04-5064

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

TESORO HAWAII CORPORATION and TESORO ALASKA COMPANY, and HERMES CONSOLIDATED, INC., d/b/a/ Wyoming Refining Company,

Plaintiffs-Appellants,

v.

THE UNITED STATES,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES COURT OF FEDERAL CLAIMS IN NO. 02-CV-704, JUDGE ERIC G. BRUGGINK, AND IN NO. 02-CV-1460, JUDGE LAWRENCE J. BLOCK

BRIEF OF *AMICUS CURIAE* NATIONAL PETROCHEMICAL & REFINERS ASSOCIATION IN SUPPORT OF REVERSAL IN NO. 02-CV-1460 AND AFFIRMANCE IN NO. 02-CV-704

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May 5, 2004

CERTIFICATE OF INTEREST

Under Federal Circuit Rule 47.4, counsel for *Amicus Curiae* National Petrochemical & Refiners Association certifies the following:

1. The full name of every party or *amicus curiae* represented by me is:

   National Petrochemical & Refiners Association.

2. The name of the real party in interest represented by me is:

   National Petrochemical & Refiners Association.

3. All parent corporations and any publicly held companies that own 10 percent or more of the stock of the *amicus curiae* represented by me are:

   None.

4. The names of all law firms and the partners or associates that are expected to appear in this Court are:

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INTEREST OF THE *AMICUS CURIAE*[1]

The membership of *amicus curiae* National Petrochemical & Refiners Association (NPRA) includes more than 450 companies, including virtually all U.S. petroleum refiners and petrochemical manufacturers. NPRA members supply to consumers of all types – including individuals, companies, and government entities – a variety of products essential in daily life. In filling this role, NPRA members make vital contributions to national economic growth and to national security. NPRA has been in existence for more than 100 years, and serves its members in part as an advocacy voice before the Executive and Legislative Branches and before the courts.

Many NPRA members regularly contract with the Department of Defense, forming contracts that are subject to the Federal Acquisitions Regulation (FAR). Many NPRA members, including appellants, are suppliers of military fuel currently in litigation with the Defense Energy Supply Center (DESC) regarding contracts with the same economic price adjustment clauses that are the subjects of these cases.

In its role as a voice for the petroleum refining industry, NPRA is well situated to help this Court understand the merits of the legal issues presented by this appeal. It is imperative that the Executive Branch of the government, like any contracting party, be required to follow governing legal principles when entering contracts with

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1 Under Federal Rule of Appellate Procedure 29(a), the parties have consented to the filing of this brief.

members of *amicus*, as with all other government contractors. When the contracts are subject to the FAR, as they are in this case, the government and the contractor must be required to comply with the FAR during bidding, negotiation, and execution of the contract.

The waiver rule proposed by DESC, and accepted by one of the courts below, instead grants power to the parties to a contract effectively to amend the FAR, and permits individual contracting officers unilaterally to bind contractors to unauthorized price terms that the contracting officer inserts into a contract up for bid – although the law is clear that DESC itself never can be bound to an illegal term. The waiver rule derogates from this Court's past holdings that a contractor cannot waive a claim of illegality in a contract. *Amicus* NPRA has a substantial interest in seeing the rule that is faithful to the FAR and to contract law, and to any conception of an equitable distribution of risk among contracting parties, prevail in this case.

BACKGROUND

A. The PMM Clauses

Economic price adjustment (EPA) clauses are a common feature of federal procurement contracts, authorized by the FAR, 48 C.F.R. Part 16.2, to protect both the contractor and the government against fluctuations in the contract price of the item sold or service rendered. EPA clauses might be appropriate in any procurement

contract involving markets with price fluctuations. See, *e.g.*, *Barrett Refining Corp.* v. *United States*, 242 F.3d 1055, 1058 (Fed. Cir. 2001) (military fuel contract like those at issue in this appeal); *Allied Signal, Inc.* v. *United States*, 941 F.2d 1194, 1194-95 (Fed. Cir. 1991) (contract for the development of an aircraft engine); *Beta Systems, Inc.* v. *United States*, 838 F.2d 1179, 1180 (Fed. Cir. 1988) (procurement of tank/pump units); *American Western Corp.* v. *United States*, 730 F.2d 1486, 1487 (Fed. Cir. 1984) (contract for the supply of polyethylene bags).

The FAR permits such clauses to be used in fixed-price contracts if the contract officer considers it "necessary either to protect the contractor and the Government against significant fluctuations in labor or material costs or to provide for contract price adjustment in the event of changes in the contractor's established prices." 48 C.F.R. § 16.203-3. The FAR permits EPA clauses based on (1) "established prices"; (2) "actual costs of labor or material"; and (3) "cost indexes of labor or material." *Id.* § 16.203-1(a).

