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Commonwealth Of Kentucky

Court Of Appeals

NO. 1999-CA-000490-MR (DIRECT)
NO. 1999-CA-000676-MR (CROSS)

GENERAL DYNAMICS ORDINANCE
SYSTEMS, INC.;
AND LOCKHEED MARTIN
ORDNANCE SYSTEMS, INC. APPELLANTS/CROSS-APPELLEES

v. APPEAL AND CROSS-APPEAL FROM JEFFERSON CIRCUIT COURT
HONORABLE GEOFFREY P. MORRIS, JUDGE
ACTION NOS. 96-CI-001534 AND 005129

CONCO, INC. APPELLEE/CROSS-APPELLANT

OPINION
AFFIRMING DIRECT APPEAL AND CROSS-APPEAL
** ** ** ** **

BEFORE: BUCKINGHAM, GUIDUGLI AND HUDDLESTON, JUDGES.

GUIDUGLI, JUDGE. General Dynamics Ordnance Systems, Inc. and Lockheed Martin Ordnance Systems, Inc. (collectively Ordnance) appeal from an order and judgment entered by the Jefferson Circuit Court on November 9, 1998, following a jury trial in which Conco, Inc. (Conco) was awarded $1,092,281.50 and from an order and judgment entered February 24, 1999, which awarded Conco $263,321 in pre-judgment interest. Conco appeals from a decision of the trial court which precluded it from seeking damages

stemming from an alleged loss of an unrelated contract. We affirm.

As these appeals stem from two separate and distinct contracts, we will address each separately.

ORDNANCE'S APPEAL

Conco's business centers around the production of ammunition boxes. Prior to January 1993, Conco manufactured only cylindrical containers. Ordnance operated an ammunition production facility in Milan, Tennessee. Ordnance was reimbursed by the Army for supplies purchased from contractors such as Conco. As such, Ordnance's operation was subject to oversight by the Defense Contractor Audit Agency (DCAA). Ordnance was subject to loss of operating fees for the Milan plant for failure to follow DCAA directives. Ordnance had historically been one of Conco's biggest customers.

Ordnance was involved with the production of 81mm artillery rounds for the Army. In January 1993, Ordnance sent a formal Request for Quotation (RFQ) to Conco seeking bids for the production of 76,250 PA156 ammunition boxes (PA156s) for the 81mm mortar rounds. According to the RFQ, 22,000 units were to be delivered to Milan by June 12, 1993, and the balance by December 15, 1993. The RFQ itself was composed of several different documents, each of which contained provisions relating to the production of the PA156s.

The military specifications for the PA156s were contained in MIL-C-71083, which was a part of the RFQ. Section 4 of this document dealt with quality assurance provisions. Section 4.1 provided:

> Responsibility for Inspection. Unless otherwise specified in the contract or purchase order, the contractor is responsible for the performance of all inspection requirements (examinations and tests) as specified herein. Except as otherwise specified in the contract or purchase order, the contractor may use his own or any other facilities suitable for the performance of the inspection requirements specified herein, unless disapproved by the Government. The Government reserves the right to perform any of the inspections set forth in this specification where such inspections are deemed necessary to ensure supplies and services conform to prescribed requirements.

Inspections were to be done on each lot, which consisted of either 2,304 or 4,608 units. From each lot, a representative sample was to be drawn and tested. Table II of Section 4 set forth the number of units to be sampled depending on the lot size, and also stated "Accept on zero and reject on one or more for all inspection levels."

Also attached to the RFQ was a document entitled "General Requirements for Supply of Ammunition Components - Martin Marietta Ordnance Systems, Inc." Section 3 of this document dealt with quality assurance issues. Section 3.1 set forth applicable quality assurance provisions, which included "applicable Government specifications and Martin Marietta Ordnance Systems, Inc. Purchase Description M-PD-200." Section 3.2 required the seller to "perform, or have performed, all inspections, tests, and analyses required by the applicable specifications and/or purchase descriptions[.]" Section 3.3 stated:

> The purchaser reserves the right to conduct any of the inspections and/or tests on additional samples, in accordance with the

> applicable specifications as deemed necessary to confirm acceptability of the items.

The M-PD-200 was also a part of the RFQ. Section 5 dealt with "Inspection and Acceptance." Section 5.2 provided:

> All material will be subject to inspection and acceptance at Milan Army Ammunition Plant and will remain the property of the supplier until so accepted. Material rejected by the purchaser for failing to meet all requirements will be returned to the supplier at his expense, unless other disposition is agreed upon.

Section 5.6 stated:

> Inspection at Milan . . . will normally consist of taking a representative sample from each lot in accordance with the sampling procedures of MTL-STD-105. Unless otherwise specified, Inspection Level II shall be used. Normally, inspection will be based on single sampling plan Table II-A for normal inspection, but the purchaser reserves the right to use any other applicable sampling table of MTL-STD-105. The units in the sample may be examined, inspected, gaged, and tested as required.

Unlike previous ammunition containers manufactured by Conco, the PA 156s were square. In anticipation of bidding on the PA 156 contract, Conco began negotiating with another company for the purchase of a production line capable of producing PA156s. Conco went as far as to send a copy of the bid specifications to the other company and ask for assurances that the equipment could produce the PA156s. Notes from a meeting of Conco personnel on February 1, 1993, indicated that Conco realized it had "daunting circumstances to overcome "if it obtained the PA156 contract. Conco ultimately secured the purchase of the production line and began estimating its bid on the PA156 contract.

