so desired. The Vice Chief then left for his daily 9:15 a.m. meeting with the Deputy Secretary of Defense.

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Mr. Rule returned to his office where the General Counsel of Newport News and his associates had gathered. In their presence, Mr. Rule dictated a transmittal letter imposing two conditions upon the modification. Mr. Rule gave a copy of the modification which he had signed to the General Counsel of Newport News.

Mr. Rule was then called into the Office of the Vice Chief of Naval Material. The Vice Chief explained that the Under Secretary of the Navy would keep all executed copies. Mr. Rule then explained that he had already handed Newport News a copy of the modification. According to Mr. Rule, upon returning to his office, he signed the covering letter and handed it to a Newport News representative at 10 a.m.

Shortly afterward at 11:50 a.m., Gordon Rule received notice from the Deputy Chief of Naval Material (Procurement and Production) that his appointment as Contracting Officer was rescinded.

CGN-41 PROCUREMENT
HISTORY OF THE LITIGATION AND ISSUES PRESENTED

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CGN-41 PROCUREMENT
HISTORY OF THE LITIGATION AND ISSUES PRESENTED

NARRATIVE

I. ORIGIN OF THE LAWSUIT

A. Original Contract and the CGN-41 Option

On June 25, 1970, the Navy contracted with Newport News Shipbuilding and Drydock Company for the procurement of the long-lead time material and equipment necessary to construction of a single nuclear-powered guided missile frigate, the DLGN-38 (later designated a cruiser (CGN)). The contract also contained an option exercisable by the Navy for the construction of the CGN-38. Subsequently, the contract was amended to provide for longlead time items for two additional ships of the same class--the CGN-39 and -40--and to expand the option clause to include provision for construction of these additional vessels.

The parties executed Modification P00007 on December 21, 1971, by which the Navy exercised its construction options for the CGN-38, -39, and -40. At the same time, Navy alleges that it was granted two further options for the construction of the CGN-41 and -42, to be exercised by February 1, 1973, and February 1, 1974, respectively. Modification P00018, executed by Navy and Newport News on February 1, 1973, extended by two years the time for the exercise of options on the CGN-41 and -42. The option on the CGN-41 was therefore extended, Navy alleges, to February 1, 1975.

B. U.S. Government Sues For Specific Performance on the CGN-41 Option

On January 31, 1975, the Navy, exercising what it considered to be a valid contract option, directed Newport News to begin construction of the CGN-41. Newport News, however, asserted that the option was invalid and unenforceable and, after extensive discussions and negotiations, notified the Navy on August 25, 1975, that as of 4 p.m., August 27, 1975, all work on the CGN-41 would cease.

The United States filed suit on August 29, 1975, in the District Court for the Eastern District of Virginia, requesting the court to grant specific performance 1/ to compel Newport News and Tenneco, Inc., (the parent corporation) to honor and perform under the contract option and to enjoin Newport News from suspending work in preconstruction and construction of the CGN-41.

The Government's complaint, alleging a contractual right to Newport News' performance under contract modifications P00007, P00018, and P00024, also cites a guarantee given to the Navy by Tenneco, Inc., that Newport News would construct 5 nuclear-powered guided missile cruisers: 2/

Asserting that the CGN-41 is "vitally needed by the Navy as a major combatant ship for the Navy's all-nuclear carrier striking forces," the complaint states that Newport News is the only U.S. shipyard currently qualified to construct a nuclear surface vessel, and the only U.S. shipyard capable of performing without "considerable delay" and "substantial additional Government investment." Moreover, the Government asserts that specific performance is required inasmuch as monetary damages are "incalculable" and in any event would not assure the timely construction and delivery of the CGN-41.

A hearing was held the same day on the United States' motion for a temporary restraining order. During a recess, the parties negotiated a stipulation that was then read into the record and made an order of the court. The stipulation provided that Newport News would immediately resume work on

1/ Specific performance, a remedy for breach of contract, compels the defendant to render to the plaintiff the performance promised. It is a remedy that will not be granted if the loss can be compensated adequately by assessment of monetary damages.