For several years, DESC wrote and offered for bid fixed-price contracts with EPA clauses tied to statistics in the "Petroleum Marketing Monthly" (PMM), a Department of Energy publication. Empirically, the PMM statistic was an ineffective indicator of the fair market value of jet fuel supplied under the contracts. In *MAPCO Alaska Petroleum, Inc.* v. *United States*, 27 Fed. Cl. 405 (1992), the court held that

PMM clauses were not permitted by the FAR. The *MAPCO* holding has achieved near unanimous acceptance: all but one decision from the Court of Federal Claims has held the PMM clause illegal (see Louis Kozloff, *Economic Price Adjustment Clause Litigation in the Court of Federal Claims*, 17-24 ANDREWS GOV'T CONT. LITIG. REP. 12 (March 25, 2004)),[2] and noted commentators have referred to it as a "defective price term." *Invalid Clause but Valid Contract: Clearing up the Mess*, 15-5 NASH & CIBINIC REP. ¶ 23 (May 2001).

B. Challenges to PMM Clauses

When holding that the PMM is not one of the permissible indices for price adjustment (under 48 C.F.R. § 16.203-1(a)), the *MAPCO* court discussed the failure of the PMM clauses to protect contractors (as is also required for this type of clause by 48 C.F.R. § 16.203-3). In one circumstance, the PMM clause reduced by more than one-third the price of military fuel under a fuel-supply contract in Alaska, while during that time the cost of Alaskan crude oil had *increased* nearly 100%. *MAPCO*, 27 Fed. Cl. at 407. Dozens of members of *amicus*, who are suppliers of military fuel

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2 Derogating from the unanimity of authority in the Court of Federal Claims, and from the law that this Court accepted in its *Barrett Refining* opinion, the court in *Williams Alaska Petroleum, Inc.* v. *United States*, 57 Fed. Cl. 789 (2003), held that the PMM clause was permissible.

to DESC, have suffered similarly; many cases currently in litigation raise the same issues as this appeal.

This Court also has addressed the legal implications of DESC's use of the PMM clauses. In *Barrett Refining*, 242 F.3d 1055, the Court recognized that *MAPCO* had held the PMM clause violative of the FAR. *Id.* at 1058. Because the contractor and the government had fully performed contracts with an illegal EPA clause, this Court affirmed the Court of Federal Claims' holdings that the illegal clause should be set aside, and that both the contractor and the government could recover in *quantum valebant* the difference between the amount paid under the illegal PMM clause and the "fair market value" of the military fuel supplied under the contracts. *Id.* at 1065-1066.

C. The Proceedings Below

These appeals are from conflicting holdings of the Court of Federal Claims in two cases filed shortly after this Court's *Barrett Refining* opinion clarified contractors' rights.

There have been no arguments in any of the PMM-clause litigation that contractors expressly waived their rights to contest the validity of the PMM clauses. DESC's claims are of implied waivers, based on appellants', and other contractors',

bidding, signing, and performing contracts that were written by DESC with illegal EPA clauses.

In *Tesoro Hawaii Corp.* v. *United States*, No. 02-740C (Fed. Cl. Sept. 15, 2003)), Judge Bruggink held – consistent with every decision but one from the Court of Federal Claims following *MAPCO* – that the PMM clauses violated the FAR. Slip op. 6 ("We find no reason to depart from the consistent holding of this court that those clauses are illegal.").[3]

Judge Bruggink then rejected DESC's argument that plaintiffs waived their right to contest the illegality of the PMM clauses by entering into and performing their obligations under the contracts. *Tesoro*, slip op. 11. The court highlighted the distinction between individual rights, which are waivable (see, *e.g.*, *Johnson* v. *Zerbst*, 304 U.S. 458 (1938)), and "rights which implicate the institutional concerns of the United States government in application of the law," which "may not be waived." *Tesoro*, slip op. 12 (citing *Commodity Futures Trading Comm'n* v. *Schor*, 478 U.S. 833, 850-851 (1986), and *Kaiser Steel Corp.* v. *Mullins*, 455 U.S. 72, 82 (1982)).

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3 There are also issues relating to the DESC's attempted use of individual and class deviations, which the *Tesoro* court held did not comply with the FAR. *Amicus* supports the argument of plaintiffs-appellants on this issue, but does not separately address it.

The *Tesoro* court also distinguished this Court's decisions that have permitted the waiver defense. DESC had urged the court to follow *AT&T* v. *United States*, 307 F.3d 1374 (Fed. Cir. 2002) (*AT&T V*), and *Whittaker Elec. Sys.* v. *Dalton*, 124 F.3d 1443 (Fed. Cir. 1997). Judge Bruggink held, however: "'[I]f government officials make a contract they are not authorized to make, in violation of a law enacted for the contractor's protection, the contractor is not bound by estoppel, acquiescence, or failure to protest.'" *Tesoro*, slip op. 12 (quoting *LaBarge Prods., Inc.* v. *West*, 46 F.3d 1547, 1552 (Fed. Cir. 1995)). In *Whittaker* the illegality was in the exercise of an option, and arose after the contract award, whereas the illegality in the contracts with a PMM clause is inherent in the formation of the initial contract. See *Tesoro*, slip op. 12. And *AT&T V* addressed waiver in *dicta* – after this Court already had held, *en banc*, that the contractor could assert a contract claim. See *Tesoro*, slip op. 13-14 (citing *AT&T* v. *United States*, 177 F.3d 1368 (Fed. Cir. 1999) (*en banc*)).