On February 9, 1993, Conco submitted its formal bid in which it proposed to produce PA156s at a unit cost of $26.06, for a total of $1,987,075.00. Conco characterized its bid as a "firm, fixed-price quotation" with terms of Net 30 days. Ordnance ultimately awarded the PA156 contract to Conco. Prior to awarding the PA156 contract, Ordnance conducted pre-award inspections of Conco's facilities to ensure that its manufacturing process, including inspection procedures and equipment, met military specifications. Conco was deemed to be in compliance. On March 24, 1993, Ordnance executed a purchase order to Conco for 76,250 PA156s at a unit price of $26.06. The shipment schedule was established as follows:

> First article to be submitted to MAAP by 8 Jul 1993;
> 3,000 ea to be at MAAP by 22 Jul 1993;
> 3,750 ea to be at MAAP by 29 Jul 1993;
> 4,500 ea to be at MAAP by 5 Aug 1993;
> 5,750 ea to be at MAAP by 12 Aug 1993;
> 5,000 ea to be at MAAP by 19 Aug 1993;
> 9,100 ea to be at MAAP by 27 Sep 1993;
> 9,100 ea to be at MAAP each month thereafter, continuing until order completion.

The purchase order reflected terms of Net 30 days. Relevant portions of the terms and conditions attached to the purchase order provided as follows:

> 2. INVOICES:. . .[P]ayment and discount period expressed within the Purchase Order are understood to begin from the date of invoice or date of acceptable goods receipt at Milan . . . whichever occurs last.
>
> . . .
>
> 6. INSPECTION: Acceptance of any article shall not discharge the seller from liability and damage or other legal remedy for breach of any warranty herein expressed or implied by law or otherwise. Everything delivered is

> subject to final inspection and approval by buyer at our plant or such other place as is deemed proper by buyer. Payment by us does not constitute approval. We are to be the sole and exclusive judges in our sole opinion of the suitability of the material to our use.

Conco produced an initial PA156 sample following the award of the contract. The sample was inspected and accepted by Ordnance.

On April 22, 1993, after Conco received the PA156 contract, Ordnance received a letter from the Army regarding a DCAA audit report finding it to be in non-compliance with applicable standards. Specifically, the letter indicated an over-abundance of inventory in regard to 10 recorded items (which were not listed), and stated that "[i]t is unreasonable for a business concern to carry excess dollars in the inventory . . . without having a requirement outstanding."

On May 19, 1993, Ordnance wrote to Conco and asked that the delivery schedule under the purchase order be altered due to "a major U.S. Government 81mm mortar ammunition realignment LAP program adjustment from CY 1993 into CY 1994." Under the new schedule proposed by Ordnance, delivery would be as follows:

> 6,750 ea to be at MAAP during May 1994;
> 15,250 ea to be at MAAP during Jun 1994;
> 9,100 ea to be at MAAP each month thereafter, continuing until order completion.

Ordnance directed Conco to define any increase in cost stemming from its request in its response and to attach appropriate documentation. Conco responded by letter dated June 1, 1993, in which it estimated a probable cost increase of $85,140. Conco indicated that if it "were granted the latitude to schedule execution on this contract so as to best complement other

customer commitments, we could avoid or absorb the extra costs." It appears that Ordnance never came forth and directly told Conco that it was having production problems with the 81mm rounds.

On June 7, 1993, an internal memorandum generated by Ordnance stated in pertinent part:

> Subject material purchase order components for 81mm, M983/M984 were discussed as to originate a Stop Work release, or to originate an extension to current contracts. After full justification of cost and etc. . . . it was decided for MMOS Purchasing to extend delivery of each purchase order item for as long of time that could be economical, without any cost, to each purchase order vendor.

On June 24, 1993, Ordnance prepared a change order with respect to its contract providing:

> First article sample to be submitted to MAAP by 2 Aug 1993;
> 10,000 ea to be at MAAP by 1 Feb 1994;
> 10,000 ea to be at MAAP by each month thereafter, continuing until order completion.

The change order reflected that no cost increase would be incurred as a result of the change.

In January 1994, before Conco had commenced production, Ordnance once again pushed back its 81mm production to July-December 1994, and subsequently requested another change in the delivery schedule. In a letter to Ordnance dated January 31, 1994, Conco requested:

> that the delivery schedule for PA156 ammunition containers . . . be changed in order to better accommodate production of your order for PA120 containers. We propose to change the delivery schedule to that requested in your letter of 19 May 1993[.]
>
> . . .

> Conco actually intends to ship somewhat in advance of this schedule, including initial delivery in late April.

This agreement was reflected in a change order issued by Ordnance on February 2, 1994, which was "necessary to modify subcontractor's delivery schedule per bilateral agreement[.]" The change order again reflected no cost increase stemming from the alteration.

Minutes from a Production Workload Review meeting at Ordnance on May 11, 1994, showed that its DCAA problems were ongoing. One entry dealing with the DCAA states:

> Martin Marietta is receiving intense pressure from the DCAA on ordering more material than they need to. Martin Marietta orders material based on the PAS and for no more than one year at a time. It was suggested that this HQ concur on schedule when it is felt they are questionable.

An internal memorandum from Ordnance specifically concerning the PA156s dated May 16, 1994, stated:

> Due to production schedule changes, request subject material purchase order delivery for June and July 1994 be moved and added to November and December delivery. This change will also help storage space for stores.

To this end, Ordnance wrote to Conco again on May 25, 1994, and requested yet another revision to the delivery schedule.

Prior to Ordnance's third request for delay, Conco had already delivered several PA156 lots to Ordnance in April 1994. Prior to shipping the PA156 lots, Conco inspected each lot for defects by randomly sampling a certain number of individual boxes from each lot. Under the accept on zero, reject on one standard, the entire lot was to be accepted if no defects were found in the

random sampling.[1] If Conco found a defect in its sampling, it would then screen either the entire lot or portions of the lot for the defect it found. Thus, the PA156 lots had already been inspected before leaving Conco.