2/ In its answer to the Government's complaint, Newport News admits that Tenneco wrote a letter to the Navy dated December 29, 1970, but asserts that such letter referred to a 1970 Newport News proposal and not to the contract subsequently executed by the parties on December 21, 1971 (Modification P00007).

the CGN-41 and that "applicable" changes made in the specifications for the CGN-38, -39, and -40 "will be incorporated in the plans and specifications for CGN-41." Additionally, the stipulation stated:

2. The parties agree to negotiate in good faith to reach an agreement as rapidly as possible to modify these contract provisions requiring amendment or to take other appropriate action.

II. DEFENSES TO CLAIM FOR SPECIFIC PERFORMANCE RAISED BY NEWPORT NEWS PRIOR TO APPOINTMENT OF MR. GORDON RULE AS NEGOTIATOR

A. Newport News Disputes the Enforceability of the Option Exercise; Claiming:

In its answer (amended and filed March 22, 1976), Newport News contends that the Navy's purported exercise of the contract option is invalid and unenforceable because of:

(1) Illegality

Newport News asserts that the Navy, having estimated that the cost for construction of the CGN-41 would greatly exceed the appropriations therefor, purported to exercise the option in spite of insufficient available funds, in violation of the Anti-Deficiency Act and other laws, as well as the Armed Services Procurement Regulations (41 U.S.C. §11(a); 31 U.S.C. §§627, 665; ASPR 1-1505(c)(1)). 3/

3/ The Comptroller General, in the decision of Newport News Shipbuilding and Dry Dock Company, 55 Comp. Gen. 812 (1976), determined that the amount of appropriations available to the CGN-41 was not \$268 million, as contended by Newport News, but \$360 million, sufficient to meet the Navy's estimated \$337.4 million for constructing the ship. The Comptroller General noted that full funding, i.e., funding a program on the basis of its entire

[Footnote continued on next page]

Moreover, Newport News argues that Navy's failure to incorporate the "technical baseline"--the accumulated changes in the specifications, designs, and drawings of the CGN-38, -39, and -40--into the CGN-41 requires Newport News to build a ship which is not a "follow ship of the DLGN-38 class" in contravention of the DOD Appropriations Act, 1975 (Pub. L. No. 93-437) and, consequently, in violation of 41 U.S.C. §11(a), 31 U.S.C. §627, and 31 U.S.C. §665, 4/ since the Navy is

[Footnote 3 continued]

estimated costs over several years, is not a statutory requirement, nor does departure of an agency from this practice necessarily constitute a violation of the Anti-Deficiency Act. The decision concludes:

"* * *[I]t is our opinion that the exercise of the DLGN 41 option by Navy on January 31, 1975, did not violate either 31 U.S.C. §665(a) or 41 U.S.C. §11(a). To hold otherwise would be to view these statutes as requiring 'full funding' which we do not believe to be the case. It would appear to follow that the exercise of the option also did not violate ASPR §1-1505(c)(i)."

- 4/ According to the Comptroller General's Newport News decision, id., Navy contends that a "follow ship" merely means that it "have the same basic characteristics as the other ships of the class." The Comptroller General went on to hold:

"While we recognize that the question is not free from doubt, our review of Public Law 93-437 and its legislative history has not revealed a sufficient basis to dispute the more general concept of 'follow ship' advanced by Navy. The record indicates that the ship ordered under the option will meet the general criteria specified in S. Report No. 93-1104. Further, Contractor has not shown that any of the unincorporated modifications significantly alter these basic characteristics. Accordingly, we do not find sufficient legal basis to warrant a conclusion that the Appropriation Act was violated."

attempting to contract for a ship for which no funds have been appropriated. 5/

(2) Navy's Failure or Refusal to Negotiate in Good Faith

Newport News also alleges that, despite the Modification P00018 mandate for Newport News and Navy to negotiate in good faith to reach agreement. Navy failed or refused to negotiate and, as a result:

-- made impossible any meaningful negotiation on the specific matters required by Modification P00018 to be negotiated, thus constituting a material breach of a condition precedent to the validity of the option. Accordingly, no contract could come into being.

-- the option provisions, that were to have been negotiated, were left completely indefinite, so that no contract could arise from Navy's attempt to exercise the option. Alternatively, Newport News argues that the parties expressed the intention that if they failed to reach agreement before Navy exercised the option, the parties would be bound only if the parties had made their best efforts to reach agreement. Inasmuch as Navy failed to use its best efforts to negotiate provisions of the option, no binding contract was formed.