In *Hermes Consolidated, Inc.* v. *United States*, No. 02-1460C, slip op. 11 (Fed. Cl. Aug. 7, 2003) (*Hermes I*), Judge Block held that the PMM clause was illegal. "[I]nclusion of the EPA clauses * * * was an unauthorized deviation under the FAR." *Ibid.* Nonetheless, he held the claim of illegality waived as a matter of law. See *Hermes Consol., Inc.* v. *United States*, No. 02-1460C (Fed. Cl. Nov. 3, 2003) (*Hermes II*).

The court in *Tesoro* discussed dispositive legal distinctions between this Court's no-waiver authority and cases allowing a waiver defense: in the option-contract cases (*Whittaker* and *E. Walters & Co., Inc.* v. *United States*, 217 Ct. Cl. 254 (1978)), the breach was not in the contract itself, but in the illegal exercise of the option afterward. See *Tesoro*, slip op. 12. In *AT&T V*, the statute violated was "intended as 'internal governmental direction,'" so did not raise the kind of institutional concerns implicated by the FAR. *Tesoro*, slip op. 15 (quoting *AT&T V*, 307 F.3d at 1380). Also, the waiver discussion in *AT&T V* was *dicta*. *Tesoro*, slip op. 13. The *Hermes II* court, by contrast, assumed the existence of a waiver defense, and examined factual distinctions between the *Chris Berg, Inc.* v. *United States*, 426 F.2d 314 (Ct. Cl. 1970), line of cases and *AT&T V*, *Whittaker*, and *E. Walters* – focusing on the court's perception of how good a reason it thought the specific contractor had for not raising the illegality earlier. The *Hermes* court thus made no attempt to distinguish the line of no-waiver authority on legal grounds.

SUMMARY OF ARGUMENT

The FAR is a pervasive set of regulations promulgated to protect contractors and to permit Congress to maintain control over Executive Branch spending. Such control is required as a federal constitutional matter, and Congress has exercised its appropriations control by creating a centralized office and requiring the promulgation

of the FAR, complete with congressional oversight. Allowing DESC to assert a waiver defense to a claim based on an illegal term, inserted into a contract by a single contract officer, is tantamount to allowing DESC to amend the FAR – permitting Executive Branch employees to usurp Congress's constitutionally conferred duty to control federal spending. It is the role of the courts to ensure that powers constitutionally assigned to Congress are not co-opted, as has occurred in these cases.

When the regulation in question protects institutional concerns, rather than merely individual rights, it cannot be waived by silent acquiescence or even express agreement by a contractor. "[I]f government officials make a contract they are not authorized to make, in violation of a law enacted for the contractor's protection, the contractor is not bound by estoppel, acquiescence, or failure to protest." *LaBarge Prods.*, 46 F.3d at 1552. Little question can exist that the preeminence of the FAR, and its place in the constitutional scheme, is a matter of institutional concern.

Cases from this Court that have allowed a waiver defense (see *Whittaker*, 124 F.3d 1443; *E. Walters*, 576 F.2d 362), involve situations in which institutional concerns are *not* subverted by allowing the contractor to waive its personal rights, because in those cases the illegality was in the performance, not the drafting and bidding, of the contract. *Whittaker* and *E. Walters* do not control in cases such as these in which allowing waiver would undermine the FAR.

The *Tesoro* court below understood the legal distinction between the *Chris Berg* line of authority and *Whittaker* and *E. Walters*, and correctly applied the *Chris Berg* rule to hold that waiver could not occur in this case. In contrast, the *Hermes II* court undertook a factual analysis and concluded that this case was more like *Whittaker* than like this Court's extensive no-waiver authority. But that factual inquiry into each "contractor's conduct" (*Hermes II*, slip op. 4) put the cart before the horse. The *Hermes* court never asked the dispositive *legal* question, which is whether this Court's precedent permits waiver at all in these cases.

The FAR allows EPA clauses as necessary to protect both the government *and* the contractor from price fluctuations. But permitting DESC to advance a defense of waiver results in a one-sided waiver scheme that produces severe inequity to contractors. The government cannot be held to have waived the defense of illegality of a contract term. See *Federal Crop Ins. Corp.* v. *Merrill*, 332 U.S. 380, 384 (1947). Allowing such a one-way ratchet in government contracting stands on its head the Supreme Court's admonition that the United States is not exempt from the body of contract law that applies generally to private individuals. See *Mobil Oil Expl. & Prod. Southeast, Inc.* v. *United States*, 530 U.S. 604, 607-608 (2000) (citing *United States* v. *Winstar Corp.*, 518 U.S. 839, 895 (1996) (plurality opinion)).

Subjecting contractors to a waiver rule is especially unfair in view of the adhesion-contract nature of the bidding process. When the terms of a contract are drafted by the government, the terms are not subject to negotiation, and the government is the sole purchaser of the goods, even large, sophisticated contractors are unable to protect their rights. As the circumstances of these PMM clauses demonstrate, protests are not realistic options for contractors. This manifest unfairness to contractors is contrary to the express goals of the FAR.