Despite Conco's pre-shipment inspection of the PA156s, Ordnance wrote to Conco on May 31, 1994, and stated that certain PA156 lots delivered to Ordnance had been rejected due to deficiencies. Unbeknownst to Conco at this time, Ordnance was conducting its own random sample testing on the delivered lots. Faced with Ordnance's claims that the first eight lots were unacceptable, Conco conducted an engineering study and found that the Army's schematic drawings of the PA156 were defective in that there was a discrepancy between the individual part dimensions and the way they actually fit together. Due to this defect, there was no way Conco could produce a conforming product. The so-called "stack-up" problem was eventually remedied through the issuance of change orders and Ordnance ultimately paid Conco for the first eight PA156 lots.

In August 1994, Ordnance determined that it would begin production of the 81mm rounds in January-June 1995. This is best evidenced by an internal memorandum of Ordnance dated November 17, 1994, wherein it was noted that Conco should begin delivery of 18,000 PA156s to Ordnance each month beginning in February 1995 in order to accommodate the production of the 81mm rounds in

[1]As Conco points out, the accept on zero reject on one standard was not a zero defect standard because "only a statistically significant sample from each lot of ammunition boxes is inspected for each of a number of specified criteria in order to economically insure product quality."

April-May 1995. The memorandum stated that "[t]his revised delivery necessary to help cut cost of inventory on hand." Faced with Ordnance's request for more PA156s, Conco wrote to Ordnance on September 28, 1994, and expressed the following concerns:

> a. The rejection notification letter for Lot 008 dated July 1994, mentioned certain damage to the handle brackets. Our investigation of this leads us to conclude that these containers were most likely damaged by a fork lift in the handling, loading, or unloading of the pallets. We do move and load palletized boxes by fork lift and, certainly, this problem could have happened here although we have not had problems with other products. Nonetheless, we have contacted our fork lift operators regarding this problem and instructed them to take extra care in both the handling and truck loading of these pallet lots.
>
> It is my understanding that our pallets are unloaded and handled by forklift at your facility which means it is also possible that the damage could have resulted from handling at your end. Specifically, the fork lift operators have been instructed to make sure the fork tines do not extend beyond the pallet edge and that pallet loads are not butted against each other while being lifted or dropped. It would be beneficial if you could alert your personnel about this as well to help avoid recurrence of this problem.
>
> b. Overall height and overall width stack-up problems: As you know, an ECP has been put forth to resolve the stack-up problem concerning the overall height. . . .Steps need to be taken to address the overall width stack-up problem, just as the overall height is being resolved. These are clearly design flaws.
>
> These problems have cost us tens of thousands of dollars in both the PA156 and the PA125 as we have tried to make containers to meet the current, impossible specifications. While we are not trying to recover these losses as they pertain to PA 156 units already produced,cannot perpetuate them. The design

> errors must be corrected (or waived) before we can resume production of this box.
>
> c. Source inspection at Conco: As we have discussed, this box calls for extremely high acceptance standards. The lack of coordination between our inspection here and yours there has resulted in double sampling of each lot. First, it is sampled and inspected here and then another sample is pulled and inspected upon receipt at your location which, in effect, doubles the sample size. We refer to this as "double jeopardy" as the two samples being selected from each lot essentially double the chance for rejection, (This is especially critical since acceptance is based on zero defects.) The net effect is still further tightening of the quality standard.
>
> We are hereby requesting that the balance of this order be source inspected at Conco so as to eliminate the effect of double sampling. Further, if a lot is rejected, it would eliminate the shipment of containers back from your facility to Conco for screening and the return of these containers to you.
>
> In any event, we must eliminate the double sampling before we resume shipping containers to you.

This letter was followed by another letter from Conco dated November 8, 1994, which stated in pertinent part:

> This letter will serve as a follow-up to our phone conversation today regarding the open PA156 ammunition box issues. Based on our conversation, it is my understanding that the ECP covering both the overall height and overall width issues has been approved and goes before the Configuration Control Board on 11/15 for final approval.
>
> . . .
>
> As I mentioned, it is critical that we are able to resume PA156 production no later than Monday, December 5, in order to avoid the shutdown of our box production line and the lay off of our production employees.

> With the approval and incorporation of the ECP, the only other major PA156 issue involves the sampling and inspection of these containers. As you know, we are extremely concerned about what we are referring to as "double jeopardy." A full inspection is done on a sample from each production lot here at Conco. When the containers arrive at your location, a different sample is pulled and the same inspection is done. The result is that each lot is subjected to the zero defects criteria for two times the normal sample size (our sample plus your sample). Although this has not been a problem in prior contracts, it becomes much more critical now with acceptance criteria which have been sharply tightened.
>
> The best answer seems to be customer source inspection here at Conco. . . . This would enable both the Conco inspectors and the Martin Marietta inspectors to examine the same sample in parallel, thus eliminating the double jeopardy issue. It would also mean that it a particular lot was rejected, it would still be here at Conco where it could be screened on the most efficient and timely basis.
>
> Another alternative would be to designate the "official sample" here at Conco so that it could be inspected both here and there. As we discussed, perhaps DCAS could be designated to select the sample units from each lot.
>
> In any event, it is absolutely vital that both these issues be fully resolved so that we can resume production on this order in the first of December. This is the production window reserved for execution of your order.
>
> In addition, as you are well aware, we have deferred production on this order as your requirements have slipped. It has now been twenty months since the order was placed. We simply must proceed now to avoid further escalation and additional carrying costs, as our pricing was based on the delivery of the full quantity at 1993 costs.

An internal memorandum from Ordnance shows that a telephone conference was held on November 17, 1994, to address

Conco's concerns. According to the memorandum, Ordnance personnel told Conco that:

> MMOS's inspection are [sic] the same for this order as any other. There have been no change in MMOS inspection procedures and Conco's material is inspected as required in TDP. . . . I re-emphasized that MMOS could accommodate delivery schedule of 18,000 Ea. beginning 1 Feb. 1995 and that this was not a recommendation to extend or slip schedule, but only information to supplier regarding delivery. Stated that MMOS would assist to the extent that it is plausible to MMOS & the USG.

