

# ADR Law Notes

Legal Developments, Issues and Other Matters of Interest Concerning Alternative Dispute Resolution

Defense Logistics Agency ADR Practice Group September 1998

Special Edition: A Comparison of Two Contract Dispute ADR Cases

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Case 1:

## **In the Appeal of Spray Booth Systems, Inc. (SBS)**

DSCC awarded a contract to SBS for the production of six ovens for the Army Ammunitions Activity located at Crane, Indiana. These ovens were to be used in drying explosive chemicals and compounds (pyrotechnics) needed for the production of various types of military ordinance. SBS, a small business located in Texas, was an experienced DoD contractor and had successfully completed a number of prior contracts for paint drying ovens. However, this was apparently their first contract to make pyrotechnic drying ovens for military munitions.

SBS experienced a number of difficulties in complying with the required specifications while attempting to perform the contract. Although modified a number of times both to clarify SBS technical concerns and extend the delivery schedule, the contract was ultimately terminated for default (T for D) because of the company failure to meet the contract's

extended delivery terms. In June, 1997 SBS appealed the T for D to the ASBCA claiming that the contract specifications were defective which precluded timely performance. As relief, SBS sought to have the T for D converted to a termination for convenience (T for C) to allow it to recoup all of its performance costs which were just over \$140,000.

During the discovery phase of the appeal, the parties discussed the possibility of settlement. However, an impasse was soon reached due to SBS's demand to recoup essentially all of its contract performance costs. In November, 1997 shortly after the settlement discussions became deadlocked, SBS's attorney indicated that a key concern of his client was to minimize both the costs and duration of litigating the appeal, and inquired as to whether there was anyway to resolve the case short of the full litigation process. Mike Kraft, the Government attorney, suggested the use of ADR as a way of resolving the pending litigation.

At this point, the first wave of discovery had been completed, with a second round of discovery in process, including proposed depositions of key witnesses.

SBS's attorney was very receptive to the proposal. The attorneys for the Government and SBS then discussed preliminary ADR matters. Both sides wanted the non-binding mediation process that would allow the ASBCA case to continue in the event the dispute was not resolved through ADR. Also, each side felt it was essential to have an impartial mediator who had expertise in Government contract law. They decided that having the ASBCA mediate the dispute was the best way to accomplish these objectives.

A telephone conference was held in the latter part of November, 1997 with ASBCA Judge Gruggel to discuss the proposed mediation. Judge Gruggel, who had been assigned as the hearing judge for the appeal, agreed to handle the ADR. An agreement was then reached to follow the ASBCA's Settlement Judge Procedure in preparation for the mediation. Under this procedure, the parties were required to enter into a written agreement covering all the procedural details of the ADR such as the time period, dates, and location of the ADR; and the party representatives

who would be present.

During the next one and one-half months, the agreement to utilize ADR was worked out between the parties. There were also several more conference calls with Judge Gruggel to finalize the details. They agreed that two days would be set aside for the mediation which was to be held in early February, 1998. The Board's office in Falls Church, Virginia was selected as the site. Although Judge Gruggel was willing to travel to any location agreed to by the parties, the Falls Church location was determined to be the most convenient and neutral local for the parties since there were representatives from Ohio, Indiana and Texas that would be attending. Judge Gruggel required that each of the parties have a representative present who had authority to settle the case.

Although SBS initially wanted to keep Judge Gruggel as the hearing judge should the ADR prove unsuccessful, Judge Gruggel made it clear that he was going to disqualify himself from the case if it was not resolved through the ADR process. He explained that he wanted to have open and frank discussions with the parties during the mediation, and he did not want them to feel they might possibly be prejudiced at a later hearing by statements made during these discussions. The fact that Judge Gruggel was to be recused from further proceedings in the appeal was also incorporated into the written agreement.

Judge Gruggel also required each of the parties to submit a brief of their case summarizing their positions. Sections of the brief were to include what each side felt were the weaknesses in their own positions, as well as an indication of the amount each party would offer to settle the case. The briefs were to be furnished to Judge Gruggel a week before the ADR, and were to be kept strictly confidential by him and not exchanged between the parties.

During the two day ADR process which took place on February 2 and 3, 1998 SBS had present two attorneys, three technical witnesses, and two corporate officers, including its president. The Government was represented by the DSCC trial attorney, two Army technicians, and the Contracting Officer. On day 1 of the hearing, the parties and their representatives met together with the Judge in a hearing room to present their cases. Each side was given two hours for their presentation, as had been decided upon in conferences between both parties. The presentations were informal and given only by the attorneys.

SBS presented their case first, followed by the Government's presentation. Judge Gruggel actively participated in these presentations, and unlike the more restrictive demeanor of a litigation judge, asked numerous technical and legal questions of both parties and their various representatives throughout the proceedings. Afterwards, both parties went to separate rooms, where the Judge met privately with them. During these private discussions, he asked additional questions, and thoroughly discussed his views of the case and the issues presented. He pointed out what he thought were weaknesses in the case and problem areas of note, both technical and legal.