ARGUMENT

This Court many times has reiterated the rule articulated by *Chris Berg*, 426 F.2d 314: rights granted by a provision in a regulation binding on contracting officers, and in place for the benefit of government contractors, cannot be waived. See generally Thomas M. Abbott & Janice R. Hawkins, *Enforcing "Illegal Contracts" – the Federal Circuit's Selective Application of the Doctrine of Waiver*, 39 PROCUREMENT LAW 3, 4-7 (Fall 2003) (discussing cases). The no-waiver rule is particularly forceful in the context of regulations that reflect institutional concerns, rather than merely conferring personal rights[4] – a rule DESC has conceded. See Def.

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4 See *Kaiser Steel Corp.*, 455 U.S. at 77 (citing *McMullen* v. *Hoffman*, 174 U.S. 639, 669 (1899)) ("There is no statutory code of federal contract law, but our cases leave no doubt that illegal promises will not be enforced in cases controlled by the federal law. * * * '[T]o permit a recovery in this case is in substance to enforce an (continued...)

S.J. Rep. in *Williams Alaska Petroleum, Inc.* v. *United States*, Fed. Cl. No. 02-705C, 21-22 (filed Feb. 10, 2003) (Def. *Williams* Rep.) ("[I]n cases where strong public policy is evident, courts are reluctant to permit parties to overturn the policy by mutual consent.") (citing *Clark* v. *United States*, 95 U.S. 539 (1877)); see also Hearing Transcript in *Hermes Consolidated, Inc.* v. *United States*, No. 02-1460C, 28-29 (May 15, 2003) (*Hermes* Tr.) ("The only theory of the law that is clear to us is: In those cases of important public policy – * * * [t]here is no way the courts will enforce that.") (government counsel explaining when waiver of a claim of illegality will not be allowed). Each of the reasons for the no-waiver rule is present in these cases: FAR § 16.203 inures to the benefit of contractors like appellants; and faithfulness to the FAR system is a matter of institutional concern.

In advancing its arguments for waiver, DESC conflates the necessary question whether a waiver defense is permissible at all, with the question – irrelevant unless the former question first is answered in the affirmative – of how good an explanation contractors have for not having asserted their rights earlier. DESC has urged courts to ask the second question first. At least the *Hermes* court below was misled, and held

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4(...continued)
illegal contract, and one which is illegal because it is against public policy to permit it to stand. The court refuses to enforce such a contract and it permits defendant to set up its illegality, not out of any regard for the defendant who sets it up, but only on account of the public interest.'").

that rights granted by the FAR could be waived, largely because of what it considered evidence that Wyoming had not done enough to protect its rights. *Hermes II*, slip op. 4; see also *Hermes I*, slip op. 11-14. But, because there can be no waiver, appellant Wyoming's supposed delay in complaining or bringing suit is irrelevant.

To explain why this is so, *amicus* first discusses the important institutional concerns that are jeopardized if courts refuse to look beyond the individual contracting officer's demand for an illegal clause and the particular contractor's failure to object in what the court deems a timely fashion. Second, *amicus* shows that the case law honors those interests by making the waiver doctrine unavailable in cases such as this one, even if the doctrine is available in other cases raising more individuated concerns.

I. The Important Institutional Concerns Embodied in the FAR Should Not Be Subordinated to the Caprices of Individual Contract Officers

Congress directed the promulgation of the FAR to control strictly the manner in which the Executive Branch, including DESC, spent appropriated monies. Congress's control over the purse strings "is at the foundation of our constitutional order" – the Federal Constitution states (U.S. CONST. art. I, § 9, cl. 7): "No money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law." See Kate Stith, *Congress' Power of the Purse*, 97 YALE L.J. 1343, 1344 (1988). Therefore, "the appropriations clause enjoins the President to spend funds in

the name of the United States only as appropriated by Congress." *Id.* at 1351. Properly understood, "the appropriations clause *affirmatively obligates* Congress to exercise * * * power already in its possession." *Id.* at 1348 (emphasis added).

The Supreme Court has recognized the importance of faithful adherence to the Appropriations Clause. See *Office of Personnel Management* v. *Richmond*, 496 U.S. 414, 427-428 (1990). "'The object is apparent upon the slightest examination. It is to secure regularity, punctuality, and fidelity, in the disbursements of the public money. * * * If it were otherwise, the executive would possess an unbounded power over the public purse of the nation * * *. The power to control and direct the appropriations, constitutes a most useful and salutary check.'" *Id.* at 427 (quoting 2 JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 1348 (3d ed. 1858)). For these reasons, "claims for estoppel cannot be entertained where public money is at stake." *Richmond*, 496 U.S. at 427. As the Supreme Court explained, "the Clause has a more fundamental and comprehensive purpose, of direct relevance to the case before us. It is to assure that public funds will be spent according to the letter of difficult judgments reached by Congress as to the common good and not according to the individual favor of Government agents." *Id.* at 427-428. That "more fundamental and comprehensive purpose" counsels every bit as much against allowing the government to insist on *enforcement* of illegal terms

(through doctrines of waiver or otherwise) as it counsels against allowing the government to have illegal terms enforced against it.

The scheme chosen by Congress to fulfill its constitutional responsibility has proven fragile. Whether through bad faith or neglect, individual contracting officers have in these cases engaged in a pattern of "unauthorized deviation" (*Hermes I*, slip op. 11) from the FAR. By doing so at the level of individual contracts, contracting officers made the PMM clauses a staple of procurement policy for more than a decade, while escaping the oversight of any centralized authority and of the Legislative Branch.