(3) Unconscionability

Newport News also contends that it would be unconscionable to require it to absorb the escalation (allegedly unprecedented and unforeseeable in 1973) to be incurred once Newport News fails to meet a delivery date Navy knows is impossible to meet and refuses to change. Navy's exercise of the option would therefore require Newport News to assume undue risks in violation of section 1-1503(b)(ii) of ASPR.

5/ In a related allegation Newport News contends that the Navy failed or refused to adequately assure Newport News that available appropriations were sufficient to fulfill the option commitment. This failure, it is alleged, constitutes a material breach and repudiation of the option contract, excusing performance by Newport News.

(4) Substantially Different Procurement

Construction of the CGN-41 under the option without including the technical baseline of the CGN-38, -39, and -40 would allegedly require Newport News, at significant cost, to construct a ship substantially different from the ship contemplated under the contract. Newport News thus argues that no contract could have resulted from the exercise of the option but, even if a contract did result, construction of the CGN-41 would be substantially different from the construction of the earlier ships, so as not to be within the scope of work originally contemplated by the parties ("cardinal change"), justifying Newport News in declining performance.

(5) Failure of Conditions to Come Into Existence

Contending that the parties presupposed certain conditions would exist at the time the option would be exercised --e.g., reasonable stability in labor and material costs, material availability--and such conditions not having come into existence when Navy attempted to exercise the option, Newport News argues that no contract could thereby have been created.

(6) Other Defenses

Newport News cites additional defenses to enforcement of the option, including:

- impossibility of performance;
- mutual mistake;
- noncooperation of the Navy as well as hindrance of Newport News performance;
- lack of legal consideration to Newport News.

B. July 13, 1976: Newport News Moves the Court to Compel The Navy to Enter Into Good Faith Negotiations

Newport News, on July 13, 1976, filed a motion to require Navy to negotiate in good faith, to appoint a special master to oversee the negotiations between the parties, and to suspend

Newport News' obligation to the Navy under the August 29, 1975 court order until the Navy had negotiated in good faith with Newport News.

In this motion, Newport News alleges that despite its repeated attempts to negotiate with the Navy, the latter has failed to engage in any meaningful negotiation, and has refused to negotiate in good faith on issues concerning contract delivery date, construction schedule, and overall contract pricing, thereby ignoring its obligation under the stipulation and court order of August 29, 1975, to negotiate as to all issues outstanding between the parties.

The day this motion was filed--July 13, 1976--the Navy decided to appoint Gordon Rule as negotiator on the CGN-41 controversy. Several days later, Newport News asked the district court not to take action on its July 13 motion pending its negotiations with Gordon Rule.

III. THE ISSUES IN THE CONTROVERSY BETWEEN THE PARTIES SINCE THE APPOINTMENT OF MR. GORDON RULE AS NEGOTIATOR ON JULY 13, 1976, CULMINATING IN A DISTRICT COURT DECISION OF MARCH 8, 1977, FAVORING NEWPORT NEWS

A. Whether An Enforceable Agreement was Reached on August 20, 1976, and, If So, Whether Entry of Judgment in Favor of Newport News is an Appropriate Remedy

(1) Was An Enforceable Agreement Reached on August 20, 1976, Between Newport News and the Navy?

On August 20, 1976, Mr. Gordon Rule of the Navy met in Washington with representatives of Newport News to commence negotiations with respect to the CGN-41, and by the end of the day, the parties reached some form of oral understanding. Subsequently, on October 7, 1976, Mr. Rule and Mr. Dart executed in writing Modification P00031 to the CGN contract.

On October 14, 1976, Newport News filed a motion with the district court for entry of judgment in favor of Newport News based on the oral agreement reached between Newport News and Navy on August 20, 1976. Newport News asserts that, having agreed that day on all of the outstanding issues concerning the contract for construction of the CGN-41, Gordon Rule, Navy's authorized representative, and Charles Dart, Newport

News' authorized representative, negotiated a final settlement of all substantial matters at issue between the Navy and Newport News.