In these private caucuses, Judge Gruggel also inquired as to what each party would truly take to settle the dispute. The Government told the Judge that its maximum settlement proposal was \$35,000. This amount was considered appropriate because there were minor issues involving the adequacy of some of the contract specifications that posed the risk of an adverse decision in a fully litigated case. But, the bottom line from the Government's standpoint was that SBS had taken on a contract that it was not qualified to complete. Since SBS was a small business and had performed successfully on numerous past contracts, the Government also agreed that it would convert the T for D to a T for C with a maximum payment of \$35,000 in order to help SBS clear their record. The Government's proffer made through Judge Gruggel was rejected outright by SBS who indicated it would require substantially more (almost three times the amount offered by the Government) to resolve the matter.

On day 2, Judge Gruggel again met privately with both parties for several hours. The Judge let the Government know, in one of these private sessions, that SBS had dropped its earlier higher demands and was willing to settle the case for \$75,000. While he was meeting with both parties separately, he again adeptly pointed out to each side what he felt were the weaknesses in their case, expenses they could encounter if the appeal went to a hearing, and their respective financial risk in losing the case in its entirety. The Judge later in the day advised the Government he felt \$35,000 was too low and should be reconsidered. After further discussion between the Government representatives in private, and then later with Judge Gruggel, the Government agreed to up its offer to \$45,000 together with the already agreed to conversion of the T for D to a T for C.

The Judge then met privately again with SBS to inform them of the Government's revised and final offer. He met with them for approximately two hours during which time they discussed their case, its weaknesses, and the expense and risks inherent in proceeding with the litigation. At the conclusion of this caucus, SBS agreed to the Government's offer.

Once the agreement was reached, the parties were then called back together before Judge Gruggel to finalize the settlement terms. SBS agreed to provide documentation of all costs incurred in performing the contract, and upon receipt, the Government agreed to pay \$45,000 within 30 days. After the ADR was concluded, SBS furnished the necessary cost information and the Contracting Officer, after review and approval, issued a modification to the contract which converted the T for D to a T for C and provided for payment of \$45,000 as full settlement of any and all claims by SBS under the contract.

In later discussions between the parties' attorneys, SBS's attorney indicated that the company's president eventually accepted an amount significantly less than he had initially set at the start of the ADR process as the minimum to settle the case. The Government attorney advised that, similarly, the Government had agreed to a higher amount than had been initially contemplated at the outset of the process as a maximum settlement offer.

Although neither side got exactly what they wanted in terms of a settlement amount, the attorneys for each party felt the ADR process shortened the case by at least eight to twelve months and considerably reduced each side's expenses that would have otherwise been incurred if it had been fully litigated to a decision. Also, each of the attorneys in talking with their clients learned another positive aspect of the ADR process which ultimately led to the settlement agreement; i.e., the ADR process allowed the parties to hear first hand not only the other side's position and concerns, but also directly from an independent third party neutral and government contracting expert, the weaknesses in each of their cases, the additional time and expense necessary to pursue the appeal, and the risks associated with losing their case in a fully litigated decision.

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#### Case 2:

### **The Appeals of General Dynamics Land Systems, Inc. (GDLS)**

In the early 1990's, the U.S. Army (Army) awarded five contracts over a three-year period to GDLS, to both produce and upgrade M1A1 Abrams Battlefield Tanks to the M1A2 model tank for Saudi Arabia, Kuwait, and the United States. GDLS is headquartered at Sterling Heights, Michigan, a suburb of Detroit.

Shortly after delivery of the first tanks under these contracts, GDLS notified the Army that the contracts had system specification (system spec) defects in both the Commander's Integrated Display (CID) and the Fire Control Electronics Unit (FCEU), and the tanks were hazardous to operate. The Army informed GDLS that since the system spec defects meant that the tanks being presented for delivery also had prime item product fabrication specification (prime fab spec) failures, the Army, under the terms of the contract, would no longer accept tanks unless these problems were corrected by the contractor. GDLS was also notified that the warranty claims of the contracts required GDLS to redesign and retrofit the CIDs and FCEUs on the tanks. The Army and GDLS then agreed that the tanks previously accepted would be considered accepted on a conditional basis, the condition being that GDLS would redesign and retrofit the CIDs and FCEUs on both the delivered and undelivered tanks. In 1995, GDLS filed two claims for the costs related to its redesign and replacement of material to fix the CID and FECU on all the tanks under the contracts, for an approximate total of \$2,350,000.

Two attorneys from the Washington DC office of a large Chicago law firm experienced in government contracts represented GDLS. Steve Pereira represented the Government. Based upon the initial suggestion of Mr. Pereira, the parties early on discussed the use of ASBCA ADR procedures as an appropriate option for a speedy resolution. Nevertheless, it took almost three years to reach an agreement to utilize an ADR process. The time period was primarily taken up with normal pre-litigation matters such as submitting the Rule 4 file, submitting and answering the complaints, developing a proposed discovery schedule, and consolidating the two appeals.