Conco responded by letter dated November 17, 1994, which stated in pertinent part:

> 2 - Quality Requirements - The issue surrounding redundant inspections has not, however, been resolved. As we understand it, you are refusing to provide concurrent inspection at Conco by either Martin Marietta employees, Martin Marietta designated contract individuals, or by DCAA. Further, you have refused to achieve the same end by inspecting (only) the samples we have used to qualify individual lots to avoid a very substantial increase of the sample size and thereby unilaterally imposing a tightened quality standard. In addition, you have not yet committed to confine any reinspection efforts required to the characteristics and attributes found defective initially which further tightens quality standards on a unilateral basis.
>
> These inspection practices which you have imposed on this contract from its inception, despite our vigorous protests, have caused us very substantial expense beyond the scope of our commitment to you. We simply will not continue to incur these expenses caused by your spurious rejection of good products.
>
> Therefore, if Martin Marietta holds to this series of positions, we will need an amendment to the Purchase Order increasing the price by $1.92 to $27.98 to cover this change in quality requirements.

> 3 - Resumption of Production - As we have told you, we have been reserving the productive capacity of our box manufacturing facility to complete this order for you commencing in early December. Conco must decide no later than November 23, 1994, to continue building the PA156 (based on confirmation from you regarding the design changes and the acceptability of the price adjustment cited above to reflect the change you have imposed on quality requirements) or to shut that half of our facility down.
>
> If we are forced to shut down, we will be unable to resume production on your order for 4 - 10 weeks. In view of this additional delay, we will be further inhibited in delivery against a contract entered into two years ago. We will therefore require a price adjustment to reflect the escalation and carrying costs which Conco has incurred through these extensive, frequent delays.
>
> Although we have not attempted to develop precise estimates of this impact, historical trends in material costs, etc. indicate it will be in the neighborhood of 10-15% over and above the adjustment for changed quality standards identified above.

Another teleconference between Conco and Ordnance regarding the sampling issue was held on November 21, 1994. Ordnance suggested resolving the problem by inspecting the same sample inspected by Conco upon delivery of subsequent PA156 lots. Conco agreed to this procedure. An internal Ordnance memorandum dated November 22, 1994, indicated that Ordnance would "support acceptance inspection for future production . . . based on inspection of the same random sample used for acceptance at Conco's facility," and that the details would be worked out in the future. Ordnance wrote to Conco on the same date and advised that:

> Martin Marietta concurs in Conco, Inc's request that an official lot sample be

> designated by Conco, Inc. for lot acceptance purposes by both Conco, Inc. and Martin Marietta. Based on this concurrence, Conco, Inc. will segregate and properly identify this official sample with each lot shipment. Martin Marietta maintains the right to perform random incoming inspection sampling at Martin Marietta's discretion to insure product quality. Martin Marietta will provide technical assistance upon re-start of production at Conco's request.

It appears that portions of Ordnance's prime contract with the United States Government were negotiated every year. Terry Smith (Smith), the United States Government Contract Administrator at Milan testified at trial that one of his ongoing concerns with Milan was that when a government contract came in Milan would buy all their needed inventory up front, which would result in materials sitting in inventory until needed for production. To address this issue, Smith inserted an inventory reduction incentive in the terms of Ordnance's prime contract which took effect on December 13, 1994. Under the incentive, Ordnance was not penalized for failure to reduce inventory, but would not receive the incentive bonus if reduction was not made. While the PA156s were part of the reduction program in 1995, they were expressly excluded in 1996.

Conco resumed shipment of the PA156s to Ordnance in January 1995, beginning with Lot 9. On February 2, 1995, Conco was notified by Ordnance in a telephone conversation that Lots 9 and 12 were being rejected for stenciling problems. Conco was also advised that for all shipments after Lot 12, Ordnance intended to stop inspecting Conco's sample, and that Ordnance had

only agreed to check Conco's sample "on an interim basis to assure no gaging conflicts existed."

Upon receiving this notice of continued defects, Conco made arrangements for several of its employees to go to Milan and review the defects which were being reported. Conco stopped production on the PA156 contract again, and began producing PA156s to satisfy another contract.[2] According to a trip report prepared by Conco on April 7, 1995, their employees were able to review the defects reported by Ordnance. Following the April trip, Conco wrote to Ordnance on April 19, 1995, and requested another round of meetings aimed at resolving their differences. Ordnance held another Production Workload Review meeting on May 3, 1995. Minutes from that meeting show that Ordnance did not anticipate beginning production of the 81mm rounds until "Jan-June 1996 period due to various component problems[.]"

Conco and Ordnance personnel met in Milan on May 3, 1995. Based on Ordnance's position that many of the defects could be handled by Conco's application for a wavier from the Army on the PA156s, Conco forwarded the information necessary to obtain a waiver to Ordnance on May 4, 1995. For whatever reason, Ordnance did not forward the waiver request to the Army for another four months, and even when it did some of the required documentation was missing.

After hearing nothing from Ordnance regarding the status of the waiver and after calls to Ordnance were no longer

[2]This contract was with the Navy. The Navy appears to have accepted all of the PA156s produced by Conco.

being returned, Conco prepared a Request for Equitable Adjustment (REA) regarding the PA156 contract and forwarded it to Ordnance on August 23, 1995. The purpose of the REA was two-fold: (1) to avoid the costs associated with litigation; and (2) to obtain compensation for Conco's costs which were over and above that of the contract. According to documentation attached in support of its claim, Conco was seeking over four million dollars from Ordnance.