In the alternative, Newport News contends that attempts by certain Navy officials to repudiate the agreement Newport News negotiated with Gordon Rule constitute a gross violation of Navy's duty to negotiate in good faith, justifying dismissal of the case with prejudice. 6/

The Justice Department, representing the Navy, opposed Newport News' motion in briefs filed November 8, 1976, and January 7, 1977, to which Newport News filed additional briefs on December 10, 1976, and January 12, 1977. A hearing based on Newport News' motion was held January 13, 1977. The District Court handed down its opinion on March 8, 1977, granting Newport News' motion to enforce the provisions of Modification P00031 and dismissing the Government's suit for specific performance. The following discussion identifies the issues raised by both parties in briefs filed with the district court, as well as the court's decision on each such issue raised.

(a) Is an oral agreement enforceable under Government procurement law?

The Government argues that, even if Gordon Rule had authority to enter into an agreement settling the CGN-41 controversy, the failure of the parties to reduce this agreement to writing renders the agreement unenforceable under 31 U.S.C. §200(a)(1), which provides that:

"* * * no amount shall be recorded as an obligation of the Government of the United States unless it is supported by documentary evidence of--

"(1) a binding agreement in writing between the parties thereto, including Government agencies * * *."

The Government also cites section 1-201.2 of the Armed Services Procurement Regulations which defines a contract modification as a "written alteration."

6/ A dismissal with prejudice is a determination on the merits in favor of the moving party, barring the right to bring or maintain an action on the same claim or cause.

Newport News counters that a long line of cases hold that oral agreements with the United States are binding on both parties, even where the parties continue their efforts to agree on a detailed and formal contract. Moreover, even if 31 U.S.C. §200(a)(1) could somehow be construed as a Federal statute of frauds ^{7/}, a note or memorandum in writing, sufficiently specific in its description of the oral agreement and signed by the party to be charged, satisfies the statute. Newport News alleges that a handwritten draft modification delivered to Newport News by representatives of the Government on August 20, 1976, (and the contract modification executed on October 7, 1976) satisfy any Federal statute of frauds requirement.

The District Court in its opinion of March 8, 1977, finds it unnecessary to decide whether 31 U.S.C. §200(a) is applicable to the August 20, 1976, agreement inasmuch as it accepts Newport News' argument that the oral agreement, reduced to writing on October 7, 1976, and supplemented by the cover letter of October 8, 1976, meets the requirement of 31 U.S.C. §200(a)(1) for evidence of a written binding agreement.

In addition, the Court finds that the oral agreement had been reached pursuant to the courts' order of August 29, 1975, in satisfaction of 31 U.S.C. §200(a)(6), evidence of a liability which may result from pending litigation brought under authority of law.

(b) ~~Has there been the meeting of the minds~~ .
~~necessary to existence of a contract?~~

The Government contends that, if the parties' actions evidence an intent not to be bound until a written document is executed, there is no meeting of the minds that can give rise to a contract prior to the execution of that document.

The factors to be considered, the Government continues, are: (1) whether the parties showed an intent from the beginning to await a written memorial of terms already discussed; (2) whether the bargaining between the parties ever came to a rest; and (3) whether the nature of the agreement proves it was too much for a verbal understanding only.

^{7/} "Statute of frauds" is a statutory requirement that certain types of contracts, to be enforceable, must be in writing.

Applying this test to the facts, the Government cites a series of written drafts which followed the August 20, 1976, meeting, and the continued bargaining which occurred up to October 8, 1976, (along with the complexity of the purported settlement) as evidence that neither party believed it could have a binding contract prior to execution of a written document. Moreover, since Gordon Rule conditioned the effectiveness of the written document delivered on October 8, 1976, upon two conditions--(1) approval of the modification by Deputy Secretary of Defense Clements, and (2) agreement that escalation payments would be equal to 100 percent of the monthly change in the Bureau of Labor Statistics Labor and Material Indices, or according to actual experience, whichever is less and Newport News has failed to agree to the second condition, no agreement can exist.

Newport News disputes the Government's contention that the cases it cites touch on the factual situation here. Whereas in the Government's cited cases, one of the parties asserted that no agreement ever existed, Newport News alleges that here, both it and Gordon Rule, the contracting officer, believe that there was a meeting of the minds on August 20, 1976, and all their subsequent acts did not negate their belief that a firm contract was agreed to on that date. Moreover, it is alleged that bargaining did not continue after August 20.

