

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

In re:

MURDOCK MACHINE &
 ENGINEERING COMPANY
 OF UTAH,

Bankrupt.

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Bankruptcy Number B-75-484

[Chapter X]

MEMORANDUM DECISION and ORDER

James B. Lee, Esq., Craig B. Terry, Esq., and E. Russell Vetter, Esq., of Parsons, Behle & Latimer, Salt Lake City, Utah, and Robert H. Koehler, Esq., and Jonathan S. Baker, Esq., of Patton, Boggs & Blow, Washington, D.C., appeared representing Logan A. Bagley, Trustee of Murdock Machine & Engineering Company of Utah, Bankrupt.

Stuart M. Gerson, Esq., Assistant Attorney General, Dee Benson, Esq., United States Attorney, and Margaret R. Nelson, Esq., Assistant United States Attorney, Salt Lake City, Utah, and J. Christopher Kohn, Esq., Tracy J. Whitaker, Esq., and Bernard J. McKay, Esq., Attorneys, Civil Division, U. S. Department of Justice, Washington, D. C., appeared representing the United States of America, Claimant.

Two related matters are pending for consideration by this court in this fifteen year old Bankruptcy Act case. The first is the Trustee's Motion for Partial Summary

Judgment Regarding Government Claims No. 764 and 764A (Summary Judgment Motion) filed as a contested matter by Logan A. Bagley (Trustee), Trustee for Murdock Machine & Engineering Company of Utah (Murdock). The court heard concurrently the Motion to Dismiss or Defer to the ASBCA or Claims Court (Motion to Dismiss or Defer) filed by the United States of America (Government), on behalf of the Department of Defense and its military components, the Departments of the Army, Navy, and Air Force. The Motion to Dismiss or Defer was filed as both a response to the Trustee's Summary Judgment Motion in the main case relating to Government claims numbered 764 and 764A, and to the Trustee's objection in the adversary proceeding to certain other claims filed by the Government.

For clarity, the court will deal with the contested matter and the adversary proceeding separately, although a common thread binds the two. This opinion deals only with the Trustee's Summary Judgment Motion and the Government's Motion to Dismiss or Defer filed in the contested matter.

JURISDICTION

This court has jurisdiction over the subject matter of and the parties to this matter pursuant to section 2a(2) of the Bankruptcy Act of 1898, 11 U.S.C. § 11. Section 2a(2) of the Act invests bankruptcy courts with jurisdiction to "[a]llow claims, disallow

claims, reconsider allowed or disallowed claims, and allow or disallow them against bankruptcy estates." Venue in this division is proper pursuant to Bankruptcy Rule 116.

APPLICABLE LAW

The Chapter X petition in this case was filed on May 23, 1975, thus the Bankruptcy Act of 1898, as amended, is the applicable law. Bankruptcy courts are specifically granted jurisdiction over the determination of claims allowance and disallowance. The court is charged with the duty to resolve claims disputes in summary proceedings under the Bankruptcy Act. *Katchen v. Landy*, 382 U.S. 323, 329 (1966).

The Government asserts the applicability of the Contract Disputes Act of 1978 (CDA), stating that the CDA provides the exclusive system for resolving government contract disputes. 41 U.S.C. §§ 601-613. However, as Judge Baldwin noted in his concurring opinion,

[s]ection 16 of the CDA permits a contractor to proceed under the Act "with respect to any claim pending . . . before the contracting officer or initiated" after the effective date of the statute. The contracting officer issued a final decision terminating the contract for default on May 16, 1975. Appeal No. 20409 was filed on May 22, 1975. Murdock had no claim pending before the contracting officer on the effective date of the CDA, therefore the CDA does not apply to that decision.

Murdock Mach. & Eng'g Co. v. United States, 873 F.2d 1410, 1413 (Fed. Cir. 1989) (citations omitted). The Senate report accompanying the CDA explained that as a result of the CDA, "United States district court jurisdiction [was] eliminated from government contract claims." S. Rep. No. 1118, 95th Cong., 2d Sess., *reprinted in* 1978 U.S. Code

Cong. & Admin. News 5235, 5244. It follows that the federal district courts had jurisdiction over government contract claims prior to the CDA.¹ As a result, this court has summary jurisdiction to consider this matter.