A. Directing the Promulgation of the FAR was Congress's Chosen Manner of Maintaining Control over Appropriations

The FAR was promulgated "in accordance with the requirements of the Office of Federal Procurement Policy Act of 1974 (Pub. L. No. 93-400), as amended by Pub. L. No. 96-83." 48 C.F.R. § 1.103(a) (citing Pub. L. No. 93-400, 93d Cong., 2d Sess., 88 Stat. 796 (1974), and Pub. L. No. 96-83, 96th Cong., 1st Sess., 93 Stat. 648 (1979)). Congress sought in 1974 "to promote economy, efficiency, and effectiveness in the procurement of property and services by and for the Executive Branch" (Pub. L. No. 93-400, § 2, codified at 41 U.S.C. § 401) – the "number one recommendation of the report submitted to the Congress by the Commission on Government

Procurement after a 2½-year unprecedented review of the Federal procurement process." S. REP. NO. 93-692, 93d Cong., 2d Sess. (1974), reprinted at 1974 U.S.C.C.A.N. 4589, 4594. That goal was to be accomplished in part by "[a]chieving greater uniformity and simplicity, whenever appropriate, in procurement procedures" (Pub. L. No. 93-400, § 2(6)) and by "[p]romoting fair dealing and equitable relationships among the parties in government contracting" (*id.* § 2(10)).

Responsibilities were placed in the hands of a new Office of Federal Procurement Policy (Pub. L. No. 93-400, § 4) (OFPP), to overcome the problem of "[m]any segments of Government, operating to a large extent in an uncoordinated manner, mak[ing] or strongly influencing procurement policy [without] strong central leadership of the segments." 1974 U.S.C.C.A.N. at 4591. By centralizing procurement policy, Congress hoped to fill "the void that exists in policy leadership and a fragmented and outmoded statutory base" and "to restore credibility to the procurement process." *Id.* at 4596. According to Professor John Cibinic, Jr., "an expert in contract law," "[t]he subject of Federal government contracts is so complex and so important that an independent, centralized, on-going policy group with authority to require procurement agency adherence to its promulgations is absolutely necessary." *Id.* at 4610, 4611.

Consistent with its constitutional duties, Congress maintains close oversight over the OFPP. "[L]egislation is needed to insure a high degree of responsiveness to Congress." 1974 U.S.C.C.A.N. at 4592. Annual reports must be made to the President of the Senate and the Speaker of the House. Pub. L. No. 93-400, § 8(a). Reports must also be made 30 days in advance of any new major policy or regulation, waivable only by a specific, written request by the President to Congress (*id.* § 8(b), (c)) – to give either House of Congress the opportunity to reject the proposed major policy or regulation by resolution. See 1974 U.S.C.C.A.N. at 4591. The Administrator and Deputy Administrator of the OFPP must be confirmed by the Senate, and employees or officers of OFPP must testify before Congress on command. *Ibid.*

B. The Great Institutional Concern in a Consistent and Rational Procurement Policy is Reflected in the FAR

In keeping with Congress's express goals, the FAR has the purpose of "codification and publication of uniform policies and procedures for acquisition by all executive agencies." 48 C.F.R. § 1.101. The FAR's "guiding principles" include the goals of "maintaining the public's trust and fulfilling public policy objectives" (*id.* § 1.102(a)) and "[c]onduct[ing] business with integrity, fairness, and openness" (*id.* § 1.102(b)(3)).

OFPP has recognized the importance of consistent, fair, and rational administration of procurement policy.

> [O]ur ability to achieve good overall results also requires that acquisition processes take a balanced approach among all of the basic building blocks of acquisition: sound planning, consistent use of competition, well structured contracts designed to produce cost-effective quality performance from contractors, and solid contract management. All of these activities must occur in an environment that fosters fairness, integrity, and transparency. Adherence to these values, and policies that promote them, will garner the public's confidence and help to encourage robust participation in federal procurement by contractors small and large.

Administrator for Federal Procurement Policy Angela B. Styles, Statement Before the Readiness and Management Support Subcommittee, U.S. Senate Committee on Armed Services 2-3 (Feb. 27, 2002), available at http://www.acqnet.gov/Notes/sasc6testimony.doc. Administrator Styles emphasized the overarching importance of appropriate administration of the procurement system (*id.* at 4):

> Far from the mechanical or administrative-laden label that some might like to assign to the contracting function, procurement personnel remain vital to ensuring the proper stewardship of the $220 billion in goods and services the federal government buys each year. These people are the *key* component of our acquisition workforce and are looked upon to ensure sound application of the varied contracting tools now available.

In addition to general policies of sound stewardship of procurement policy, the FAR also fills the important role of protecting contractors and maintaining the government's credibility as a contracting partner. "Supplier loyalties stemming from good

relationships provide inestimable benefits to all buyers of goods and services." Norman R. Augustine & Robert F. Trimble, *Procurement Competition at Work: The Manufacturer's Experience*, 6 YALE J. REG. 333, 340 (1989). The FAR establishes that EPA clauses exist to protect contractors *as well as* the government from changing market conditions. 48 C.F.R. § 16.203-3.