Newport News contends that Gordon Rule unconditionally signed the contract modification, despite indicating orally in hand-delivering it to Newport News that the modification was somehow conditioned upon agreement by Newport News to a different escalation provision. At most, continues Newport News, Mr. Rule's "condition" is an offer for additional terms which, unless accepted by Newport News, effects no change in the agreement reached on August 20, 1976.

Observing that the mere fact that the parties intend to reduce an oral agreement to writing does not prevent the oral agreement itself from being binding, the Court finds that there was a meeting of the minds of the parties on the provisions to the August 20, 1976, agreement. The Court concludes that the parties agreed on August 20, 1976, to grant the Government the most favorable escalation provision as disclosed by the Shipyard's actual experience. The second condition imposed by Mr. Rule in his letter of October 8, 1976, does no more than reflect the substance of that agreement.

The District Court finds it unnecessary to decide whether the parties contemplated on August 20, 1976, that approval by Deputy Secretary of Defense Clements was necessary to limit the Government since the Court determines that Mr. Clements did indeed approve the agreement.

(c) By not complying with regulations nor obtaining contractual clearance, did the contracting officer fail to act within the scope of his authority so as not to bind the Government to any agreement negotiated?

The Government contends that any authority granted to the contracting officer, Gordon Rule, must be subject to the Armed Services Procurement Regulations which, at section 3-807.3, require the contracting officer to obtain cost or pricing data for any contract modification in excess of \$100,000. This cost or pricing data was not obtained from Newport News by Mr. Rule, even though he stated in his deposition that the increased cost to the Government of his proposed modification was approximately \$33.9 million. The requirement for cost or pricing data cannot be waived. Inasmuch as the contracting officer failed to comply with ASPR 3-807.3 (and the statute it implements--10 U.S.C. §2306(f)), it is alleged the agreement cannot be binding on the United States.

Moreover, Navy regulations require that any negotiated agreement be subject to both business and legal clearances, neither of which was obtained by Mr. Rule. Hence, the Government alleges that any agreement which Mr. Rule attempted to consummate with Newport News was outside the scope of his actual authority, therefore not to be binding upon the United States. In addition, Newport News officials were informed repeatedly prior to October 8, 1976, that any agreement would be subject to review by higher Navy authority and the Department of Justice, such restrictions being proper if imposed prior to the time the contracting officer's actions become final.

Newport News argues that Mr. Gordon Rule had full authority to negotiate and settle the CGN-41 matter and at no time prior to the agreement reached on August 20, 1976, did anyone suggest to Newport News that Mr. Rule was not so authorized. This authority, consented to by counsel for the United States and Navy, was communicated to the Department of Justice before Mr. Rule's appointment and was manifested in his contracting

officer warrant (valid until 11:50 a.m., Oct. 8, 1976) granting him "unlimited authority with respect to negotiations with Newport News" for construction of the CGN-41. Mr. Rule's actions, thus, as a fully authorized agent of the United States, were binding on the United States.

Newport News argues further that the statute and regulations concerning cost or pricing data are inapplicable to the agreement reached on August 20, 1976, inasmuch as the target cost, profit, and ceiling of the CGN-41 remain unchanged by the modification and any increase in cost to the Government would occur--if it does occur--only through escalation adjustments over the life of the contract. Moreover, if failure to submit cost or pricing data on this modification renders it invalid, then Modification P00018, extending the date for exercising the option and revising upward the target cost, profit, and ceiling for the CGN-41, is similarly invalid, and the Government has in effect argued itself out of court.

Even if the contracting officer failed to obtain business and legal clearances, the Navy regulations which require these clearances do not have the force and effect of law, it is alleged, nor is there any credible evidence that Mr. Rule's "unlimited authority" was subject to such clearances. Moreover, Deputy Secretary of Defense Clements' approval and forwarding of the agreement to the Department of Justice would constitute a waiver of all these procedural steps. Therefore, Newport News contends that Mr. Clements' action has "placed the imprimatur of the Secretary of Defense on the agreement, thus moot-ing any contention by the Government that it does not represent a binding agreement between the United States and Newport News."