FACTS

The ASROC Contract

On June 25, 1971, the Government awarded Murdock a fixed price contract for the construction of anti-submarine rocket launchers (ASROC). Soon after the award, Murdock experienced production delays allegedly resulting in part from defective specifications and from defective tooling and other components received from the Navy, and was financially unable to perform on the contract. The Navy procuring command was concerned with timely receipt of the ASROC launchers, and therefore provided Murdock with a \$2,500,000 government-guaranteed loan and encouraged Murdock to apply for relief pursuant to Public Law 85-804 (P.L. 85-804). On April 7, 1975, the Navy Contract Adjustment Board (NCAB) approved Murdock's P.L. 85-804 request and converted the ASROC contract to a cost-reimbursement/no-fee contract with a ceiling of approximately \$22,000,000, as set forth in the NCAB's April 7, 1975, draft Memorandum of Decision.

¹ In *United States v. American Pouch Foods, Inc. (In re American Pouch Foods, Inc.)*, 30 B.R. 1015, 1024 (N.D. Ill. 1983), *aff'd*, 769 F.2d 1190 (7th Cir. 1985), *cert. denied*, 475 U.S. 1082 (1986), the district court noted that the CDA did not become effective until March 1, 1979, and that since the contract in that case was entered into before the CDA's effective date, the CDA was determined inapplicable. The district court abstained from reaching the merits of the government contract dispute counterclaims.

In the meantime, the Navy located a new manufacturer for the ASROC contract and withdrew its support of Murdock's P.L. 85-804 request. Nine days later, the Government informed Murdock that the ASROC contract would not be converted to a cost-reimbursement/no-fee contract, that the P.L. 85-804 request was being withdrawn from the NCAB, and that Murdock had ten days to cure its delinquent ASROC delivery schedule or face default termination. Murdock was allegedly unable to cure within the given time without the additional funding from the Government.

The Navy ASROC contracting officer subsequently issued a final decision on May 16, 1975, terminating for default the ASROC contract. Murdock appealed the decision and on the following day, May 23, 1975, filed a petition under Chapter X of the Bankruptcy Act. Judge Monroe E. Freeman, Jr. of the Armed Services Board of Contract Appeals (ASBCA) presided over Murdock's ASROC appeal (Appeal No. 20409) of the contracting officer's decision and ruled in favor of the Government. The ASBCA found, among other things, no nexus between the Government's actions and Murdock's inability to perform on the ASROC contract.

The Federal Circuit Court of Appeals Decision and Subsequent Events

The ASBCA decisions in Appeals No. 27860 and 28031 were reversed on April 26, 1989, by the Federal Circuit Court of Appeals finding that the NCAB's April 7, 1975, decision was final and converted the fixed-price contract to a cost-reimbursement/no-fee contract that obligated the Government to pay Murdock its costs incurred in performing the ASROC contract. The Federal Circuit dismissed Appeal No. 20409 after

determining that the jurisdictional issue raised therein need not be reached because of the reversal in Appeals No. 27860 and 28031. The Federal Circuit subsequently found that the Government materially breached the contract by failing to reimburse Murdock for performance costs and that the breach relieved Murdock of the default termination and its consequences. Murdock's default termination was thus automatically converted into a termination for the convenience of the Government. The Federal Circuit remanded the ASROC case to the ASBCA for a determination of quantum under the contract's termination for convenience clause. *See Murdock*, 873 F.2d at 1413.

Several matters have transpired since the ASBCA submitted the case to the contracting officer for quantification. On January 5, 1990, the ASBCA denied the Government's motion to dismiss the ASROC claim for lack of jurisdiction. The ASBCA indicated that the *Murdock* decision set forth the Federal Circuit's implicit judgment and mandate resolving against the Government all jurisdictional objections to the relief granted. According to the ASBCA, "[i]f the [Federal Circuit] Court committed error, jurisdictional or otherwise in granting this relief, correction should have been sought by writ of certiorari, or by motion to the Court for rehearing. But such correction is not available from this Board within the limited scope of the remand." *Murdock Mach. & Eng'g Co.*, 90-1 BCA ¶ 22,604, at 113,430 (1990).