DESC has contended that there is no "institutional concern" generated by the use of one index over another in a military-fuel supply contract: "Here, there is no legislative mandate regarding the EPA clauses at issue." Def. *Williams* Rep. 24. Phrasing the question that narrowly, there never could be an "institutional concern" over a contract term. The essential question is the broader one: Whether there is an institutional concern with the preeminence of the FAR over decisions by individual contracting officers. To state that question is to answer it; of course the preeminence of the FAR is a matter of institutional concern. If it were not, there would be no need for the FAR at all.

C. The Judicial Branch Has an Important Role to Play in Protecting Congress's Scheme for Administering Procurement Policy

"[T]he Constitution places responsibility for appropriations in the legislative branch," but when Congress's prescribed scheme is undermined the courts should become involved "in implementing the constitutional requirement by enforcing against the Executive the limitations that Congress has placed on spending authority." Stith, *supra*, at 1386. In *OPM* v. *Richmond*, the Supreme Court undertook the responsibility of ensuring that Congress's power over appropriations was not undermined by "individual" decisions of employees of the Executive Branch. 496 U.S. at 427-428. As the government has noted, in "cases * * * involving important public policy[,] * * * the court steps in almost as an independent policeman acting on behalf of public policy and prevents the government from going forward." *Hermes* Tr. 19-20.

The Supreme Court repeatedly has emphasized the impropriety of entertaining "claims for estoppel * * * where public money is at stake." *Richmond*, 496 U.S. at 427; see generally *Kaiser Steel Corp.*, 455 U.S. at 77; *Sola Elec. Corp.* v. *Jefferson Elec. Co.*, 317 U.S. 173, 176 (1942) ("[R]ules of estoppel will not be permitted to thwart the purposes of statutes of the United States.")). In *OPM* v. *Richmond*, the Court refused to permit estoppel against the government (496 U.S. at 428), but the

Kaiser Steel Corp. decision, and this Court's decisions (see Br. of Appellants 38-43), make clear that the rule applies to any assertion – whether against the government or against a contractor – of a waiver-and-estoppel rule that asks a court to enforce an illegal contract term.

By asserting a waiver defense, the government has asked the Court of Federal Claims to acquiesce in the illegal PMM clauses. Courts may not do so. See, *e.g.*, *INS* v. *Pangilinan*, 486 U.S. 875, 883-884 (1988) (reversing the lower court's holding that citizenship could be ordered on the basis of equity, rather than under the conditions prescribed by Congress in the Immigration and Nationality Act). Rejecting an estoppel claim in *OPM* v. *Richmond*, the Supreme Court discussed the impermissibility of an estoppel holding that would have the effect of enforcing an illegal contract. See 496 U.S. at 430. "It is a federal crime, punishable by fine and imprisonment, for any Government officer or employee to knowingly spend money in excess of that appropriated by Congress." *Ibid.* The Court was unwilling to permit to be done by the courts what was impermissible if done by the Executive. *Ibid.* It is no less impermissible for individual contracting officers to commit appropriated funds in a manner that violates the FAR. See 48 C.F.R. § 1.602-1(b) ("No contract shall be entered into unless the contracting officer ensures that all requirements of law, executive orders, regulations, and all other applicable procedures, including clearances

and approvals, have been met."). In advancing a waiver argument, DESC asks courts to do for it what it may not do itself.[5]

II. Illegalities Implicating Institutional Concerns, Like the Orderly Operation of the FAR System, Cannot be Waived

Asking the necessary legal question whether the illegality in the PMM clause is of the type that may be waived, the Court should see these appeals as fitting within the unbroken line of authority beginning with *Chris Berg*.

A. Appellants' Claims of an Illegal Price Clause are not Waivable

A waiver defense to a claim of an illegal contract term is not permitted if the regulation violated is for the contractor's benefit (*Tesoro*, slip op. 14) or if it implicates institutional, not merely personal, concerns (*id.* at 12).

In *Chris Berg*, this Court made clear that the regulation binding on government contracting officers – in that case, the applicable Armed Services Procurement Regulation (ASPR), 32 C.F.R. § 2.406 (1967) – "governs the award and interpretation of contracts as fully as if it were made a part thereof." *Chris Berg*, 496 F.2d at 317 (citing *G.L. Christian & Assoc.* v. *United States*, 312 F.2d 418 (Ct. Cl. 1963)). *Chris Berg* distinguished *Massman Constr. Co.* v. *United States*, 60 F. Supp. 635 (Ct. Cl. 1945), an earlier decision holding that a contractor who "knew of [a] mistake [in a bid]

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5 Compare *Hermes* Tr. 28-29 ("[T]he simplest case is a contract for murder. There is no way the courts will enforce that.").

and signed the contract anyway" could not seek reformation because the contractor "was not free from negligence in making the mistake it did." *Chris Berg*, 426 F.2d at 316-317 (citing *Massman*). "A more important and, we think, controlling distinction [between *Massman* and *Chris Berg*] is that there was not any ASPR at the *Massman* date, or any other regulation called to the court's attention." *Chris Berg*, 426 F.2d at 317. In *Chris Berg*, unlike *Massman*, the presence of the ASPR demonstrated the presence of a broader institutional concern that could not be waived. This Court reiterated this distinction in *Beta Sys.*, 838 F.2d 1179. Because the index chosen "did not approximate the change in Beta's materials costs, * * * on its face the [Defense Acquisitions Regulation] was violated." *Id.* at 1185.

