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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,

Petitioners,

v.

THE UNITED STATES,

Respondents.

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

BRIEF OF *AMICUS CURIAE* NATIONAL PETROCHEMICAL & REFINERS ASSOCIATION IN SUPPORT OF PETITIONERS

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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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November 14, 2003

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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 101 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 Regulations (FAR). Many NPRA members, including petitioners, 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.

The inconsistent results in various Court of Federal Claims decisions dealing with military-fuel contracts demonstrate the unsettled state of the law in this Circuit regarding important legal issues. This unsettled state of the law creates uncertainty,

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

which greatly impedes speedy and consistent resolution of these cases. That uncertainty also means that federal contractors, including members of NPRA, cannot reliably assess business risks when considering federal contracting opportunities. Among the relevant risks is that the government may not be bound by an illegal contract, even though a private contractor will be held to be bound by that contract because of an implied waiver of its right to contest illegal contract terms.

In its role as a voice for the petroleum refining industry, NPRA is well situated to help this Court understand the importance of the issues presented in the petition for leave to appeal. Because it is vital that clear and consistent waiver rules face all government contractors bidding on, negotiating, and forming contracts subject to FAR, *amicus* NPRA has a substantial interest in prompt resolution of the inconsistency and uncertainty reflected in the decisions in these cases, so that contractors – including NPRA members – can more accurately assess litigation risks and order their future business arrangements.

ARGUMENT

A. CONFLICTING DECISIONS IN THE COURT OF FEDERAL CLAIMS REFLECT A FUNDAMENTAL INCONSISTENCY WITH RESPECT TO AN IMPORTANT ISSUE OF FEDERAL PROCUREMENT LAW.

Petitioners ask this Court for permission to bring a consolidated appeal, under

28 U.S.C. § 1292(d)(2), from two decisions of the Court of Federal Claims concerning the illegality of an economic price adjustment clause in petitioners' contracts to supply military fuel to the DESC. In a September 15, 2003, decision (*Tesoro Hawaii Corp.* v. *United States*, No. 02-740C (Fed. Cl. Sept. 15, 2003)), Judge Bruggink *rejected* DESC's defense that plaintiffs had waived their rights to contest the illegality of an economic price adjustment clause in military-fuel supply contracts by entering into and performing their obligations under the contracts. In a November 3, 2003, decision (*Hermes Consolidated, Inc.* v. *United States*, No. 02-1460C (Fed. Cl. Nov. 3, 2003) (*Hermes II*)), Judge Block held that the illegality *was waived* as a matter of law. And it is not just these two cases – the specific economic price adjustment clauses involved here, concerning adjustments to the price of military fuel purchased by DESC over the course of a long-term contract, are substantially identical to clauses in contracts for the supply of military fuel that are being challenged in 21 other cases currently pending in the Court of Federal Claims.

Economic price adjustment clauses are a common feature of federal procurement contracts. Under FAR, such clauses may be used in any procurement contract 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." FAR, 48 C.F.R. § 16.203-3. Thus, an economic price adjustment clause 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); *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).

Economic price adjustment clauses also play a critical role in mitigating and allocating risks under long-term government contracts. But that vital function is severely undermined when the legal rules governing such clauses are in doubt. Government contractors and potential government contractors must know whether a particular clause is legal or illegal, and whether a contractor injured by an illegal clause may seek legal redress for those injuries, because the answers to those questions can greatly reduce or increase the degree of risk those clauses impose on the contractor.

Unfortunately, today the answers to those questions are hopelessly unclear. One of the trial courts below noted that since *MAPCO Alaska Petroleum* v. *United States*, 27 Fed. Cl. 405 (1992), economic price adjustment clauses such as the clauses

at issue in these cases have been held to violate FAR. *Tesoro*, slip op. 4 ("This dispute * * * over whether the standard [economic price adjustment] clauses are legal * * * has been resolved by several prior decisions considering equivalent contracts."). But whether contractors' assertions of contract illegality are permitted, or are considered waived, depends solely on which of the conflicting waiver rules a particular judge chooses to apply in a particular case. No articulable principles guide the waiver analysis: judges of the Court of Federal Claims have adopted seemingly irreconcilable positions in cases that are not factually distinguishable. See *Hermes Consolidated, Inc.* v. *United States*, No. 02-1460C, slip op. 11-22 (Fed. Cl. Aug. 7, 2003) (*Hermes I*) (discussing the conflicting waiver rules); *Calcasieu Refining Co.* v. *United States*, 2003 WL 22049528, at *14 (Fed. Cl. July 31, 2003) ("The law does not chart a path to a decision on summary judgment.").