Faced with Conco's REA, Ordnance decided to pursue termination of the PA156 contract. An internal Ordnance memorandum dated August 31, 1995, states:

> Currently we have a number of lots in house rejected for various conditions ranging from poor workmanship to design/producibility concerns. Conco has submitted a package for consideration which includes screening of lots for defect conditions, waiver of certain conditions, and recommendation for ECP action on other conditions of the hardware. This plan was worked out with Conco during a May 1995 visitation in an effort to move the process forward and reach completion of contract activity with Conco on this item.
>
> Since Conco is by submission of this claim abdicating all responsibility for their process and product, I recommend that we pursue contract termination and re-placement with another concern. In parallel with this posture we need to see the current waiver/ECP package through to completion. Completion of this package as submitted should, with screening, make a substantial portion of the containers in house acceptable. This would buy significant time (six months estimated) too for re-procurement of the balance of our needs.

Ordnance ultimately submitted the waiver request on September 18, 1995.

On October 4, 1995, Ordnance sent a show-cause letter to Conco stating its intent to terminate the PA156 contract. Conco responded on October 16, 1995, by requesting payment of $1,321,242 representing the outstanding balance on the contract plus interest in addition to settlement of its REA. Following a flurry of communication between Ordnance and Conco pertaining to the show-cause letter, Ordnance forwarded a letter officially terminating the PA156 contract to Conco on November 21, 1995.

In January 1996, Conco learned that the Army was planning to deny the waiver submitted by Ordnance because much of the information needed to process the waiver was missing. Conco reassembled the data and submitted it directly to the Army by letter dated February 1, 1996. The Army approved the wavier in July 1996. Although a copy of the waiver was sent to Ordnance, Conco did not learn that the waiver request had been approved until some time in 1997. Even after the waiver was issued, Ordnance refused to pay for the boxes. Conco claims that the 81mm rounds were still not being produced by Ordnance during this time due to component problems.

Apparently Ordnance was never able to produce the 81mm rounds, but eventually received another contract to produce inert 81mm rounds using PA156s. Subsequently, in July 1997 Ordnance paid Conco roughly $1,200,000 representing payment in full on the PA156 contract less screening costs incurred to inspect and remove PA156s with non-waivable defects.

Conco filed suit against Ordnance on March 12, 1996. In its original complaint, Conco alleged that Ordnance breached

the PA156 contract and that it was entitled to payment of extra costs it incurred in performing the PA156 contract. The claims made by Conco were similar to those in its REA. Conco substantially amended its complaint in February 1998 to include claims of fraud as well as tortuous interference and disparagement in addition to its other causes of action.

Conco's entire theory was that Ordnance repeatedly invented defects with the PA156s to avoid taking them into inventory at Milan because of (1) its repeated delays in production of the 81mm rounds; and (2) its repeated problems with DCAA regarding the amount of inventory on hand. Ordnance refuted Conco's claims with evidence that (1) the PA156s were counted as inventory even if they weren't paid for; (2) the PA156s were excluded from the inventory reduction incentive program in 1996; (3) Ordnance received the maximum incentive payment it could have received under the inventory reduction incentive program; and (4) the Army would have reimbursed Ordnance for its purchase of the PA156s within two weeks of Ordnance's payment.

The jury was told repeatedly during trial that Ordnance had paid the contract amount, that it was not to consider damages resulting to Conco due to the delay in payment, and that the trial court would award damages for delay in payment in the form of interest. In regard to Conco's fraud claim, the jury was instructed as follows:

> Conco claims that [Ordnance] committed fraud in the performance of their agreement regarding the PA 156 ammunition containers produced by Conco. Conco claims that [Ordnance] committed fraud on several occasions, including:

(1) Misrepresenting that it would pay for the PA156 ammunition containers within thirty (30) days of delivery when it never intended to pay for the boxes until they were actually needed in production;

(2) Misrepresenting that Lots 1 through 8 were defective as an excuse for not paying for boxes when [Ordnance] knew that it could not use the boxes;

(3) Misrepresenting that [Ordnance] intended to use the official lot sample from Lot 9 forward when [Ordnance] only intended to use the official lot sample for Lots through 12;

(4) Misrepresenting that Lots 9 through 20 were defective as an excuse for not paying for boxes when [Ordnance] knew that it could not use the boxes; and

(5) Misrepresenting that [Ordnance] would prosecute the waiver and other items discussed at the May 3rd, 1995 meeting.

If you believe by clear and convincing evidence that [Ordnance] committed fraud in the performance of their agreement regarding the PA 156 ammunition containers produced by Conco then you shall find for Conco on this matter if you are satisfied from the evidence that:

(1) [Ordnance] made material representations to Conco in the performance of the PA 156 container contract;

(2) That one or more of these representations, as identified and agreed to by nine or more of you, were false;

(3) That at the time [Ordnance] made these representations, it knew that one or more of them was false;

(4) That Conco reasonably relied and acted upon [Ordnance's] representations; and

(5) That Conco suffered injury or damage in performing the PA156 contract as a

> result of one of more of [Ordnance's] representations.
>
> If you are satisfied from the clear and convincing evidence that Conco has established each element of this claim, then you shall find for Conco on this claim[.]

While the jury ultimately found that Ordnance did not breach the contract, it found that Ordnance did commit fraud in its performance of the contract and further that it breached its duty to act in good faith. The jury awarded total damages of $92,281.50, $75,281.50 representing Conco's cost over-runs and the balance of $17,000 representing lost profits on PA156s which were never produced. Finally, the jury awarded $1,000,000 in punitive damages to Conco. On November 9, 1998, the trial court entered judgment in favor of Conco in the amount of $1,092,281.50.