Chris Berg also highlights the distinction between regulations that benefit the bidder, and those that do not. In that case, the government argued that "this part of ASPR was not made for the benefit of bidders." 426 F.2d at 317. But the court held: "If a regulation appears intended to define and state the rights of a class of persons, it is presumptively intended to benefit those persons." *Ibid.* (citing *Fletcher* v. *United States*, 392 F.2d 266 (Ct. Cl. 1968)). Because the particular section of ASPR at issue *did* inure to the contractor's benefit, the *Chris Berg* court allowed the contractor to seek reformation. "In *Rough Diamond Co.* v. *United States*, 351 F.2d 636, 639-643 (Ct. Cl. 1966), we analyzed the differences as to contractor's rights under contracts

made in violation of law, when the law violated was or was not made for the benefit of the contracting party. * * * Suffice it to say that *Rough Diamond* supports plaintiff's position here, * * * once it is decided as we have that the ASPR provisions on mistaken bids were written for the protection of bidders." *Chris Berg*, 426 F.2d at 317-318. This Court reaffirmed the rule in *Cessna Aircraft Co.* v. *Dalton*, 126 F.3d 1442, 1451 (Fed. Cir. 1997) (quoting *LaBarge Prods.*, 46 F.3d at 1552) (emphasis added): "'If government officials make a contract they are not authorized to make, in violation of a law enacted *for the contractor's protection*, the contractor is not bound by estoppel, acquiescence, or failure to protest.'"

The *Hermes* court attempted to distinguish among this Court's waiver authorities based on the relative conduct of the contractors. See *Hermes I*, slip op. 12-13; *Hermes II*, slip op. 4. But the dispositive question (which this Court has answered many times in the negative) is whether a waiver defense may be asserted *at all* when the government has violated a law or regulation intended to benefit the contractor.

B. *Whittaker* and *E. Walters* Are Consistent With These Rules, and Myriad Policy Rationales Support Applying the No-Waiver Rule in These Cases

Whittaker and *E. Walters* do not establish a "competing" line of authority; those cases permitted a waiver defense to a claim of illegality in a narrow category of "option" contracts, and did not deal with illegalities inherent in the formation of the

initial contract. And *AT&T V* does not actually even reach a holding on the waiver question. See *Tesoro*, slip op. 12-15; Br. of Appellants 45-51.

The applicable policy rationales also support following this Circuit's entrenched no-waiver authority. DESC has pointed to the Restatement of Contracts test for unenforceability on public policy grounds. Def. *Williams* Rep. 22. The Restatement prescribes a balancing of the reasonable expectations of the parties and any public interest favoring enforcement of the term against the public policy forbidding the contract term. See RESTATEMENT (2D) CONTRACTS § 178. The latter side of the balance includes the questions (among others) of "the strength of [the] public policy as manifested by legislation" and "the likelihood that refusal to enforce the term will further that policy." *Ibid.*

Application of the Restatement test resoundingly counsels against enforcing the illegal PMM clause – and therefore, against permitting the government to assert a waiver defense. Although DESC asserts estoppel claims, it has been utterly unable to articulate any "justified expectation" that supports enforcing the PMM clause. In fact, any expectation that DESC had from the clause was an expectation of illegal benefit – so not "justified" at all. These are not cases in which DESC can argue that, had the contractor pointed out the illegality, it might have pursued other options; in these PMM-clause cases, DESC insisted on these contracts over many years (Br. of

Appellants 6-7), and cannot now credibly contend that it would have accepted an alternate EPA clause. Moreover, appellants seek only to be paid the fair market value of the product delivered, which is what DESC has represented that it intended to do with the EPA clauses. See *La Gloria Oil & Gas Co.* v. *United States*, 56 Fed. Cl. 211, 224-225 (2003) (quoting a Defense Fuel Supply Center (DFSC – DESC's predecessor) memorandum seeking an interim deviation from the FAR, as evidence that DFSC intended to pay fair market value).

And there is no identifiable public interest in enforcing the illegal contract term. It is worse to allow DESC to get away with violating validly promulgated regulations than to "allow[] a contractor to walk away from a deal that it freely entered into * * * if the result is only to give the contractor a fair price for the goods and services that were furnished to the Government." *Nonconforming Economic Price Adjustment Clauses: Myriad Issues*, 18-1 NASH & CIBINIC REP. ¶ 4, at 16 (Jan. 2004).