The Court, agreeing with Newport News that Mr. Rule had unlimited authority to negotiate a compromise in the CGN-41, holds that submission by a contractor of cost or pricing data is not prerequisite to a binding contract. Thus, Newport News' failure to provide such cost or pricing data does not relieve the Government of its duty to perform under the contract, although it does provide the Government the right to seek a reduction in the price of its contract with Newport News, based on this failure.

The Court notes, without binding, that Mr. Clement's forwarding of the agreement to the Department of Justice could

be viewed as a waiver of the requirement for cost or pricing data, such a waiver being authorized under 10 U.S.C. §2306(f).

(d) Does the Attorney General have exclusive authority to prosecute or compromise matters in litigation, so that a purported settlement not approved by the Attorney General is unenforceable?

The Government contends, based in part on decisions of the Supreme Court, statutes (28 U.S.C. §§516 and 519), and an Executive Order, that the interests of the United States in litigation are subject to the exclusive and absolute control of the Attorney General. Therefore, once a dispute has been referred to the Department of Justice, it is the Attorney General, not the client agency, who determines the propriety and desirability of settling or compromising that dispute, so that the Department of the Navy cannot make an effective settlement absent the approval of the Attorney General. Inasmuch as the Attorney General has refused to approve this settlement, it cannot be given effect as a final agreement between the parties.

In addition, it is alleged that the provisions of the agreement are almost totally one-sided in favor of Newport News. The only benefit of the agreement is that, as a result, the Government will no longer have to assume the litigative risk inherent in pursuing an action for specific performance. The very fact that litigative risk is the sole legal consideration for the agreement emphasizes the need for the approval by the Attorney General of the settlement.

Newport News counters that the authorities cited by the Justice Department do no more than establish the general supervisory authority of the Attorney General over litigation conducted on behalf of the United States, and in no way establish a right by the Attorney General to block a settlement agreed to by a Government agency involved in that litigation. Agreement between the parties having been reached, there is no longer any question of the Attorney General's approving or disapproving anything.

Newport News also argues that the agreement is not unfair to the Government, inasmuch as escalation payments thereunder are less than what was provided in Modification P00007, and it is entirely too speculative for anyone to determine at this

time whether Newport News' actual labor and material escalation costs will underrun or overrun the Bureau of Labor Statistics indices, on which payment is based.

Moreover, so long as there is evidence of some consideration supporting the agreement, it is an elementary principle, Newport News continues, that the law does not inquire into the adequacy of that consideration. However, besides other bases of consideration, the agreement is supported, as set forth in Modification P00031, by Newport News' promise to give up all of its claims against the Government arising out of the CGN-41 matter, a form of consideration held sufficient by the Court of Claims to support a Government contract even when the claim is "disputed or doubtful, the real consideration to each party being not the sacrifice of the right, but the settlement of the dispute."

The District Court rejects the Government's argument that the Department of the Navy cannot make a binding settlement of a dispute absent the approval of the Attorney General.

The Court finds that the Department of Justice--having agreed to and promoted the court order of August 29, 1975, and reaffirmed it at the time of Mr. Gordon Rule's appointment as negotiator, having then neglected to fulfill its obligation to the Court and Newport News by both declining to participate in the CGN-41 negotiations and by failing to ensure that good faith negotiations were conducted by the Navy, this despite its knowledge that Navy officials were "in utter default" of this obligation prior to Mr. Rule's appointment--is now "estopped to deny the authority of the Department of Defense officials to approve an agreement which in effect moots or settles this litigation."

Moreover, the Court holds "there is ample and sufficient consideration to support a compromise if it is based upon a claim, unliquidated or disputed in good faith, and if the parties make or promise mutual concessions." Declining to review on the merits the adequacy of that consideration, the Court concludes that there is consideration sufficient to support this compromise agreement.

(2) Is Entry of Judgment in Favor of Newport News to Enforce the Agreement a Remedy that can be Granted by the Court?

Newport News observes that, while the Federal rules do not specifically provide for the enforcement of settlement agreements, Rule 58 permits a court to grant "other relief" to be entered as a judgment of the court. Inasmuch as Federal courts have the power to enforce pretrial settlements reached by the parties to pending litigation, it is argued that an appropriate procedural mechanism for bringing the existence of a settlement agreement and a party's attempt to repudiate the agreement to the attention of the court is a motion for judgment in accordance with the settlement agreement.