As noted earlier, the trial court took up the issue of damages for delay of payment following the trial. On February 24, 1999, the trial court entered an order and judgment in favor of Conco on this issue in the amount of $295,212.43. In so ruling, the trial court stated:

> The Court heard avowal testimony on the matter of damages during the course of the trial and then placed this matter under submission. The Court has reviewed the testimony, considered the arguments of counsel and believes an award of prejudgment interest at the rate eight percent (8%) [is warranted].
>
> The terms of the invoice indicate that the amount due and payable was "Net 30 days." Therefore, unless other arrangements were made when Conco delivered the shipments under the contract to [Ordnance's] facility, the amount was due within thirty (30) days of receipt of the ammunition containers. No

> other arrangements were made by the parties thus interest shall be awarded as [Ordnance] failed to pay for the "goods" in a timely fashion. While it is true from the evidence presented at trial there may have been legitimate concerns by [Ordnance] as it relates to some of the containers received, it does not excuse their non-payment of the entire shipment nor does it excuse their inability to resolve their differences by making additional adjustments or partial payments. Delays of payment included time periods from as little as 35 days and as much as 1,340 days. The bulk of the containers were shipped between December 22, 1994 and March 24, 1995, but the payments were not received until July 17, 1995[3] which is clearly unacceptable.
>
> The plaintiff calculated their measure of damages based on Tennessee Code Section 47-14-123, this Court, however, will apply an eight percent (8%) calculation and therefore the plaintiff shall recover at the daily interest rate of .0002191 for the delays in payment.

All post-judgment motions for relief were denied, and this appeal followed.

> I. DID THE TRIAL COURT ERR IN REFUSING TO DIRECT A VERDICT IN ORDNANCE'S FAVOR ON CONCO'S CLAIMS FOR FRAUD AND PUNITIVE DAMAGES?

Ordnance argues that the trial court erred in not entering a directed verdict in its favor in regard to Conco's claims for fraud and punitive damages because (a) the jury's verdict on the fraud claim was not supported by evidence of a clear and convincing nature; and (b) the punitive damage award was not supported by evidence showing the existence of

[3]It appears that the trial court was mistaken on this fact as the record on appeal shows that the payments were ultimately made in 1997.

aggravating circumstances. Our review of Ordnance's argument is guided by the following standard:

> Upon review of the evidence supporting a judgment entered upon a jury verdict, the role of an appellate court is limited to determining whether the trial court erred in failing to grant the motion for directed verdict. All evidence which favors the prevailing party must be taken as true and the reviewing court is not at liberty to determine credibility or the weight which should be given to the evidence, these being functions reserved to the trier of fact. [citations omitted] The prevailing party is entitled to all reasonable inferences which may be drawn from the evidence. Upon completion of such an evidentiary review, the appellate court must determine whether the verdict rendered is " 'palpably or flagrantly' against the evidence so as 'to indicate that it was reached as a result of passion or prejudice.' " NCAA v. Hornung, Ky., 754 S.W.2d 855, 860 (1988). If the reviewing court concludes that such is the case, it is at liberty to reverse the judgment on the grounds that the trial court erred in failing to sustain the motion for directed verdict. Otherwise, the judgment must be affirmed.

Lewis v. Bledsoe Surface Mining Co., Ky., 798 S.W.2d 459, 461-462 (1990).

FRAUD

Ordnance claims that Conco failed to show evidence that Ordnance had a financial motive to delay paying for the PA156s. Ordnance also claims that it was entitled to reject boxes for defects under the terms of the contract. We disagree.

In order to recover under an action for fraud, a plaintiff must show the following:

> (a) a material representation, (b) which is false, (c) known to be false or recklessly made, (d) made with inducement to be acted

> upon, (e) acted in reliance thereon, and (f) causing injury.

Wahba v. Don Corlett Motors, Inc., Ky. App., 573 S.W.2d 357, 359 (1978). As plaintiff below, Conco was required to prove its claim of fraud through a showing of clear and convincing evidence. Wahba, 573 S.W.2d at 359. However, for purposes of proving fraud, the clear and convincing evidence standard does not require Conco to show direct evidence of fraud. Instead, Conco may meet its burden of proof by showing circumstantial evidence of fraud. Grant v. Wrona, Ky.App., 662 S.W.2d 227, 229 (1983). The logic for allowing fraud to be proven by circumstantial evidence is best stated as follows:

> [I]t is not necessary that direct evidence of fraud be adduced and that fraud may be established by evidence which is wholly circumstantial. [citations omitted] The courts of this Commonwealth have long recognized that "(p)arties contemplating the commission of fraud do not usually blow a horn or beat a drum to call attention to what they are doing," and have accordingly held that frauds may be established by circumstances. Bolling v. Ford, 213 Ky. 403, 281 S.W. 178 (1926). Further, even though each bit of circumstantial evidence in and of itself may seem trivial and unconvincing, the combination of all the circumstances considered together may be decisive in a given case of fraudulent design. [citations omitted]

Johnson v. Cormney, Ky.App., 596 S.W.2d 23, 27 (1979), overruled in part on other grounds, Marshall v. City of Paducah, Ky. App., 618 S.W.2d 433 (1981). Ordnance correctly argues that "circumstantial evidence must go far enough to induce a reasonable conviction that the facts sought to be proved are true and must tend to eliminate other rational theories." United

Electric Coal Companies v. Brown, Ky., 354 S.W.2d 502, 503 (1962). However, "[p]roof that is clear and convincing . . . does not lose its character merely because it is disputed or contradicted by evidence introduced by the opposing party." Glass v. Bryant, Ky., 194 S.W.2d 390, 393 (1946).

Having reviewed both the trial transcripts and the substantial number of trial exhibits, we believe that Conco met its burden of proving fraud by clear and convincing evidence. While the majority of Conco's evidence of fraud is circumstantial, "there is proof of a probative and substantial nature carrying the weight of evidence sufficient to convince ordinary prudent minded people." Rowland v. Holt, Ky., 70 S.W.2d 5, 9 (1934).

Ordnance's claim that Neal's testimony as well as other testimony debunks Conco's theory of fraud does not require reversal. Under the Lewis standard, we are to take the evidence presented by Conco as true and leave questions pertaining to the weight and credibility of the witnesses and evidence to the jury for resolution. Lewis, 798 S.W.2d at 461.