The ASBCA also indicated Murdock was required to submit a termination settlement proposal to the contracting officer "consistent with the terms of the ASROC contract as modified by the 7 April 1975 decision of the Navy Contract Adjustment

Board." *Murdock*, 90-1 BCA ¶ 22,604, at 113,430. The ASBCA submitted the matter to Steven J. Caracciolo, the Navy ASROC contracting officer, for quantification. On September 12, 1990, the Trustee submitted a proposal to the contracting officer in the amount of \$10,875,272. Subsequently, the Trustee and the contracting officer discussed a time frame within which to attempt to arrive at a settlement. The contracting officer testified at the January 14, 1991, hearing that he would be in a position to negotiate with the Trustee sometime in February of 1991. At a settlement meeting between the Trustee and the Navy on March 4, 1991, a dispute arose regarding a communication from the Department of Justice to the Department of the Navy that requested the Navy not to conduct settlement negotiations with the Trustee until the issues pending before this court were resolved. Thus, settlement discussions between the parties ceased. The Trustee then formally requested that the settlement proposal be considered a claim and demanded a final decision from the contracting officer.

The Government's position is that the contracting officer still has many issues to resolve. At the hearing on January 14, 1991, the contracting officer testified that the following issues remained to be determined: 1) the status of the Government's unliquidated progress payments and whether or not the Government could recover those payments, 2) the interest, if any, to be charged by the contracting officer on payments made by the Government, the rate of interest, and the date interest started to accrue, 3) the status and amount of the V-loan from the Navy, and 4) the appropriate termination clause to be applied, and whether the loss adjustment ratio should be applied.

The Claims

On November 7, 1975, the Government filed a First Amended Contingent Proof of Claim numbered 559A, for \$3,865,673.65 for unliquidated progress payments and excess procurement costs relating to Department of the Army contracts associated with production of Rocket Fin and Nozzle Assemblies² and Delay Plungers.³ On November 28, 1975, the Government filed a First Amended Contingent Proof of Claim numbered 764A, for \$11,728,841.98. The claim was for a Government-guaranteed "V-loan" relating to the Navy ASROC contract, and for unliquidated progress payments associated with an Air Force contract for the production of practice bombs and for unliquidated progress payments for three Navy contracts including the ASROC contract, the A/B Dispensers contract and the Zuni Launchers contract.⁴

The Objection to Claims

On July 26, 1990, the Trustee filed an objection as a contested matter to portions of the claim numbered 764A filed by the Government for unliquidated progress

² The Government sought \$2,024,615.27 for progress payments and \$1,288,139.78 for procurement costs on contract number DAAA-09-74-C-0060.

³ The Government sought \$552,918.60 for unliquidated progress payments on contract number DAAA09-74-C-0114.

⁴ Proof of Claim 764A

AF	F42600-74-C-2534	—	\$ 1,309,598.00	unliquidated progress payments
Navy	N00017-71-C-1430	—	7,933,291.71	unliquidated progress payments
Navy	N00104-74-C-B431	—	547,611.91	unliquidated progress payments
Navy	N00104-75-C-B004	—	10,582.36	unliquidated progress payments
Navy	NOFI 5-VL-303	—	<u>1,927,758.00</u>	"V-loan" from Navy
	Total		\$11,728,841.98	

payments resulting from the ASROC contract. On September 18, 1990, the Trustee filed the Summary Judgment Motion seeking to have the court disallow portions of the claim numbered 764A relating to the unliquidated progress payments from the ASROC contract based upon res judicata stemming from the Federal Circuit's *Murdock* decision.

On July 26, 1990, the Trustee also filed an adversary proceeding objecting to the Government's claims relating to the five non-ASROC contracts and also seeking money damages. The Trustee's request for money damages was in the nature of a counterclaim. The Trustee voluntarily dismissed the counterclaim on October 22, 1990, and no further relief is sought by the Trustee on the five non-ASROC claims except for their disallowance.

On November 15, 1990, the Government filed its Motion to Dismiss or Defer in the adversary proceeding and as a response to the Trustee's Summary Judgment Motion filed in the main case. Both motions were the subject of a hearing held on January 14, 1991. The court subsequently heard the Government's motion to supplement the record and additional argument telephonically on March 21, 1991, whereupon the matters were taken under advisement.

DISCUSSION

Motion to Dismiss or Defer

The issues raised by the Government's Motion to Dismiss or Defer as they relate to the five non-ASROC claims have been fully discussed in this court's

memorandum decision and order filed in the adversary proceeding number 90PB-0601. The discussion will be adopted from that decision, but not reiterated here except for the following explanation. The issues raised in this contested matter are factually different from the five non-ASROC claims because the nature of the termination of the ASROC claim has been fully litigated, and the only matter awaiting resolution is quantification on remand under the contract's termination clause. The Government's Motion to Defer or Dismiss, then, relates to this court's ruling on the Trustee's objection to the Government's claims and the Summary Judgment Motion.