The Government argues that, absent specific congressional authorization, the United States is immune from suit, an immunity not waived merely because the United States files suit. The Tucker Act (28 U.S.C. §1346) provides consent by the United States to be sued upon its contracts in district court, provided the action or claim does not exceed \$10,000. Accordingly, since the purported settlement would result in a judgment against the United States for an amount far in excess of \$10,000, the district court lacks jurisdiction to grant Newport News' motion.

Moreover, it is alleged that since the Tucker Act does not empower a district court to grant equitable relief in the nature of reformation to the CGN-41 contract, the Court is jurisdictionally barred from entering a judgment that would effect such relief.

The Government's assertion that granting Newport News' motion would result in a judgment against the United States is misleading, argues Newport News. Newport News contends that, far from requesting a judgment on a claim, it is merely asking the court to confirm that the agreement negotiated with Gordon Rule is a valid and binding agreement between the parties. Once that determination is made, no issues remain for adjudication and this case can be dismissed. Thus, the Government's argument regarding the monetary limitation on Tucker Act claims is irrelevant.

Granting Newport News' motion would not require the court to order equitable reformation of the DLGN-41 contract, but

even if it did, the court has ample jurisdiction to so order, contends Newport News, based on a law recently passed by Congress. That law (Pub. L. No. 94-574, October 21, 1976) removes the barrier of sovereign immunity to actions brought in Federal court seeking nonmonetary relief on a claim of unlawful official action by an agency or one of its officers. It is alleged that, under the new law, the court clearly may entertain a request by Newport News for equitable relief in the form of a determination that the settlement agreement between Navy and Newport News is valid, binding, and enforceable.

The District Court rejects the Government's contention of sovereign immunity. Rather, the Court accepts Newport News' argument that, by granting judgment for Newport News, it is neither granting a money damages judgment against the United States nor ordering equitable reformation of the contract. The Court states that it is merely declaring that the parties are legally bound by a compromise agreement which, thus, moots the issue as to whether the prior contract was enforceable.

Thus, the Court in its Order, grants Newport News' motion to enforce the compromise and settlement agreement between the parties, and dismisses the Government's case.

- B. Whether the Navy has Failed to Negotiate in Good Faith in Compliance with the Court's Order of August 29, 1975; Justifying Dismissal of the Action with Prejudice
- (1) Did Navy's Failure; Prior to July 13, 1976; to Negotiate Regarding Delivery Date and Construction Schedule Violate the Court Order of August 29, 1975?

Newport News contends that the obligation of Navy and Newport News to negotiate in good faith to amend the contract "or to take other appropriate action," as required by the court's order of August 29, 1975, was intended by the parties to include bargaining on all issues outstanding between them, and negotiating "wholly new and different terms" for the construction of the CGN-41. Until July 13, 1976, continues Newport News, Navy completely refused to negotiate or show any willingness to compromise on the most substantial issues--including ship delivery date and construction schedule--without which it was impossible to negotiate other issues. Thus, Newport News alleges that

Navy failed to comply with the court's order, justifying dismissal of the Government's complaint.

The Government asserts that the language "or to take other appropriate action" was intended to refer only to the eight items left for negotiation : Modification P00018 as well as any delays or construction cost increases for which the Government was responsible.

The contested language dates back to a Memorandum of Understanding executed by the parties on January 31, 1975, and was proposed by attorneys for Newport News. Navy feared that the language would permit renegotiation of the option without contractor entitlement or adequate new legal consideration, and allegedly informed Newport News on January 30, 1975, that the words "or to take other appropriate action" were to be construed to refer to the eight items left for negotiation by Modification P00018 and other items only where new legal consideration was involved. Therefore, the Navy's unwillingness to renegotiate the items of the option absent contractor entitlement or new and adequate consideration did not violate the court's order of August 29, 1975, and did not constitute bad faith negotiations.