Under one rule, judges of the Court of Federal Claims have numerous times held that a government contractor need not be concerned about the risk of loss from a clause in a contract that turns out to be illegal. See, *e.g.*, *MAPCO*, 27 Fed. Cl. at 416 ("Assumption-of-the-risk analysis is not applicable under these circumstances, however. The contractor cannot, by waiver, permit the Government to enter an illegal contract."). This rule prevailed in the court below in one of the two cases sought to be appealed. *Tesoro*, slip op. 4 (citing cases holding the clauses illegal).

But the DESC continues to argue that entering and performing under a contract that contains illegal terms constitutes a waiver of a claim of contract illegality – citing this Court's decisions in *Whittaker Electronic Systems* v. *Dalton*, 124 F.3d 1443 (Fed. Cir. 1997), and *E. Walters & Co.* v. *United States*, 576 F.2d 362 (Ct. Cl. 1978). See, *e.g.*, *Tesoro*, slip op. 11; *Hermes I*, slip op. 14. In both *Whittaker* and *E. Walters*, the illegality was an option clause that violated regulations. And, in both cases, the contractor was estopped from asserting contract illegality when the option clause, to which it had agreed, was exercised. *Whittaker*, 124 F.3d at 1446; *E. Walters*, 576 F.2d at 367-68. In the other case currently sought to be appealed to this Court, the court held the illegality argument waived. *Hermes II*, slip op. 10.

The conflict in the Court of Federal Claims represented by the two decisions sought to be appealed is not only direct, it is very deep – several judges have lined up on each side of the conflict. Compare *La Gloria Oil & Gas Co.* v. *United States*, 56 Fed. Cl. 211, 226 (2003) (rejecting waiver defense); *Phoenix Petroleum Co.* v. *United States*, No. 97-315C, slip op. 6 (Fed. Cl. April 30, 2003) (rejecting waiver defense); *Gold Line Refining, Ltd.* v. *United States*, 54 Fed. Cl. 285, 297 (2002) (rejecting waiver defense); and *MAPCO*, 27 Fed. Cl. at 416 (rejecting waiver defense), with *Navajo Refining Co.* v. *United States*, ___ Fed. Cl. ___, 2003 WL 22436045, at *16 (Oct. 27, 2003) (failing to find waiver "on the basis of the record before the court");

Calcasieu, 2003 WL 22049528, at *9-*14 (holding that waiver is an issue of fact); and *Williams Alaska Petroleum, Inc.* v. *United States*, No. 02-705C, slip op. 21 (Fed. Cl. Oct. 1, 2003) (waiver is an issue of fact). The conflict will not be reconciled unless and until this Court provides a definitive ruling.

B. A PROMPT RESOLUTION OF THESE CONFLICTS WILL MATERIALLY ADVANCE THE RESOLUTION OF NUMEROUS PENDING CASES AND PROMOTE EFFICIENT AND EFFECTIVE FEDERAL PROCUREMENT POLICIES.

This Court should resolve the conflicts now, not later. In his September 15 *Tesoro* opinion, Judge Bruggink noted "the importance of the issues addressed herein, and the prospect of lengthy and expensive litigation on damages," and invited the parties to seek certification of the issues to this Court. Slip op. 19. Judge Block, granting leave to appeal in *Hermes*, stated likewise: "Approximately 22 other similarly-situated cases are currently pending in this court, and this confusion as to the state of the law is likely to become worse if the issues here are not soon resolved. Promptly resolving the issues raised above would materially advance the ultimate termination of the litigation here and in other similarly situated cases." *Hermes II*, slip op. 12.

The costs of continued confusion are substantial in the context of the numerous cases now in litigation. Equally important, continued confusion will have adverse

consequences outside of the litigation context, because such confusion will seriously impede the effective operation of the government contracting process, affecting contracts (and the firms considering whether to bid on or form those contracts) that are being put into place on an ongoing basis. Government contractors – and firms considering whether to enter into government contracts – have an overriding interest both in the fairness of the contracting rules *and* in the predictability of those rules.