In a case dealing with deferral of a government contract claims dispute, *Gary Aircraft Corp. v. United States (In re Gary Aircraft Corp.)*, 698 F.2d 775, 780 (5th Cir. 1983), *cert. denied*, 464 U.S. 820 (1983), the Fifth Circuit discussed those particular concerns.⁵ Based upon the Federal Circuit's ruling, there are no highly esoteric and technical contract disputes applicable to the res judicata effect of the Federal Circuit's ruling in *Murdock* to

⁵ The Fifth Circuit applied five criteria in reaching its conclusion that the lower court should have deferred to the Board of Contract Appeals and Court of Claims:

- 1) Resolution of the claims by a specialized tribunal would not impair the requirement that satisfaction of all claims against the bankrupt's estate should proceed in a central forum,
- 2) Technical and esoteric issues relating to government contracting law are present,
- 3) The specialized forum designed specifically to resolve government contract disputes may fulfill the needs for expertise, speed, and uniformity in resolving government contract disputes,
- 4) The bankruptcy court may not have authority to grant affirmative relief in excess of the amounts of the claim filed by the Government, and the contract dispute might have to be tried twice,
- 5) Congress has endorsed the transfer of disputes to specialized tribunals.

Gary Aircraft, 698 F.2d at 783-84.

the ASROC claim objection. Some of this court's concerns regarding the untimely resolution of the ASROC claim are alleviated because the issues have already been fully litigated. However, the resolution of the Summary Judgment Motion, as it arises here, is not before any other court and can be timely determined here. This court can apply the Federal Circuit's ruling without resort to the expertise of the ASBCA because of the definitive nature of the ruling. The fourth issue regarding deferral in *Gary Aircraft* is inapplicable because the Trustee does not seek affirmative relief; rather, he only seeks disallowance of the ASROC portion of the claim pursuant to the doctrine of res judicata.⁶ This court is compelled to accept its responsibility to determine claims presented to it.⁷ Therefore, for the reasons set forth above, as well as those included in the memorandum decision filed in the adversary proceeding, the Government's Motion to Defer or Dismiss is denied.

Motion For Partial Summary Judgment

The court reviews this dispute by applying the traditional summary judgment analysis. Pursuant thereto, the inference to be drawn from the underlying facts must be viewed in a light most favorable to the party opposing the motion. *Matsushita Elec. Indus.*

⁶ Res judicata applies to proceedings in bankruptcy court. *Katchen v. Landy*, 382 U.S. 323, 334 (1966).

⁷ "Among the granted powers [of bankruptcy courts] are the allowance and disallowance of claims, the collection and distribution of the estates of bankrupts and the determination of controversies in relation thereto; the rejection in whole or in part 'according to the equities of the case' of claims previously allowed; and the entering of such judgments 'as may be necessary for the enforcement of the provisions' of the act. In such respects the jurisdiction of the bankruptcy court is exclusive of all other courts." *Pepper v. Litton*, 308 U.S. 295, 304 (1939) (footnotes omitted).

Co. v. Zenith Radio Corp., 475 U.S. 574, 599 (1986). The nonmoving party may oppose a summary judgment motion by showing that there is a genuine issue as to a material fact. The movant has the burden of proving that there is an absence of evidence to support the nonmoving party's case. *Celotex Corp. v. Catrett*, 477 U.S. 317, 325 (1986).

In *Murdock*, the Federal Circuit held that the NCAB's April 7, 1975, decision converted the fixed-price contract to a cost-reimbursement/no-fee contract. The Federal Circuit also determined that the Government materially breached the contract by failing to reimburse *Murdock* and that the Navy's termination for default was improper and converted the termination for default into a termination for the convenience of the Government. *Murdock*, 873 F.2d at 1413. In its decision, the court stated that the determination of quantum would be made under "the contract's termination for convenience clause. See 32 C.F.R. §§ 7.103.21(c), 8.701(a) (1971)." *Murdock*, 873 F.2d at 1413. The citations refer to clauses for fixed-price supply contracts, not to termination under a cost-reimbursement contract.

In support of its defense to the Trustee's Summary Judgment Motion, the Government argues that the Federal Circuit decision merely addressed the propriety of the default termination. The Government contends its right to recover unliquidated progress payments⁸ was not foreclosed by the conversion to a termination for convenience.

⁸ Progress payments "are determined on the basis of costs incurred, percentage of work completed, or the stage reached in a particular project. 32 C.F.R. § 163.11 (1982)." *American Pouch Foods*, 30 B.R. at 1018.