Public policy militates *against* a waiver holding here. On this side of the equation are concerns for the preeminence of the FAR system over the caprices of individual contracting officers; the unfairness of placing on contractors the burdens of policing contracting officers' compliance with the FAR; and the necessity of preserving the balance of reciprocity in contractual negotiations. As long as DESC can continue to assert its waiver defense, government contracting officers may believe

that they have latitude to rewrite the important governmental policies that underlie the various regulations in the FAR. As the *Tesoro* court below noted, "[i]f we were to adopt DESC's argument that contracting parties are free to waive mandatory FAR requirements, the parties to fuel contracts such as those at issue here would be free to rewrite federal procurement policy through negligence or collusion." Slip op. 12. As a leading commentator has noted, "[w]hat I would really like to see is for someone to do something about those who refuse to follow the rules because they think that by doing so some advantage is gained by the Government." *Nonconforming EPA Clauses*, *supra*, at 16. To allow the government to plead waiver in these cases is effectively to recreate the very system of decentralized lawmaking that Congress sought to get away from in 1974 when it mandated promulgation of the FAR.

DESC has been arguing that *contractors* must seek out illegal terms and contest them before entering into the contract. This is not a realistic option for contractors presented – as in these cases – with take-it-or-leave-it contract terms. See *Navajo Refining Co., L.P.* v. *United States*, 58 Fed. Cl. 200, 214 (2003) ("[T]here is evidence in the record that the government disfavored any challenge to its use of the [EPA] clauses. Indeed, DESC explicitly stated in its pre-negotiation briefing memoranda that it deemed its price adjustment clause to be non-negotiable."). See generally Richard E. Speidel, *Contract Excuse Doctrine and Retrospective Legislation: The* Winstar

Case, 2001 WIS. L. REV. 795, 818 & n.122 ("In most government contracts, the markets are limited to competition among private contractors seeking government business, and the government has superior bargaining power with which to call the shots.") (citing John Cibinic, Jr., *Retroactive Legislation and Regulations and Federal Government Contracts*, 51 ALA. L. REV. 963, 974-975 (2000)).

DESC's bargaining leverage is especially overpowering when it is the sole or predominant purchaser of a product, such as military fuel. Contractors are forced to choose between bidding on a contract, thereby risking the waiver of any claim of illegality, or not bidding at all, and thereby passing up potential business. "Obviously, a prudent contractor often cannot afford to walk away from potential business." Michael T. Janik & Margaret C. Rhodes, Gould, Inc. *v.* United States*: Contractor Claims for Relief Under Illegal Contracts with the Government*, 45 AM. U. L. REV. 1949, 1978 (1996). Once a bid is accepted, the contractor has little choice but to perform, even if parts of the contract may be illegal. "'If [the contractor] questions the award and refuses to accept it because of his own doubts as to possible illegality, the contracting officer could forfeit his bid bond for refusing to enter into the contract.'" Abbott & Hawkins, *supra*, at 4 (quoting *United States* v. *Amdahl Corp.*, 786 F.2d 387, 394 (Fed. Cir. 1986)).

Most compellingly, DESC's position places the entire risk of harm from an illegal contract term on the contractor – although DESC drafts the contracts, and contractors are practically precluded from negotiating to change them. Under a waiver rule, if an impermissible contract clause operates to the government's benefit, the government realizes a windfall. On the other hand, if the government suffers because an impermissible clause operates to the contractor's benefit, the government cannot be estopped to assert that the clause is invalid.[6] See *Merrill*, 332 U.S. at 384. See also *Richmond*, 496 U.S. at 419 ("From our earliest cases, we have recognized that equitable estoppel will not lie against the Government as it lies against private litigants.") (citing *Lee* v. *Munroe & Thornton*, 7 Cranch 366 (1813)). If this Court accepts the waiver rule DESC proposes, government contracts with potential illegalities will be illusory: nothing would prevent the government from refusing to abide by an illegal clause, but government contractors would be prevented by the one-sided waiver rule from contesting the illegality.

The unfairness of such one-sided risk allocation supports applying this Court's established no-waiver rule as a necessary corollary to the *Federal Crop. Ins. Corp.* v.

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6 Courts have recognized the inequity in such a result. *Compare United States* v. *American Renaissance Lines, Inc.*, 494 F.2d 1059 (D.C. Cir. 1974) (holding that the government should not be allowed to hide behind its own failure to follow regulations and limit the private party to *quantum meruit* recovery).

Merrill rule. "Simply because a party is a defense contractor does not mean that all doubts automatically are to be resolved against it." *John Doe Agency* v. *John Doe Corp.*, 493 U.S. 146, 158 (1989) (statement of Blackmun, J.). Appellants' approach is faithful to another express admonition of the Supreme Court, that the United States is bound by the same body of contract law that binds private individuals. See *Mobil Oil Expl. & Prod. Southeast*, 530 U.S. at 607-608 (quoting *Winstar*, 518 U.S. at 895 (plurality opinion)) ("'When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals.'").

This Court will respect the Supreme Court's decisions and avoid unfairness to defense contractors if it applies this Court's rule that contractors cannot waive their rights to contest illegalities.

CONCLUSION

For the foregoing reasons, and for the reasons stated in appellants' brief, this Court should affirm the decision of the Court of Federal Claims in *Tesoro*, No. 02-CV-704, and reverse the decision in *Hermes II*, No. 02-CV-1460.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that this brief contains 6949 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii) and Rule 32(b) of the Rules of this Court. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using WordPerfect Version 10 in 14-point Times New Roman font.

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