> There were issues of material facts presented in this case requiring submission to a jury, and under such a circumstance, where certain testimony must be believed and other testimony must be consequently rejected, we are most hesitant, even if we were so inclined, to substitute our surmise for the findings of a jury.

Johnson, 596 S.W.2d at 27. We do not believe that the jury's verdict of fraud is palpably or flagrantly against the evidence presented at trial.

PUNITIVE DAMAGES

Ordnance maintains that it should have been granted a directed verdict on Conco's claim for punitive damages because Conco failed to prove by clear and convincing evidence that Ordnance acted outrageously in conjunction with its performance of the PA156 contract. We disagree.

Ordnance correctly asserts that "[t]he threshold for the award of punitive damages is misconduct involving something more than merely commission of a tort." Fowler v. Mantooth, Ky., 683 S.W.2d 250, 252 (1984). Ordnance is also correct in arguing that "a plaintiff is not entitled to an instruction on punitive damages merely because the plaintiff has met his burden of production on an intentional tort such as fraud." Miller's Bottled Gas, Inc. v. Borg-Warner Corporation, 56 F.3d 726, 734 (6th Cir. 1995). However, the reasoning of these two cases does not apply to the case at hand due to the application of KRS 411.184.

KRS 411.194(2) provides that a plaintiff may recover punitive damages upon showing "by clear and convincing evidence, that the defendant . . . acted toward the plaintiff with oppression fraud or malice." Thus, under the provisions of this statute, Conco was "entitled to have the jury consider punitive damages because [it] had demonstrated fraud by clear and convincing evidence." United Parcel Service Co. v. Rickert, Ky., 996 S.W.2d 464, 470 (1999). In so ruling, we are aware that the Kentucky Supreme Court declared certain provisions of KRS 411.184 unconstitutional in Williams v. Wilson, Ky., 972 S.W.2d 260 (1998). However, as Ordnance concedes in its brief on appeal:

> [since Conco] did not challenge the constitutionality of the statute at trial and since the statute was in effect at the time of . . . the trial, we will review the question under the terms of the statute as it then existed.

Bowling Green Municipal Utilities v. Atmos Energy Corp. Ky., 989 S.W.2d 577, 580 (1999). See also Rickert, 996 S.W.2d at 470; and Hanson v. American National Bank & Trust Company, Ky., 865 S.W.2d 302, 310 (1993).

Ordnance also argues that the trial court erroneously instructed the jury on the issue of punitive damages because Ordnance did not ratify or authorize any improper action on behalf of its employees as required by KRS 411.184(3). As this argument was not presented to the trial court we are without authority to consider its merits on appeal. Regional Jail Authority v. Tackett, Ky., 770 S.W.2d 225, 228 (1989).

II. DID THE TRIAL COURT ERRONEOUSLY DENY ORDNANCE'S MOTION FOR A NEW TRIAL?

Ordnance claims that it was entitled to a new trial under CR 59.01 (d) and (f). We will not reverse a trial court's refusal to grant a new trial in the absence of an abuse of discretion on behalf of the trial court. Speck v. Bowling, Ky. App., 892 S.W.2d 309, 313 (1995).

Under CR 59.01(f), a new trial may be granted upon a showing "[t]hat the verdict is not sustained by sufficient evidence or is contrary to law." To the extent Ordnance maintains that the jury's verdict is not sustained by the evidence, it must show that the verdict was both palpably and flagrantly against the evidence presented at trial. Nugent v.

Nugent's Ex'r., Ky., 135 S.W.2d 877, 883 (1940). Aside from merely claiming that the verdict in this case was not supported by evidence or contrary to law, Ordnance presented no argument to illustrate why it is entitled to relief under CR 59.01(f). Thus, this argument must fail.

Under CR 59.01(d), a new trial may be granted if the appellant can show "[e]xcessive . . . damages, appearing to have been given under the influence of passion or prejudice or in disregard of the evidence or instructions of the court." Our standard of review in this area is as follows:

> [I]t is the primary function of the trial judge to determine whether, at "first blush" and in accordance with the criteria set forth in CR 59.01(d), (e), and (f), the verdict is excessive. On appeal, the trial judge's determination is considered presumptively correct and will be reversed only if "clearly erroneous."

Owens-Corning Fiberglass Corporation v. Golightly, Ky., 976 S.W.2d 409, 414 (1998)(citations omitted).

In arguing that the punitive damage award is excessive, Ordnance focuses almost entirely on the fact that the punitive damages verdict is more than ten times the compensatory award. While the ratio between actual and punitive damages may be considered in reviewing a punitive damage award for excessiveness, it is not the sole deciding factor. The United States Supreme Court has noted its refusal to rely on "an approach that concentrates entirely on the relationship between actual and punitive damages." TXO Production Corp. v. Alliance Resources Corp., 509 U.S. 443, 460, 113 S.Ct. 2711, 2721, 125 L.Ed.2d 366, 381 (1993). See also BMW of North America, Inc. v.

Gore, 517 U.S. 559, 116 S.Ct. 1589, 134 L.Ed.2d 809 (1996). In addition to the reasonableness of the ratio between punitive and actual damages, we are also to consider:

> the amount of money potentially at stake, the bad faith of the party against whom judgment was rendered, whether a scheme was employed which was part of a larger pattern of trickery, fraud and deceit, and the wealth of the offending party.

Hanson, 865 S.W.2d at 311. As Ordnance's argument only addresses the correlation between the actual and punitive damage award and does not address the additional requirements set forth in Hanson, we do not believe that the disparity in this case is enough, on its own, to justify a finding that the trial court's decision was clearly erroneous.