The contracting officer's testimony at the hearing was that a loss ratio does not exist under the termination clause for a cost-reimbursement contract. He stated that a loss ratio only exists under a fixed-price contract. The contracting officer nonetheless is considering applying the loss adjustment concept because of the specific reference to the fixed-price contracts section in the Federal Circuit's opinion and because the fixed-price termination for convenience clause in the contract provides for adjustment in the settlement price if the contract was in a loss position at the time of the contract.⁹ The original fixed-price contract contained the standard Armed Services Procurement Regulations (ASPR) clauses promulgated by the Department of Defense for termination for default and termination for convenience. If the contracting officer proceeds as set forth above, the Government argues there may still be available some affirmative claim on the unliquidated progress payments.¹⁰

⁹ The Government asserts the ASROC contract was in an approximately fifty-two percent (52%) loss position at the time of termination according to a Defense Contract Audit Agency report, apparently conducted prior to the Federal Circuit's determination that the contract had been converted to a cost-reimbursement/no-fee contract. The added assertion of the contracting officer is that the amount of credit the Trustee has given the Government in its settlement offer includes the unliquidated progress payments and the liquidated payments. The contracting officer was unclear on the amount of payments made to Murdock and the amount that the Government disbursed against the Government-guaranteed loan to Murdock.

¹⁰ The Government maintains that under a termination for convenience, costs would be reimbursed, provided that the costs are allowable, allocable, and reasonable under the terms of the contract and also after offset for payments already made. The contracting officer has determined the cost elements based on the termination for convenience clause, namely, ASPR 7-103.21. The termination for convenience clause requires that unliquidated progress payments be deducted from allowable costs in determining the final amount owed to the contractor. The Government argues that the Federal Circuit's conversion of the Navy's wrongful default termination to a termination for convenience does not preclude it from recovering unliquidated progress payments and other adjustments on the ASROC contract.

The Trustee argues that the Government's claim is based only on unliquidated progress payments and not calculated for the V-Loan or for sums due under the loss recprocurement ratio. ASPR 7-103.21 requires that unliquidated progress payments be deducted from allowable costs in determining the final amount owed to the contractor. The Trustee asserts that the claim should be disallowed as an affirmative claim, although the amount asserted by the Government would be considered as a setoff to the amount now owed Murdock by the Government as finally determined in the remanded case. If the court denies the Trustee's Summary Judgment Motion, the Government may be entitled to amend its claim to assert an additional claim for interest; thus, the applicability of the law to the ASROC claim as stated in the Federal Circuit *Murdock* decision becomes significant.

Murdock has cited several cases holding that no basis exists for an affirmative claim under the progress payment clause absent a proper default. In *Ralcon, Inc. v. United States*, 13 Cl. Ct. 294 (1987), the United States Claims Court appeared to reiterate settled law when it indicated that

if a default termination proves to be invalid, it is no longer a termination executed pursuant to the default clause; it retroactively becomes a termination executed pursuant to the termination-for-convenience clause. In a termination for convenience, the Government takes title to the goods completed to-date and is liable to the contractor for the cost of the goods, plus the profit earned to the date of termination. The contractor's liability for the return of progress payments is offset by this amount. Therefore, the Government's right to the return of unliquidated progress payments clearly depends upon the validity of the default termination.

Ralcon, 13 Cl. Ct. at 301 (citations omitted). See *Nuclear Research Corp. v. United States*, 814 F.2d 647, 649 (Fed. Cir. 1987) (the net amount of money owed by NRC is dependent on the propriety of the contracting officer's decision to terminate the contract for default); *Composites Horizons*, ASBCA Nos. 25,529, 26471, 85-2 BCA ¶ 18,059 at 90,652-53 (1985); *J.M.T. Mach. Co.*, ASBCA No. 23,928, 85-1 BCA ¶ 17,820 at 89,180 (1984). The Government has cited no cases to the contrary.

This court finds that the Trustee has presented the legal basis for disallowance of that portion of the claim numbered 764A relating to the unliquidated progress payments affirmatively asserted by the Government as arising from the ASROC contract. The Government has presented no case law indicating that unliquidated progress payments are applicable to an improperly terminated contract. It has only indicated a potential claim if the loss ratio concept is applied and if, given the nature of the contract as a cost-reimbursement contract, eventual accounting shows that some claim remains. In making the pivotal decision regarding the termination of the ASROC contract, the Federal Circuit eliminated the legal basis upon which the Government could have claimed an affirmative recovery against the estate. See *Malone v. United States*, 849 F.2d 1441, 1446 (Fed Cir. 1988), *modified*, 857 F.2d 787 (Fed. Cir. 1988). The Government's defense to the Summary Judgment Motion fails to raise a genuine issue as to a material fact sufficient to defeat the motion.