Newport News counters that to accept the Government's position, the words "or to take other appropriate action" would have no meaning since, assuming the existence of a contract, a showing of Government fault would entitle Newport News to relief, whether Navy agreed or not. Likewise, the proposition that Navy might give Newport News new consideration (i.e., new and different contractual terms) if Newport News gave the Navy new consideration "is no more than a superfluous legal truism hardly requiring the extensive negotiations and drafting efforts which went into the Memorandum of Understanding." Newport News points out that the court's order does not refer to "government fault" or "new consideration."

Newport News argues that the Memorandum of Understanding was expressly premised on its position that the purported option, as well as its exercise, was a nullity and that the parties agreed to attempt to negotiate this and their other differences in good faith. The language of the Memorandum of Understanding, incorporated into a stipulation of the parties and made an order of the court, therefore obligates Newport News and Navy to negotiate in good faith regarding all issues

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outstanding between them with respect to the construction of the DLGN-41.

The Court finds that "the United States has fully and totally ignored not only its own February, 1975 agreement, but also the Order of this Court, that negotiations in good faith should ensue." The Court terms as "incredible" the Government's contention that it was obligated to negotiate only with respect to the eight items left unresolved by Modification P00018. The Court concludes:

"Despite the Navy's appointment of two succeeding chief negotiators, we find that in the eleven months following our August 29, 1975 Order, the United States totally failed to meet its obligations to negotiate in good faith, although at the same time it was receiving the benefits of the Shipyard's continued performance under the disputed contract."

- (2) Did the Navy; Subsequent to the Negotiations Conducted by Gordon Rule; Attempt to Repudiate the Agreement Reached by Mr. Rule and Newport News; in Violation of the Court Order to Negotiate in Good Faith?

Newport News alleges that, shortly after it reached agreement with the Navy on August 20, 1976, certain other "elements in the Navy voiced their objections and mobilized their efforts to scuttle the agreement." An "after-the-fact review panel" staffed with individuals who had opposed any settlement with Newport News was established to review and approve an agreement that had already been concluded. Even after Mr. Rule had signed Modification P00031, officials at the Navy informed Newport News that it was of no force or effect. In sum, Newport News contends that the Navy acted in bad faith to repudiate the agreement that had been reached, and, therefore, the Government's complaint should be dismissed with prejudice.

The Government argues that Newport News presupposes the existence of a binding agreement between the parties which is capable of being repudiated. Inasmuch as no such binding agreement exists, Newport News' argument must fail. Even Gordon Rule, the Government alleges, does not believe he has reached a final

settlement with Newport News in that the latter has not accepted a condition he placed on the cost escalation clause contained in the proposed settlement. Moreover, in spite of Newport News' expressed concern that it cannot construct the CGN-41 until changes in the technical baseline specifications are resolved, the settlement agreement which it asks the court to adopt does not even refer to those changes, leaving unsettled the very issue which Newport News claimed earlier precluded it from constructing the CGN-41.

Newport News counters that the technical baseline issue was resolved by the court order of August 29, 1973, (confirmed by letter of January 16, 1976) which declared:

"It is understood by the parties that all of the changes made in the plans and specifications for the DLGN 38, 39, and 40 that are applicable will be incorporated in the plans and specifications for DLGN 41, and the parties agree to negotiate in good faith the appropriate equitable adjustments for all such changes."

Newport News contends that the issue of the technical baseline was resolved by January 16, 1976, after discussions with Navy and was not addressed by Mr. Rule because the problem had been resolved at least 8 months before the settlement was negotiated.

The Court notes that the changes in the technical baseline were covered by its order of August 29, 1975, and finds that a binding agreement exists between the parties, both conditions of Mr. Rule's letter of October 8, 1976, having been fulfilled. With respect to the Government's actions subsequent to the appointment of Gordon Rule as negotiator, the Court finds that an effort was mounted both before and after August 20, 1976, to "undercut" and "undermine" Mr. Rule's authority and "bring it under further Navy scrutiny."

Having granted Newport News' motion to declare as legally enforceable the settlement agreed to on August 20, 1976, the Court finds that it is not required to pass on the validity of the original CGN-41 option. However, the Court notes that it is a fundamental equity principle that one who asks for specific performance of a contract must have "clean hands." The United

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States, having not acted in good faith, "does not have clean hands to ask this Court to specifically enforce the original" CGN-41 construction option.