DESC has argued that even if an economic price adjustment clause is illegal under FAR, contractors waive their right to challenge that legality when they enter into and perform their obligations under the contract. See DESC Rep. Br. 19, filed in *Williams Alaska Petroleum, Inc.* v. *United States*, No. 02-705C ("By adopting the [economic price adjustment] clauses in its offers (with the text of the FAR available to it for consultation), Williams signaled its intent to forego any other benefits contained in the FAR."). NPRA believes that contention to be wrong. Whichever way this Court ultimately resolves the question, resolution sooner will be better than resolution later, because the answer will affect current and future decisions concerning procurement contracts, made both by the government and by private firms. Uncertainty about the legal principles governing economic price adjustment clauses is particularly damaging. These clauses are often used in long-term contracts, whose effects in some cases may be felt for years to come.

As long as DESC can continue to assert its waiver defense, government contracting officers may believe that they have latitude to rewrite the important government policies that underlie the various regulations in 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.

The government has been arguing – and some courts have held – that contractors must seek out illegal terms and contest them before entering into the contract. It is at best highly doubtful that this is a practicable option. Contractors often are presented with take-it-or-leave-it contract terms. See *Navajo Refining*, 2003 WL 22436045, at *16 ("[T]here is evidence in the record that the government disfavored any challenge to its use of the [economic price adjustment] 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 WISC. 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."). The government's bargaining leverage is especially overpowering when it is the sole or predominant purchaser of a product, such as military fuel. As a practical matter, under DESC's view, contractors often will be forced to choose between bidding on a contract and thereby risking the waiver of any claim of illegality, or not bidding and thereby passing up on potential business. See 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) ("Obviously, a prudent contractor often cannot afford to walk away from potential business.").[2]

In NPRA's view, it makes no sense to face potential contractors with this Hobson's choice; but if, as DESC advocates, those ultimately are to be the only options available to potential contractors, it is better for potential contractors to know that at the earliest possible time in order accurately to assess their risks under

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2 Janik & Rhodes also note that the contractor may lodge a protest and thereby incur additional costs. *Ibid.* But bid protests rarely are granted and are very costly. See 1/29/03 Letter of Anthony H. Gamboa, General Counsel, GAO to the Honorable J. Dennis Hastert, available at http://www.gao.gov/special.pubs/bidpro02.pdf (visited November 12, 2003) (noting that, in 2002, 3 bid protests were sustained in contracts with defense agencies, none of which were in cases in which the protest was filed before the contract award). Even under ideal circumstances, the defense contracting industry may experience "perilously low levels of return," Norman R. Augustine & Robert F. Trimble, *Procurement Competition at Work: The Manufacturer's Experience*, 6 YALE J. ON REG. 333, 344 (1989) – such that incurring additional costs to contest an illegal contract term is a false choice.

potential contract opportunities.

DESC's proposed waiver defense also threatens either to upset the balance of reciprocity in contractual obligations or to undermine the established principle that the government may not be held to a contract that violates FAR. The rule that a contractor's claims of contract illegality under FAR are not waived by accepting a contract is an essential corollary to the well-understood rule that individual contracting officers cannot bind the *government* to an illegal contract term. See *Federal Crop Ins. Corp.* v. *Merrill*, 332 U.S. 380, 384 (1947); see also *Office of Personnel Management* v. *Richmond*, 496 U.S. 414, 419 (1990) ("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 the waiver rule advanced by DESC in these cases is accepted, government contracts with potential illegalities will be illusory: nothing would prevent the government from refusing to abide by the illegal clause, but government contractors would be prevented by the one-sided waiver rule from contesting the illegality. The only way to avoid this potential unfairness would be to preserve the symmetry of rights and obligations between DESC and contractors, by abandoning the rule that the government cannot waive its right to seek reformation of illegal contract terms.

The risks of imposing these undesirable effects on the government contracting

process must be eliminated. Firms considering whether to enter into a government procurement contract should know what their rights and obligations will be, and what remedies will be available to them for illegal contracting practices. Clearly defined rules and predictable outcomes will promote a fair and efficient government procurement process. But the present state of confusion about the validity of DESC's waiver defense is antithetical to these goals of fairness and predictability. This Court should provide a definitive ruling on this legal issue at the earliest possible time.

CONCLUSION

For the foregoing reasons, and for the reasons stated in the petition, this Court should grant permission to appeal.

November 14, 2003

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on November 14, 2003, I caused two copies of this Brief of *Amicus Curiae* National Petroleum Refiners Association In Support of Petitioners to be served by United States Mail on counsel for the parties listed below.

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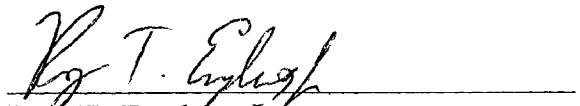

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