Exhaustion of Remedies

The Government's Motion to Dismiss or Defer relates primarily to its desire that this court not rule on the Summary Judgment Motion. The court is cognizant that bankruptcy courts possess exclusive jurisdiction over claims allowance and other matters entrusted to it. For the reasons set forth above and in the memorandum decision filed in the adversary proceeding, the court applies that jurisdictional determination here. However, the balance of the dispute regarding the remaining calculation of the amount due as a result of the improper termination of the ASROC contract should be deferred for resolution in accord with the Federal Circuit's opinion. This court reaches that conclusion based, not upon the rationale set forth in the Government's argument, but upon the doctrine of exhaustion of remedies.

The doctrine of exhaustion of administrative remedies recognizes the valuable role that expertized agencies play by providing that, "where a claim is cognizable in the first instance by an administrative agency alone" judicial interference is to be "withheld until the administrative process has run its course."

Prudential Lines, Inc. v. United States Maritime Admin. (In re Prudential Lines, Inc.), 79 B.R. 167, 176 (Bankr. S.D.N.Y. 1987) citing *United States v. Western Pac. R.R.*, 352 U.S. 59, 63 (1956). The Trustee seeks no affirmative relief as it relates to the Government's claim, but instead relies upon the remand from the Federal Circuit to enable him to pursue Murdock's claim against the Government. The quantification procedure imposed by the Federal Circuit should be allowed to run its course, and it would be improper for

this court to intervene at this point. Nor does it appear that either party suggests this court should do so.

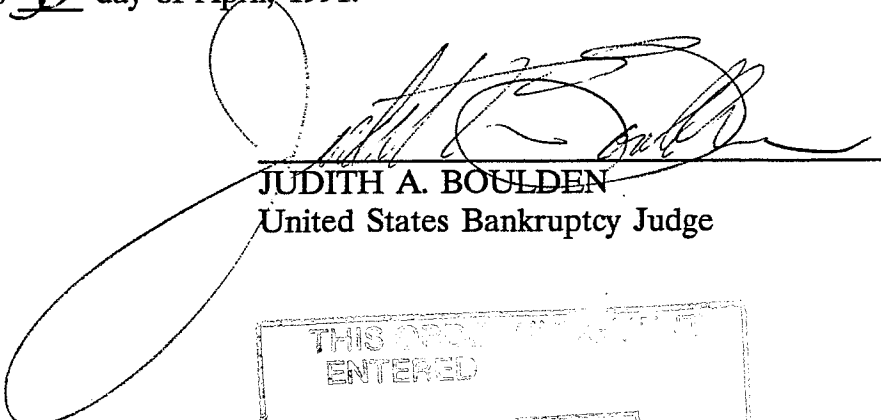
CONCLUSION

The court has carefully considered the evidence, case law, and arguments of the parties concerning the Trustee's Summary Judgment Motion and the Government's Motion to Dismiss or Defer. The Trustee has argued entitlement to partial summary judgment on the portion of claim number 764A relating to the ASROC unliquidated progress payments. The court is convinced that the issues presented in the Summary Judgment Motion are appropriate for consideration by this court. Further, the Trustee has presented a convincing case that, as a matter of law, no unliquidated progress payments survive the ruling in the Federal Circuit *Murdock* case. The Government has attempted to establish a material issue of disputed fact by asserting application of the loss ratio concept to the terminated contract. However, it has only raised an expectation and possibility, not a genuine issue of material fact. The Government has failed to show that, in fact, some amount of the unliquidated progress payment will survive the termination for convenience quantification process. Partial summary judgment is, consequently, warranted. Therefore, it is hereby

ORDERED, that the Government's Motion to Dismiss or Defer is denied, and, it is further

ORDERED, that the Trustee's Summary Judgment Motion is granted disallowing the claim of the Government for unliquidated progress payments related to the ASROC contract.

DATED this 30th day of April, 1991.



JUDITH A. BOULDEN
United States Bankruptcy Judge

THIS ORDER AND ALL
ENTERED

MAY 1 1991

DEPUTY CLERK
U.S. BANKRUPTCY COURT