In late January, 1998 the attorneys began to implement the agreement to utilize ADR. The agreement included the

submission of a joint stipulation of facts. But, due to both the complex nature of the case as well as mistrust on each side, the parties could not agree on many of the facts. Oftentimes, the government attorney had to utilize interest based negotiations to keep the dispute on the ADR "track." However, even with all the difficulties, the parties believed that ADR still presented a better option than litigation. The earliest date for a full hearing would have been sometime in 1999, with a decision in late 2000. An appeal would drag the case out to 2002. Further, Judge Delman, the ASBCA Judge assigned to the case, advised that if a full hearing were elected, no attorney fees would be awarded, and it would be held in Washington DC. Consequently, perhaps dozens of witnesses from the Detroit area would have to travel to Washington and stay for long periods of time, at great cost and inconvenience.

It took approximately three months to finalize the agreement to utilize ADR. The standard ASBCA Settlement Judge form was used by the attorneys as a model, but the Judge rejected many of the terms, sometimes for reasons not clearly understood by the attorneys. After a great deal of patience was expended on both sides, everyone involved agreed to a two-day mediation procedure. Within thirty days, the parties were to submit to the Judge a joint stipulation of facts. Within thirty days after receipt of the stipulation, the parties were to present to the Judge and to each other a position paper. After thirty to forty-five days of review, the parties were to meet in Detroit for a two-day mediation conference. Originally, the attorneys requested only one day for the conference; however, the Judge insisted on one day for presentations and one day for mediation.

In early June, 1998 the first day of the mediation conference was held in the courtroom of the Tax Court in Detroit. The parties presented their position in a relatively informal manner to the Judge in open court. Witnesses from both sides were in attendance throughout all the informal testimony. The Federal Rules of Evidence were not applied. No cross-examination or objections were allowed. Testimony was unsworn and no transcripts or recordings were made. The Judge asked numerous questions of both parties throughout the day.

A significant portion of the Government's presentation was via overhead transparencies, and included detailed pictures of the significant tank components. These were given to the GDLS attorneys the day before the hearing to prevent any evidentiary objections they might have to the use of the charts. In addition, the Government provided explanations concerning the tank production process, testing and acceptance of vehicles, and significant contract clauses.

The second day of the conference was held in the Judge's chambers of the Tax Court. Only one principal and one attorney for each side were allowed to be present. Army Major Fred Roitz and Mr. Pereira were present for the Government. Present for GDLS was one of the lawyers from the law firm, and Mr. Mike Meeusen, the Assistant General Counsel for GDLS who served as their principal. At the start of the second day and in joint conference, Judge Delman gave a three-part assessment of the case:

- For the tanks that were not accepted, most judges (8 out of 10) would hold that the failures were in violation of the Prime Fab Spec clause. Therefore, GDLS would have to absorb these costs for both the CID and FCEU.
- However, under the Correction of Deficiencies clause in the contracts, a transference of risk for defects in any non-warranted design items from the contractor to the Government would be deemed to have occurred. The ambiguous wording in this clause would be construed against the Government under the legal principle of *contra proferentem*, wherein an ambiguous provision is construed against the person who selected the language. In the case of Government contracts, the Government is considered to have selected the language, even if drafted by the contractor, once the Government accepts the language in the contract.
- For the tanks that were accepted, most judges (7 out of 10) would hold that GDLS breached the warranty of the contract. GDLS would therefore have to absorb the hardware costs because of the breach. Under a latent defect theory for the redesign costs, the Government would have the burden of proving that the defect exists, it existed at time of acceptance, and was not discoverable by a reasonable inspection. Most judges would find that a defect exists. All judges would find that it existed at the time of acceptance, and most judges would find that the CID defect was not discoverable, but that the FCEU defect was discoverable by reasonable inspection. Thus, the Government at the time of inspection should have caught the FCEU problem.

- Regarding a Government claim for hardware redesign and retrofit costs, GDLS would be responsible for these costs. However, due to a problem with the Correction of Deficiencies clause, some judges (3 out of 10) would conclude that the clause applies for all non-warranted problems. Judge Delman did not think that the clause would apply and would not be one of the 3 who would apply this clause.

Thereafter, the Judge met with each side in private caucuses. After the parties were close to a resolution, they informally met with each other in the hallway outside the presence of the Judge and resolved the remaining issues. They then met in joint conference with the Judge and finalized the settlement. The parties agreed that the Army would modify the contracts to increase the amount for a total of \$700,000 as a complete settlement of the claims. A complete settlement agreement, based on the general agreement resulting from the mediation, was negotiated between the attorneys for the two sides in the month following the mediation.

The Government estimated that it saved approximately \$2,500,000 by avoiding litigation. Although Mr. Pereira had done an extensive investigation of the case internally, he had not requested discovery of GDLS. Therefore, the Government saved costs of travel, fees and court reporters for depositions and for document review. Additional cost savings were employee time to answer discovery requests from GDLS, and sending numerous Government employees and experts to testify in Washington during a lengthy hearing. A further cost saving was the potential award of a judgment and interest to GDLS.