Ordnance maintains that counsel for Conco inflamed the jury by (1) telling it during opening arguments that Ordnance is "part of "the world's largest defense contractor" and that its parent corporation manufactures the space shuttle, the F16, and the C5A transport plane;" and (2) referring metaphorically to the fact that David killed Goliath with five smooth stones during closing argument. As no objection was made to these statements, we will not consider this argument on appeal. Louisville & N.R. Co. v. Howe, Ky., 255 S.W.2d 979, 980 (1953).

III. SHOULD THE TRIAL COURT'S AWARD OF PRE-JUDGMENT INTEREST BE VACATED OR REDUCED?

As we noted earlier, the trial court reserved for itself the question of whether Conco was entitled to an award of pre-judgment interest pursuant to the directive of the Kentucky Supreme Court in Nucor Corporation v. General Electric Co., Ky.,

812 S.W.2d 136 (1991). The trial court heard testimony on this issue under avowal during trial. Because the issue of whether Ordnance breached the terms of the contract due to its delay in payment was reserved specifically for the trial court to resolve, it was not inconsistent for the trial court to find that Ordnance's late payment breached the Net 30 day provisions of the contract despite the fact that the jury found that no breach occurred as to the balance of the contract.

Ordnance also maintains that its ultimate payment to Conco in 1997 was timely under the terms of the contract, specifically under portions of the contract which provided that the payment period was to begin from either the date of invoice or the date acceptable goods were delivered to Milan, whichever occurred last. Ordnance maintains that the PA156s were not acceptable until the Army granted the wavier in July 1996 and that once the waiver was granted it paid Conco.

We find Ordnance's proposed interpretation of the contract to be extremely tenuous. Under Ordnance's interpretation, it could merely receive shipments of goods into inventory and then put off inspection indefinitely, thus potentially forever forestalling its duty to pay. We find that the trial court's interpretation of the contract is reasonable and supported by the evidence.

Alternatively, Ordnance maintains that Conco is only entitled to pre-judgment interest from the date the Army issued its waiver. Ordnance's own behavior concerning the issuance of the waiver precludes this argument. The evidence shows that

Ordnance agreed to seek a waiver at the May 1995 meeting. Once Conco provided it with information necessary to procure a waiver, Ordnance sat on that information before sending the request to the Army. Even when Ordnance forwarded the waiver request, it withheld pertinent information, and it was not until Conco provided this information directly to the Army in February 1996 that the waiver was ultimately issued. Had Ordnance promptly provided all necessary information to the Army following the May 1995 meeting, its argument may have had some merit. However, Ordnance cannot be the beneficiary of its own delay in the procurement of the waiver.

Having considered the parties' arguments on appeal, the trial court's order and judgments of November 9, 1998, and February 24, 1999, are affirmed.

CONCO'S CROSS APPEAL

In an amended complaint filed with the trial court on February 19, 1998, Conco asserted a claim for tortious interferences against Ordnance in which it alleged that Ordnance's conduct caused it to lose a contract to produce ammunition containers for the Hydra missile system (the Hydra contract). Conco alleged that prior to the PA156 contract it had been assured by Ordnance's Vermont division that it would receive the Hydra contract, and that shortly after the May 3, 1995 meeting involving the PA156s at which one of Ordnance's Vermont employees attended, it was notified that it was not going to be considered for the Hydra contract.

Ordnance maintained that Conco was excluded from further consideration for the Hydra contract because the price it submitted was two million dollars higher than the company which ultimately received the contract. Conco alleged that Ordnance faxed it a request for a final and best offer on the Hydra contract on September 16, 1995, after Conco had been told that it was no longer being considered, and that this was an attempt by Ordnance to establish a record of competitive bidding in order to limit future liability. Conco did not respond to the bid request.

At the conclusion of Conco's case, Ordnance moved for a directed verdict on Conco's tortious interference claim. Ordnance argued that Conco's claim could not succeed because Conco could not show that Ordnance interfered in Conco's business relations with a third party. The trial court granted Ordnance's directed verdict motion on the tortious interference claim.

During cross-examination of Ordnance's damages expert, the issue of the Hydra contract came up again when Conco asserted that damages stemming from the loss of the Hydra contract were recoverable as fraud damages because Ordnance's wrongful rejection of the PA156 lots cost Conco the Hydra contract. This appears to be the first time that Conco asserted that these damages could be recovered under the fraud claim as opposed to the now-defunct tortious interference claim. Ordnance argued that whether Conco framed the issue as tortious interference, fraud, or breach of contract, it could not recover damages for loss of the Hydra contract because there is no right to force

someone to do business with you. The trial court sustained Ordnance's objection as to any further testimony regarding damages for the loss of the Hydra contract.

At the close of evidence, Ordnance moved for a directed verdict on Conco's claim for damages stemming from the loss of the Hydra contract. Ordnance maintained in its argument before the trial court that "[t]here is no authority for suing your customer when he doesn't do further business with you into the future." Ordnance also took issue with the fact that Conco had practiced this claim as a tortious interference claim up until the trial court granted a directed verdict in its favor and then attempted to argue that the damages could be recovered under the fraud claim. The trial court reaffirmed its entry of directed verdict in favor of Ordnance.

On appeal, Conco maintains that the trial court erred in granting a directed verdict in Ordnance's favor and asserts that it should have been permitted to present the loss of the Hydra contract "to the jury as the natural and proximate result of [Ordnance's] fraud and breach of the implied covenant of good faith and fair dealing." We disagree.

Conco is correct that "the victim of fraud is entitled to compensation for every wrong which is the natural and proximate result of the fraud." Sanders, Inc. v. Chesmotel Lodge, Inc., Ky., 300 S.W.2d 239, 241 (1957). However, we agree with Ordnance that in the absence of any contractual agreement to do business with Conco in the future, it had no duty to do future business with Conco, and, as Ordnance points out in its brief on

appeal, "its decision to exclude Conco from further consideration on the Hydra contract is not legally actionable[.]"

The orders and judgment of the Jefferson Circuit Court are affirmed.

ALL CONCUR.

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